

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

STRATEGY FOR ALBANIA

2009-2012

As approved by the Board of Directors at its meeting on 17 November 2009

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List of Abbreviations

ABA	American Bank of Albania
AKEP	Albanian Authority of Electronic and Postal Communications
AREF	Albania Reconstruction Equity Fund
ARMO	Albanian Refinery Company
ASPBM	Albanian Society for the Protection of Birds and Mammals
BAP	Biodiversity Action Plan
BAS/TAM	Business Advisory Services/Turn-Around Management
BEEPS	Business Environment and Enterprise Performance Survey
BIA	Banca Italo Albanese
BOO/BOOT	Build-Own-Operate/Build-Own-Operate-Transfer
BSEC	Black Sea Economic Cooperation
CAS	Country Assistance Strategy
CCUP	Climate Change Unit Program
CEB	Council of Europe Development Bank
CEI	Central European Initiative
CEZ	Czech Power Company
CITES	Convention on International Trade in Endangered Species
CPI	Corruption Perception Index
DISCO	Distribution Company
DMEP	Disaster Management and Emergency Preparedness Programme
EIB	European Investment Bank
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
FNC	First National Communication
FSA	Financial Supervisory Authority
GDI	Gender Development Indicator
GDP	Gross Domestic Product
GEF	Global Environment Facility
GHG	Greenhouse Gas
GRD	General Roads Directorate
GRECO	Council of Europe Group of States against Corruption
GSM	Global System for Mobile communications
GTZ	Deutsche Gesellschaft für Zusammenarbeit
HII	Health Insurance Institute
HPP	Hydro Power Plant
IBRD	International Bank for Reconstruction and Development (World Bank)
ICC	International Criminal Court
IDA	International Development Association (World Bank)
IFC	International Finance Corporation (World Bank)
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INSIG	Albanian Insurance Institute
INSTAT	Albanian Institute of Statistics
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IPS	Integrated Planning System

JBIC	Japan Bank for International Cooperation
KESH	Albanian Power Corporation
KfW	Kreditanstalt für Wiederaufbau
LEF	EBRD-Italy Local Enterprise Facility
LIS	Legal Indicator Survey
LTT	Legal Transition Team
MCFF	Medium Size Co-Financing Facility
MDG	Millennium Development Goals
MEI	Municipal and Environmental Infrastructure
MoEFW	Ministry of Environment, Forests and Water
MTBP	Medium Term Budget Programme
MSME	Micro, Small and Medium Enterprises
NAP	National Action Plan
NATO	North Atlantic Treaty Organisation
NBFI	Non-Bank Financial Institutions
NCB	National Commercial Bank (also BKT)
NEAP	National Environmental Action Plan
NPL	Non Performing Loans
NSSSED	National Strategy for Social and Economic Development
PPP	Private Public Partnership
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
OCE	Office of the Chief Economist
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OSCE	Organisation for Security and Co-operation in Europe
PD	Democratic Party
PS	Socialist Party
SAA	Stabilisation and Association Agreement
SDC	Swiss Agency for Development and Cooperation
SECI	South East Cooperation Initiative
SECO	State Secretariat for Economic Affairs
SMEs/MSEs	Small and Medium Enterprises/Micro and Small Enterprises
TIMS	Transition Impact Monitoring System
TNA	Technology Needs Assessment
TSO	Transmission System Operator
UB	Union Bank
UNDP	United Nations Development Programme
UNEP	United Nations Environmental Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
VPP	Vlore Power Plant
WeBSEDF	Western Balkans Sustainable Energy Direct Financing Facility
WeBSEECLF	Western Balkans Sustainable Energy Efficiency Credit Line Facility
WBIF	Western Balkans Investment Framework
WHO	World Health Organisation
WTO	World Trade Organization

Currencies

ALL	Albanian Lek (Albanian Currency)
EUR	Euro, European Union Currency
SDR	Special Drawing Right, IMF “currency”
USD	United States Dollar

Exchange Rate

1 EUR	130.76 ALL
1 USD	92.73 ALL

EXECUTIVE SUMMARY

Albania continues to fulfil the conditions specified in Article 1 of the Agreement Establishing the Bank.

Albania has continued to make progress on key structural and institutional reforms, geared towards integration into the EU and other Euro-Atlantic institutions. It is among the first in the Western Balkans region to have its Stabilisation and Association Agreement (SAA) with the EU ratified by all member states and consequently enter into force. Albania's efforts in EU approximation culminated with its formal application in April 2009 for EU membership. However, significant institutional and economic reform challenges remain, and the Bank aims to assist the country in meeting these challenges successfully over the Strategy period.

A favourable macroeconomic environment in recent years has been one factor resulting in strong GDP growth averaging about 6.3 per cent annually between 2005 and 2008. Growth has been driven mainly by the services and construction sectors. Sound economic policies and Albania's still limited integration into global markets have helped to mitigate the negative impacts of the global financial crisis. However, the financial crisis brought about a contraction in exports (minus 17.2 per cent y-o-y in the first half of 2009), lower remittances (at around 10 per cent of GDP in the first quarter of 2009 down from 15 per cent in 2007/08), and reduced foreign investments; all of which are likely to contribute to significantly lower – albeit still positive – growth in 2009-2010. The banking sector has been less affected thus far than other countries due to Albania's lower level of financial integration, improvements in regulation and supervision and a relatively high level of liquidity and capitalisation. On the other hand, lending has become more conservative and banks are showing increasing concern about the quality of loan portfolios, which has a negative impact on the availability of financing for businesses, especially SMEs.

The government has responded to the crisis through the provision of liquidity, regulatory measures (such as an increase in the deposit insurance ceiling) and continuing investment in infrastructure which is providing economic stimulus. As a result of the higher spending, the 2008 budget deficit increased to 5.5 per cent, up from 3.5 per cent in 2007, and could be slightly above this level in 2009. Key macroeconomic challenges include trade and current account deficits (the former above 25 per cent of GDP) in an environment of falling remittances and foreign investments. Fiscal risks remain high and are linked to lower than projected revenues and continued high government subsidies to underperforming state owned utilities – water, power generation and transmission.

Policy reforms and progress in European integration have helped to improve Albania's image as an investment destination and help contribute to a favourable economic outlook in the medium term. The business environment however continues to suffer from a high level of corruption, serious shortcomings in the judiciary and weak institutional and law enforcement capacity. Despite sizeable investments in recent years, infrastructure remains an obstacle to private sector development, including a transport network in need of further upgrading, lack of reliable power supply, and limited regard paid to environmental consequences of rapidly expanding

economic activity. Despite progress achieved since 2005, poverty remains widespread, particularly in rural areas, which encourages continued emigration.

Albania has made progress on its transition path since the approval of the last Country Strategy, exemplified by several upgrades of the EBRD transition indicators. In 2006, successful implementation of simplified business registration procedures and further cuts in enterprise subsidies have led to an upgrade of the enterprise-related governance and restructuring indicator. In 2007, the privatisation of the fixed-line telecommunication company, Albtelecom, and significant improvements in sectoral regulation led to an upgrade in the telecoms indicator. In 2008, the privatisation of the oil refinery ARMO and the electricity distribution company led to an upgrade of the indicator on large-scale privatisation, while effective implementation of the new banking law and increased transparency in the sector following the establishment of a new Credit Registry led to an upgrade of the indicator on banking reform.

The main transition challenges over the next strategy period are to:

- Strengthen state institutions: public administration and civil service reform, particularly increased efficiency and impartiality of the judiciary and an effective and systematic fight against corruption; further improvements in the investment climate for domestic and foreign companies, including resolution of land titling and ownership, and improvement of land registration procedures;
- Invest in infrastructure, including upgrading of the national, regional and local road networks, modernisation and expansion of seaports, and improving energy security; increase efforts to commercialise water and waste utilities as well as urban transport, while giving greater fiscal autonomy to municipalities which could plan and invest in these sectors; expand the independence and capacity of regulators of key utilities (power, telecoms and waste and water companies) to promote competition and investment;
- Further strengthen the banking system, support SMEs/MSEs and bank financing of these companies to improve competitiveness in order to reduce Albania's very high dependence on imported goods and enhance export opportunities; and support the development of the non-bank financial sector, including further enhancing the supervisory capacity of the Financial Supervisory Authority

The Bank has played an increasing and important role in the transition process in Albania: Since initiating operations, direct Bank financing was above EUR 500 million, with a further EUR 1.1 billion from sponsors and co-financiers. The Bank, working in close conjunction with other IFIs and donors, will seek to further increase its activities and impact over the strategy period through focusing selectively on identified challenges. The Bank is prepared to respond to the negative impact of the financial crisis, in particular by providing equity and debt funding to the banking system as well as risk sharing products to boost local banks' lending to the real sector. The Bank also intends to continue supporting key government infrastructure projects. In addition, the Bank is providing direct equity and debt investments with export-driven local enterprises through dedicated products, such as the EBRD-Italy Local Enterprise Facility (LEF).

Infrastructure, Energy and Municipal and Environment Projects: The Bank will continue to support investments in transport and energy, with emphasis on regional

linkages, regional integration and energy security. Using the Tirana Airport as a model, the Bank will encourage government to consider further PPPs and concessions to attract private capital in power, ports and municipal utilities (water, waste). Where possible, the Bank will finance infrastructure following privatisation, such as in the power and telecoms sectors. Further improvement to basic infrastructure, such as roads, is also necessary. The Bank will continue to support joint donor and IFI initiatives.

Enterprise Sector: The Bank continues to be seen as the leading institution to support competitive businesses and in particular larger investors, both domestic and international. The Bank will respond flexibly to support existing and new high quality investors who may not be able to finance their investments due to the worldwide financial crisis. Given the low level of foreign direct investments, the Bank will further expand its efforts to reach small and medium size companies either directly, through LEF and the new EBRD Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDF), or in complement with local banks through products such as the Medium Size Co-Financing Facility (MCFF) and the Western Balkans Sustainable Energy Efficiency Credit Line Facility (WeBSEELCF). Special attention will be devoted to companies which are implementing energy efficiency and/or sustainable energy investments and also those developing in the IT sector.

Financial Sector: In light of the world financial crisis, the Bank is prepared to respond with financial products tailored to needs of local banks, including risk sharing facilities, equity, quasi equity and debt investments coupled, where possible, with donor funded subordinated resources to support among others, SME and MSME development and energy efficiency. The primary objective is to strengthen banks' capitalisation, to support lending activities to the real economy, which is starting to feel the effect of credit tightening and higher risk aversion from local banks. The Bank will contribute to the development of the non-banking financial sector.

The Bank will reinforce policy dialogue efforts in all sectors, with a focus on addressing legal and regulatory issues that arise from specific project experience. As in the past, the Bank will coordinate its activities with other IFIs and donors, especially in the context of the new Western Balkans Investment Framework (WBIF) together with the EC, EIB, CEB and bilateral donors. The Bank is an active participant in the donor coordination effort and supports the goals of the Paris Declaration on Aid Effectiveness, which are designed to improve delivery of assistance. In this regard, the Bank expects to work with donors and the government to link TC and grant co-financing to its priority investments in transport, energy and municipal projects.

The Bank will continue to ensure that all of its operations in Albania are subject to the environmental and social commitments in the applicable policy (2003 Environmental Policy or 2008 Environmental and Social Policy), and incorporate, where appropriate, Environmental and Social Action Plans.

1. THE BANK'S PORTFOLIO

1.1 Overview of Activities to Date

As of 30 June 2009, the Bank had achieved a cumulative business volume of EUR 545 million (including regional allocations) and total project cost of more than EUR 1.6 billion. After signing Euro 89 million of new investments in 2008, the highest annual volume yet achieved, the Bank signed additional investments of more than EUR 50 million in the first half of 2009.

The active portfolio at end 2008 was EUR 339 million (in 32 projects). This figure reached EUR 370 million as of 30 June 2009. Growth has been generated in both the public and private sector, with the latter representing all new investments in 2008 and the first six months of 2009. However, given the importance of further infrastructure improvements, the Bank continues to develop public and private infrastructure projects.

Operating assets were EUR 210 million as of 30 June 2009, having grown by 76 per cent since 2006, and represent 57 per cent of the active portfolio (up from 47 per cent at the time of the previous Strategy). The Bank continues to encounter slow implementation of public sector projects (such as Levan-Tepelene Road, KESH Transmission Substations Upgrade and Durres Ferry Terminal) where disbursements should pick up in H2-2009 and 2010.

Table 1. Bank portfolio in Albania as of 30 June 2009

Sector Name	CUMULATIVE PORTFOLIO				CURRENT PORTFOLIO				
	Nr of projects	Total Cost	EBRD Signed	Weight by sector	Nr of projects	Portfolio	Weight by sector	Operating assets	Op. assets ratio
Financial Institutions	13	74.8	55.4	10.2%	7	19.3	5.2%	18.1	93.8%
Banks	8	55.9	39.3	7.2%	3	14.2	3.8%	14.2	100.0%
Equity Funds ¹	4	9.7	7.3	1.3%	4	5.1	1.4%	3.9	76.5%
Non Bank	1	9.2	8.8	1.6%	0	0	0%	0	0%
Infrastructure	13	840.1	246.7	45.2%	11	205.4	55%	112.1	54.6%
Power and Energy	7	513.1	112.5	20.6%	5	78.7	21.1%	53.5	68%
Transport	6	327	134.2	24.6%	6	126.7	33.9%	58.6	46.3%
Specialised Industries	12	330.3	136.6	25.1%	7	64.4	17.2%	31.4	48.8%
Telecommunications	5	217.7	68.2	12.5%	3	36.5	9.8%	27.5	75.3%
Agribusiness	4	31.3	13.4	2.5%	2	2	0.5%	2	100%
Property, Tourism & Shipping	3	81.3	55	10.1%	2	25.9	6.9%	1.9	7.3%
General Industry	6	417.1	106.5	19.5%	6	84.1	22.6%	47.4	56.4%
Country Total	44	1,662.3	545.2	100.0%	31	373.2	100.0%	209.0	57%

1) Participation in the Albania Reconstruction Equity Fund (AREF, developed by EBRD) as well as investments in Albania by other regional equity funds.

1.2 Implementation of the Bank's Strategy to Date

The previous Strategy for Albania was approved on 4 April 2006 and outlined the following priorities:

- (i) development of infrastructure, power and energy, municipal and environmental projects;
- (ii) privatisation and restructuring of remaining state owned utilities (e.g. telecom, power), and commercialisation of municipally-owned utilities (e.g. water);
- (iii) development and consolidation of financial sector;
- (iv) FDI and local enterprises with a particular attention to SMEs; and
- (v) Policy dialogue especially in the areas of regulating and strengthening the markets for infrastructure including capacity and institution building.

Since approval, the Bank has committed EUR 178.1 million in 14 new projects. The Bank continues to play a meaningful role and has expanded operations across its areas of expertise.

The Bank has implemented new projects in the State sector – roads, ports and power – devoting significant effort to implementation of infrastructure investments. The Bank has contributed to the reconstruction of the transport network through the financing of the Elbasan-Librazhd, Levan-Vlore and Levan-Tepelene road projects and is working on upgrading the passenger terminal at the Port of Durrës. These projects are also linked to sector reform and institutional strengthening. The Tirana Airport concession was the first major Public Private Partnership (“PPP”) project in Albania which creates strong demonstration impact for other private participation in infrastructure. Privatisation of Altelecom also has been a successful example of the Bank supporting private sector involvement in infrastructure.

In the power sector, the Bank worked with other donors to support the unbundling process which culminated in creation of the independent distribution company (DISCO), transmission system operator (TSO) and power generation company (KESH). After financing network rehabilitation, construction is being completed on the Vlore Power Plant (VPP), the first thermal generation plant built in Albania in more than 25 years. Investments to upgrade the transmission system are also ongoing. The Bank expects to support CEZ following its purchase of the DISCO.

Despite these numerous successes, the Bank's participation in the public sector has been constrained due to implementation and debt absorption capacity of public entities. Therefore, the Bank must continue to work with the donor community and the Government to bring more efficiency to implementation of projects. The recently launched WBIF will provide the optimal platform for IFI and donor co-ordination and for enhanced policy dialogue.

The Bank has helped ensure successful private investments in Albania and in the past few years has been a partner in most large FDI. These investments have a significant demonstration effect and encourage quality inward investment. The Bank also supported domestic investors, such as Euromax (retail), Bi-Invest (construction materials) and Edipack (packaging). Each operates at the highest standards in their sector in Albania, thus setting standards which other investors must strive to achieve.

During the previous strategy period, the Bank made its first investments in the Natural Resources sector. The Bank made an equity investment and provided two loans to Toronto-listed Bankers Petroleum. The Bank also provided a EUR 6 million convertible loan to the Toronto-listed Tirex Resources.

The Bank has contributed to development and restructuring of the financial sector through direct equity investments in three local banks and the signing of a co-financing agreement under MCFE with one. However, the Bank has had limited possibility to provide traditional loan products, mainly due to local banks' access to cheaper funding from deposits and subsidised parent lines. In addition, the sizeable informal economy leads to a large number of trade transactions occurring outside the banking sector, which limits the interest in the Bank's trade-finance products. The Bank has had a limited impact in the non-bank financial (NBF) sector. Although assistance was provided directly to INSIG, the state-owned insurance company, through an equity investment and technical assistance, the Bank exited from its investment after an unsuccessful privatisation in late 2008. The Bank expects to continue providing assistance for the insurance regulator and is implementing a project to develop the legislation and regulations for corporate and municipal bond issuance.

Given the limited opportunity to provide traditional on-lending to SMEs via local banks, the Bank has developed innovative products to work with local enterprises (e.g. LEF and WeBSEDF). These efforts have begun to pay dividends with the signing of a number of smaller LEF investments.

1.3 Transition Impact and Lessons Learned

A review of operations rated by the Office of the Chief Economist (OCE) and monitored through the Bank's Transition Impact Monitoring System (TIMS) shows that projects in Albania carry high transition impact potentials at signing. From 2005 to mid-2009, 93 per cent of projects were rated with either Good or Excellent transition impact potential.

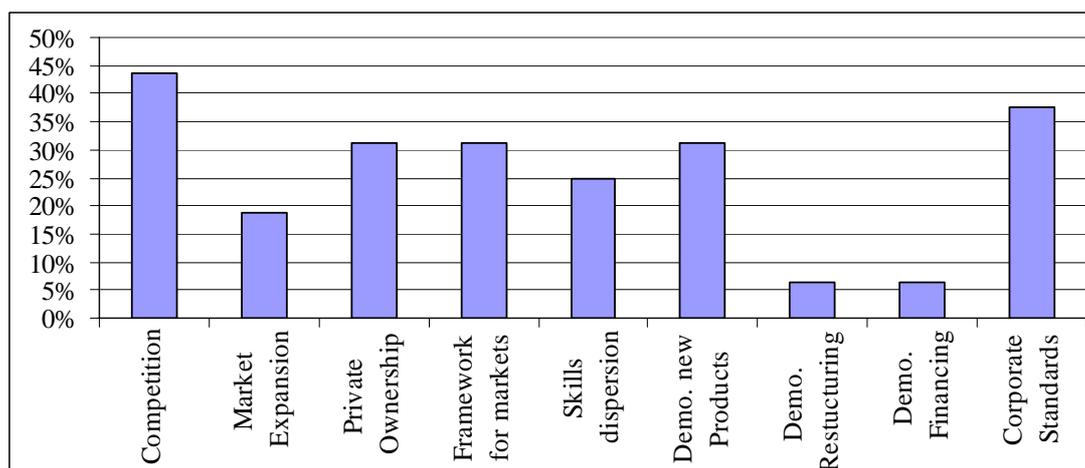
During this period, only one project monitored by OCE (Western Balkans SME Finance Facility - Banka Popullore) was downgraded. Typically, downgrades are driven by higher risks to achieving transition impact. In this case, however, the transition impact potential of the project was decreased due to cancellation of the Institution Building Plan (IBP), that the Bank had originally planned as part of this project, following the take-over of Banka Popullore by Société Générale (SG) and the subsequent commitment of the new parent to implement, as part of the integration of the newly acquired bank in the SG Group, the necessary improvements in business and corporate governance standards that were contemplated by the IBP.² Therefore, monitoring of transition impacts through TIMS does not point to any direct effects of the economic and financial crisis on the Bank's operations as of mid-2009.³

² The SME credit line to Banka Popullore was cancelled in early 2009 as, after the acquisition by SG, the bank had access to funding from the new parent and no longer needed Bank's funds.

³ If any, such effects could however become visible in the course of the year, as the monitoring cycle may not have captured it due to time lags between monitoring reports.

It is also possible to analyse the main channels through which transition impacts were pursued in Albania in the review period. As shown in Table 2 below, *Competition* and the pursuit of better *Standards for corporate governance and business conduct* were the main areas of impact. Competition was particularly important in the Banking and Corporate sectors, while Corporate Governance is a main driver of transition impact in Energy and Infrastructure – in particular Natural Resources.

Table 2: Transition impacts pursued by EBRD projects - 2005- Q2 2009



The following analysis of the impact of the Bank’s portfolio and lessons learnt relies upon previous findings found in the Transition Impact Retrospective Reports (TIRs), OCE updates on remaining challenges, TIMS reports, and studies undertaken by the Bank’s Evaluation Department during the past fifteen years of operations in Albania:

1.3.1 Enterprise Sector

Agribusiness – Given the size of most companies in the sector, these investments tend to be financed under the LEF or indirectly through Bank-supported financial intermediaries. Agribusiness companies also receive assistance from the BAS and TAM programmes. Recently, using LEF, the Bank invested in Beba, which now produces recycled paper and cardboard boxes which are available as packaging materials for agribusiness companies. The Bank’s investment in olive oil production has highlighted once again difficulties faced by start-ups in supply chain management.

General Industry – In 2008, the Bank signed its second investment in the cement industry, with Titan of Greece. As a greenfield investment, this investment is expected to increase operating standards even further and will create a more competitive environment. Moreover, the project will contribute to both upstream and downstream suppliers and contractors. Through the LEF, the Bank invested in Beba paper recycling and an asphalt plant, both of which are the first of their kind – in terms of operational and environmental standards. A number of companies benefited from access to TAM and BAS. The Bank’s earlier investment in Fushe Kruje Cement Factory was a successful privatisation, contributing to significant operational and governance improvements.

As for *lessons learned*, the Bank's project with Fushe Kruje highlighted the need to more fully explore possibilities to utilise carbon emission trading (PE07-386).

Property and tourism – Since supporting the first international standard hotels – Hotel Tirana and Hotel Rogner – the Bank has had limited impact on the property sector. In early 2009, the Bank signed a major investment in the largest shopping mall being constructed in Tirana. Tourism investment has been restricted due to uncertainty about land rights and permits, as well as poor infrastructure. As both issues are slowly being resolved, investment in property projects and in particular coastal tourism will be more likely in the coming years.

Telecommunications – The Bank has had a significant impact on the telecoms sector, by providing TC to the regulator and also financing two of three major operators. The recent investment in Albtelecom completed the lengthy privatisation process and via the related investment in Eagle Mobile, the Bank helped increase competition and therefore reduced tariffs in both fixed and mobile segments of the industry. Further regulatory reform is required before the country will begin to benefit from expanded access to products such as broadband and WiMax.

A *lesson learned* from the earlier investment in Vodafone demonstrated again that GSM telephony is a cost effective solution in countries where there is a large deficiency of basic telephony services and relatively low income levels (PEX06-287).

Overall, *Moderate* transition impact has been achieved in the *Enterprise Sector*⁴.

1.3.2 Financial Sector

Bank Equity – The Bank has participated in four different equity investments to date:

- (i) The Bank invested in Banca Italo Albanese (BIA) in 1994. The investment had a significant transition impact and demonstration effect as the Bank's first investment in the private sector in Albania and in support of the first foreign-owned bank in the country. The Bank continued to support BIA through various phases of development and consolidation, including during its sale to Sanpaolo IMI in 2005 and the merger with American Bank of Albania (ABA) in 2008 that led to the creation of Intesa Sanpaolo Bank Albania, the second largest bank in the country.
- (ii) The Bank supported the National Commercial Bank (NCB or BKT) over a long period of time since the privatisation in 2000 and in June 2009 exited by selling its shares back to the sponsor, Calik Group of Turkey.
- (iii) In 2008, the Bank entered with a minority stake in Union Bank (UB), a small, innovative locally-owned bank which, despite the financial crisis, expects to benefit from growing retail and small business operations. In addition to the equity investment, the Bank is supporting UB with technical assistance to implement a comprehensive institution building program.

⁴ EvD's summary assessment refers to the following inputs: TIR, ATC, TIMS as well as OPER/XMRAs' ratings.

- (iv) The Bank participated was a start-up investor in ProCredit Bank, which received a full banking license after converting from a micro finance institution.

As for *lessons learned*, BIA demonstrated the need for continuous and diligent monitoring of banking practices and corporate governance. In BKT, the Bank facilitated privatisation, although in structuring the transaction, the Bank would have benefited from a call on the sponsor's ownership (PEX02-165).

NBFI – The Bank's only investment in NBFI has been in the state owned insurance company, INSIG, where it acquired a minority stake alongside IFC in 2003. Unfortunately, despite supporting changes in INSIG's operations, structure and corporate governance standards, as well as technical assistance for upgrading of management and technical skills, the privatisation process collapsed in late 2008 (although the Government may reinstate it at a later stage). The Bank and IFC decided jointly to exit INSIG by putting their shares back to the Government.

Through its Legal Transition Team (LTT) the Bank has been involved in an important TC providing assistance to the insurance regulator for the enhancement of regulations and enforcement capacity, aiming to strengthen market discipline. The Bank is also implementing a project to develop legislation for corporate and municipal bond issuance.

On-Lending Activities – Although early efforts to expand financing for SMEs – loans to BIA and Tirana Bank and the investment in Procredit Bank Albania – were deemed successful in providing financing. Rapid expansion of SME lending has raised concerns for the Bank of Albania and should be closely monitored (as highlighted by the Bank's Evaluation Department, PE03-255S). While in recent years, the Bank has been unable to offer its traditional debt products, the impact of the worldwide financial crisis on the banking sector might produce growing interest in debt products. These may be linked to TC, such as for energy efficiency, credit scoring, MSE or project finance through the MCFE co-financing facilities.

Equity Funds - The Bank continues to be one of the only sources of venture capital in Albania, although in past few years, the Albanian American Enterprise Fund, the Balkan Access Fund and Bedminster Capital (the latter two themselves recipients of Bank financing) invested in Albania. LEF has now become the main source of equity financing and has so far invested in 6 companies which are in various stages of implementation. Most small equity investee companies require significant hands on support, which is being provided via targeted TC by the Bank, TAM and BAS, and through the Bank-appointed representation on boards of directors.

Overall, *Moderate* transition impact has been achieved in the *Financial Sector*.

1.3.3 Infrastructure

Power – Significant progress has been achieved in the power sector in the past few years, the result of years of joint efforts by the Bank and the donor community. Following years of chronic power shortages and poor regulation, the Government has implemented significant reforms, including unbundling generation, transmission and distribution companies and privatisation of the latter to CEZ of the Czech Republic.

The country also signed a number of concession contracts in generation, in particular for HPPs. The Bank is exploring potential financing for both domestic and foreign investors in the sector.

A *lesson learned* from the Bank's Power Sector Projects is that even a sound managerial and operational TC initiative are a less positive solution compared to a co-management or concession contract involving transfer of business rights and risks to a strategic investor (PE08-432).

Transport – Implementation of the three state sector transport projects signed in the past few years – Levan Vlore Road, Levan Tepelene Road and Durres Port Terminal – have suffered from implementation delays, mainly due to design, procurement and expropriation difficulties. However, the Fier-Tepelene Road Rehabilitation Project has brought about significant improvements in road sector financing. Although there have been some delays in achieving transition benchmarks, key elements for road maintenance were introduced, such as a National Transport Master Plan, preparation of 3 year maintenance and investment programme. On the other hand, the Tirana Airport concession, the first major PPP in the region, was constructed on time and in budget. The Bank's second phase financing (which closed in 2008) also introduced the concept of refinancing of a long-term infrastructure project once initial construction risks are reduced (in this case after the first phase of airport development had been fully constructed and was operational).

MEI – The first MEI transaction was signed in 2006, in the Tirana Public Transport Project. The transition impact of this operation is linked to implementation of a Transport Strategy, improved regulation of urban transport and a Creditworthiness Enhancement Programme aimed to improve the City's financial autonomy. The project is moving ahead according to plan. The reform dimensions are also on track although slightly behind schedule. Although it is still early to provide a firm judgment, it appears that municipalities have gained increasing independence, as exemplified by the passage of the 2008 Municipal Law granting borrowing authority to municipalities for the first time, and it is hoped that the first project will be followed by additional investments in the sector.

Overall, *Moderate* transition impact has been achieved in the *Infrastructure* Sector.

1.3.4 Technical Cooperation

In all of its TC efforts, the Bank has worked with other donors to ensure coordinated assistance. In fact, Albania has an extensive donor coordination system; the Bank will continue to work with its donor partners to improve coordination and delivery of assistance as recommended in the Paris Declaration on Aid Effectiveness and requested by the Albanian authorities in their National Strategy for Development and Integration 2007-2013.

The Bank's TAM/BAS program continues to provide support to help strengthen local companies.

The Bank's Legal Transition Team has provided policy support. With respect to telecoms, Albania has made major inroads in formally aligning its regulatory

framework with EU best practice. The Bank's ongoing TC assistance project with the telecoms regulator (AKEP) has helped in some important technical areas; however implementation of the new framework remains patchy. In particular, institutional capacity is weak, with important strategic developments being delayed due to poor governance (including notably uncertain relations between the management and board and amongst board members of AKEP). The current telecom TC continues until mid-2010, at which time the Bank will examine whether further TC support (particularly on the institutional side) is necessary to ensure timely and effective implementation of sustainable framework.

The Bank also provided technical help to the non-bank financial supervisory authority (FSA) in supervision of insurance companies and in developing a new law on corporate and municipal bonds.

1.4 Portfolio Ratio and Quality

From the current portfolio of EUR 373 million, the share of private sector is approximately 50 per cent, up from 40 per cent in 2006. In terms of number of projects, the private share of the portfolio is above 70 per cent. Public sector weight remains high, as projected in the previous Country Strategy, due to structural size difference between private and public sector projects (the latter are significantly larger as there are still few large private corporations in the country). However, recent investments in the Tirana Airport, Altelecom, Titan-Antea Cement, Bankers Petroleum and Tirana East Gate boosted the private sector component of the portfolio.

Portfolio quality was good with no impaired assets as of end 2008. However, the risk rating of the portfolio is high with most projects rated between 6 and 7 (country risk rating is 6). The continuing world financial crisis has not had a significant impact on the portfolio, although this remains to be closely monitored. The Bank should be prepared to respond as needed to individual, sector or systemic financing requirements.

2. OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

2.1.1 Political Developments

The centre-right Democratic Party (PD) has led coalition government since 2005. During the 2007 local elections, the main opposition centre-left Socialist Party (PS) emerged as the winner in a number of major cities, including Tirana. Parliamentary elections on 28 June 2009 produced a very close race. According to final results the coalition led by the PD won half the seats in Parliament, slightly more than the PS-led coalition and will lead the next coalition government. In order to enable a more stable government, PD invited not only its previous junior coalition partners from the right, but also the Movement for Socialist Integration (LSI), a splinter from the Socialist Party which led a separate coalition during the elections.

The new government is expected to maintain the key priorities of the previous one, focussing on market reforms, the fight against corruption and organized crime, and

further integration into Euro-Atlantic institutions. It should be noted that there is a reasonably wide consensus among Albanian political parties, including the opposition, on these priorities.

Albania signed the Stabilisation and Association Agreement (SAA) with the EU in 2006, and it entered into force in April 2009. On 28 April 2009, Albania formally applied for EU membership. Albania became a fully-fledged member of NATO in April 2009. Tirana plays a constructive role in regional cooperation, and the new government is expected to support further cross-border and regional projects.

2.1.2 Business environment

The Government has made important progress in improving the business climate over the last years. In 2006 the Government launched the “Albania One Euro” initiative to attract FDI and announced construction of industrial zones and the sale of land and other state property at symbolic prices. In 2007/08 the government introduced a 10 per cent flat tax rate on personal and corporate income and implement a range of administrative reforms to increase tax revenues. The creation of a new business registration centre in 2007 reduced the time and cost required to open a business. As a consequence, the number of newly registered businesses increased by 34 per cent in 2008. New laws on concessions and on public procurement were adopted to approximate European standards. Bottlenecks in the bankruptcy process were addressed by introducing amendments to the bankruptcy law, although the law is largely untested. In June 2009, a one-stop-shop for licences and permits was opened, and legal amendments to reduce the time for issuing construction permits from 60 to 45 days were adopted. These improvements were reflected in the World Bank’s Doing Business 2010 report, which ranks Albania 82nd out of 183 countries (up from 135th in 2008).

However, weak law enforcement and high perceived levels of corruption remain important impediments to business development. Although the reported frequency of corruption in the courts and customs service has improved in recent years, firms still report above-average levels of corruption in the tax administration, according to the latest EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS). The BEEPS results point to serious concerns amongst business managers in the area of land titling and ownership. Despite recent improvement in its Transparency International Corruption Perceptions Index (CPI) score, Albania still ranks 85th out of 180 countries, among the lowest in South East Europe and significantly below the OECD average.

2.1.3 Social and labour issues

Albania’s high GDP growth over the past 10 years, along with an average increase (in real terms) of wages of 36.5 per cent between 2005 and 2008, and of 17.5 per cent of pensions between 2005 and 2007, has contributed to a significant reduction in poverty. Recent World Bank figures indicate that in 2008 12.4 per cent of the population were poor compared to 18.5 per cent in 2005 and 25.4 per cent in 2002. However, Albania still ranks low in comparison with other transition countries in the region in terms of commonly used living standard and human development indicators. The public health system suffers from fragmentation, lack of investment, loss of qualified medical staff to the private sector and a large-scale reduction in staff in remote areas. Infant and

mortality rates have fallen but remain high in comparison with other European states, and maternal mortality still remains a problem. Albania has the lowest secondary school enrolment rate among the countries in the region (55 per cent in 2006). The main reason for the high level of incomplete schooling is poverty as families in rural areas are forced to use children as labour. An analysis differentiated by gender shows that many women bear the burden of poverty and lack adequate health and social services. Furthermore, during the transition period, women experienced continuing difficulties with violence and trafficking for sexual exploitation.

The domestic labour force in 2008 was 35.2 per cent of the total population. The level of unemployment fell to 12.68 per cent in 2008 compared to 13.78 per cent in 2006. The sectors with the largest increase in the number of employees were industry, transport, telecommunications, trade, hotels and restaurants. For a more detailed analysis of social and labour issues, see Annex 5.

2.1.4 Environmental issues

Albania's strategic location within South-eastern Europe allows for direct links to the Mediterranean Sea. The country is known for diversity of ecosystems (e.g. coastal zones, maritime habitats, alpine/sub-alpine pastures and meadows), and features over 3,000 species of plants and numerous rare and/or endangered species of wildlife. Natural resources include petroleum, natural gas, coal, bauxite, chromites, copper, iron ore, nickel, salt, timber and hydropower.

Albania has carried out major constitutional reforms in order to align its legislation with the EU. In 2001, the National Environmental Agency was reorganised to become the Ministry of Environment, Forests and Water (MoEFW), with the Laws on Environmental Protection (2002) and Environmental Impact Assessment (2003) as its backbone. A national Action Plan with mechanisms for public participation was also implemented, after recommendations of the Aarhus Convention Compliance Committee. Although Albania has made good progress within horizontal legislation, improvement is still needed in enforcement and administration capacity, especially at regional and local levels. The country also faces important environmental and social challenges associated with sustained economic growth, namely poverty reduction, deforestation, biodiversity conservation and land ownership reforms.

Albania's EU harmonisation process allows for dialogue on key reforms, including:

- Capacity Building: to improve environmental policy making and enforcement, together with inter-institutional cooperation and coordination;
- Addressing air quality: especially in urban areas where pollution levels are among the highest in Europe. The existing legislation on industrial pollution is poor and enforcement remains weak;
- Biodiversity conservation: Urban, industrial and tourism development are affecting ecosystems, mostly coastal and littoral areas, leading to loss of habitat and fauna. Further implementation of international agreements and legislation could decrease biodiversity loss and protect endangered species;
- Natural Disasters Impact Plan was approved in 2000, with support from UNDP Disaster Management and Emergency Preparedness Programme (DMEP);

- Waste disposal and burning causes significant environmental and health hazards; Albania has no efficient systems of waste collection, disposal and recycling;
- Water Management and Conservation: surface waters are severely affected by urban, domestic and industrial pollution. Water supplies and sanitation schemes remain outdated; and
- Spill Response arrangements: although a national contingency plan and system for accidental pollution was adopted in 1993, there is no enforcement scheme, no defined response policy and no specialised pollution equipment available.

With threats of rising global temperatures and extreme weather patterns, Albania's Climate Change Unit Program (CCUP) was recently structured with focus on three main areas: Greenhouse Gas (GHG) inventory, vulnerability and adaptation, and GHG mitigation and carbon financing. Albania signed the Kyoto Protocol but needs to include climate change issues in its national planning and policy process. In addition to GHG reduction measures, it is imperative to address adaptation, mainly under the most vulnerable sectors such as water resources, agriculture, biodiversity conservation and tourism.

2.1.5 Legal Environment

Albania's legal environment continues to remain complex and challenging despite significant reforms. Over the last few years there have been significant improvements in crucial areas such as securities markets, corporate governance and concessions laws, which were all urgently needed. As a result, the general legal framework has improved substantially and the steps taken appear to have allowed progress in establishing a legal system that conforms more closely to international standards. Effective implementation of these recent reforms needs to be tested and remains problematic. The Government needs to improve the capacity of and thereby trust in the judicial system and generally develop greater respect for the rule of law in the country. Certain specific legal areas - such as enforcement as far as mortgages are concerned - are still in urgent need of reform. A more thorough review of legal reforms in Albania is provided in Annex II.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic Conditions Relevant to Bank Operations

Based on generally sound economic policies, Albania achieved robust growth of about 6.3 per cent on average between 2005 and 2008. GDP growth was driven by the services and construction sectors, benefiting from rapid expansion of credit. Annual consumer price inflation remained within the Bank of Albania's 2 to 4 per cent target range in the last five years and reached 3.4 per cent on average in 2008 despite higher food and energy prices. As a response to falling foreign currency inflows and overall tightening lending conditions, the Bank of Albania lowered its policy rate 6.25 to 5.75 per cent in January 2009. The 2008 budget deficit increased to 5.5 per cent, up from 3.5 per cent in 2007, mainly due to a scaling up of infrastructure projects (including the Kukes-Durres highway). Revenue administration and public debt management were strengthened, leading to increasing tax revenues in 2008 despite a reduction of corporate and personal income tax rates to 10 per cent.

Albania's still limited integration into global markets and its relatively low level of exports (exports of goods and services as a share of GDP equalled only around 10 per cent during 2007-2008 compared to an average of 28 per cent in South-eastern Europe) helped to mitigate the negative effects of the global financial crisis on the economy. However, the crisis has resulted in a significant drop (by more than 10 per cent) of bank deposits during the last quarter of 2008, a situation which stabilised in the first quarter of 2009. While local banks seem well positioned to overcome the current crisis due to strong capitalisation, limited reliance on wholesale funding and still low loan-to-deposit ratios, lending has become more conservative⁵ and banks are showing increasing concern about the quality of loan portfolios.⁶ The Government's crisis response included provision of liquidity as well as regulatory measures, including a limit (10 per cent) on the amount of money that local foreign-owned banks can invest or deposit with overseas parent institutions. The Bank of Albania also has strengthened supervision measures. In March 2009 the Government increased the deposit insurance ceiling from Lek 700,000 to Lek 2,500,000 (around €20,000). Following a devaluation of the Albanian Lek of about 5 per cent vis-à-vis to the euro in early 2009, the central bank repeatedly intervened on the foreign exchange market. However, international reserves have remained broadly stable at around four months of imports as a result of a prudent monetary policy and the flexible exchange rate regime.

The biggest impact of the crisis is felt in the real economy due to lower exports (minus 17.2 per cent year-on-year in the first half of 2009), lower remittances (minus 20 per cent in the first quarter of 2009) and less foreign direct investment or debt available for investments. As a result, it is expected that the economy will achieve significantly lower – but still positive – growth rates in 2009-2010, with some increase in unemployment. Key macroeconomic challenges include the large trade deficit (26.7 per cent of GDP in 2008) and a double-digit current account deficit (at around 14.9 per cent of GDP in 2008).

While external debt is manageable at around 18 per cent of GDP, the government debt burden remains high at above 50, at 54.9 per cent of GDP. Fiscal risks remain as the Government continues to subsidise underperforming state owned utilities – water, power generation and transmission – and revenues often do not cover necessary maintenance and investments. Continuing EU approximation, which culminated with a recent formal bid for EU membership, as well as the recently obtained NATO membership, have improved Albania's image as investment destination and should contribute to a rebound in growth in the second half of 2010.

The Government is expected to continue to invest in key infrastructure given the major positive impact on the economy these projects create. For example, already in 2009, the country is seeing positive impacts from the recently completed Durres-Kukes highway, with reportedly higher tourist traffic to Albania's coastline. By reducing the time to travel from Kosovo to Durres or Tirana from 7-8 hours to as little as 3 hours, the highway could become a major boost to economic activity with Durres

⁵ Year on year credit growth is around 20 per cent as of mid-2009 compared to growth of 40 per cent or more in recent years.

⁶ System wide NPLs reached 7.6 per cent in May 2009 (from 3.4 per cent end-2007). Moreover, over 70 per cent of bank credits are denominated in FX, indirectly exposing banks to currency risk.

and Shengjin ports potentially becoming important outlets for the entire Balkan region.

2.2.2 Transition Success and Transition Challenges

Enterprise sector and competition: Good progress has been made with regard to the privatisation of large-scale enterprises, which has led to heightened competition. Apart from selling its 76 per cent stake in the local electricity distribution company (see infrastructure section below), the government also sold its 85 per cent stake in the oil refinery ARMO. In 2007 the national telecom operator Albtelecom (along with a third GSM license) was transferred to Turkey's Calik Group. Supported by Bank financing, the country already is benefiting from better service and lower tariffs. The Government also sold its remaining minority stake in AMC, Albania's leading mobile operator.

Small business continues to employ a majority of the population and a significant share of business activity remains informal (although the exact level is impossible to calculate). The Government has worked to bring companies into the formal sector, through carrots (introduction of a uniform 10 per cent tax rate on corporate and personal income) and sticks (most payments, including salary payments, must now pass through banks). As a result, a larger share of GDP is now generated by the formal economy. The Bank's investments stimulated this formalisation process by supporting companies which demonstrated their willingness to work in a formal manner. However, in the latest round of the Business Environment and Enterprise Performance Survey (BEEPS IV), companies continue to report that competition from companies operating semi-legally in the informal sector is a serious obstacle affecting their operations. Companies continue to report weak law enforcement and corruption, including in courts, licensing and permitting, as key impediments to business development. In the agribusiness sector, the comprehensive re-distribution of state agricultural land has been completed, but much land still does not benefit from secure property rights – legal and administrative procedures resolving ownership disputes are weak and the restitution processes are unfinished. In order to become more competitive, farmers will likely have to consolidate land plots.

Infrastructure upgrade: Some progress has been made in expanding market structures by completing the unbundling of the power sector. In 2007, the transmission and distribution arms of KESH, the vertically integrated state-owned power utility, were spun off and reorganised as separate joint stock companies. In April 2009, the Parliament approved the sale of a 76 per cent stake in the electricity distribution company to the Czech power group CEZ. Private sector participation in generation has increased (and the Government has been working to award small and large HPP concessions). Market rules have been approved to ensure the necessary framework for the opening and functioning of the wholesale and retail market. From January 2008, all non-domestic consumers were granted the right to choose their own suppliers. However, effective competition has been limited so far and the Energy Regulatory Authority has only begun to establish itself as an effective, independent regulator. In March 2008, electricity tariffs were increased by 15 per cent but they may still not reflect all costs. Nonetheless, with the introduction of a commercially managed DISCO and the introduction of higher energy tariffs, companies and

individuals are becoming interested in reducing energy usage. The government can work with donors to develop ways to support energy efficiency initiatives.

In the transport sector, there have been restructuring efforts in recent years, and a restructuring plan for the General Roads Directorate (GRD) was approved in 2008. The Government has made significant progress in rebuilding road networks although the sector requires further investment. Major improvements include the main road from Tirana Airport into Tirana, as well as highways to the North (to Shkoder) and South (to Vlore and Saranda) and East-West (to Korca and Pogradec). Meanwhile, the Government has invested as much as EUR 800 million in the new road to Kosovo, with hopes of opening new export routes for the entire Balkan region via Durres and Shengjin ports. The road improvements are having a demonstrable impact on all sectors of the economy – tourism, agribusiness, general industry – by making it easier to deliver people and goods around the country to the target markets.

Another major development was the concession awarded to rehabilitate Tirana International Airport. The project demonstrated the benefits of involving the private sector in development of public infrastructure. The Bank has so far financed two phases of the modernisation and extension, and the project reached its expansion phase faster than projected. Government also mooted the idea of increased private participation in the port sector. Private operators are involved in Port Romano and Vlore, which are being developed as fuel import terminals. Durres and Vlore may also be expanded as passenger and cargo terminals, but Government needs to put more focus on the sector if this potential is to be realised. The Bank's investment in Durres Ferry Terminal is proceeding, albeit slowly.

There has been limited reform of the railway sector, although labour restructuring brought staff numbers down from 8,800 in 1989 to 1,900 in 2008. There are opportunities for further reform and investment, and the Government has initiated discussions with EC via IPA and the Bank about financing the sector in 2010-2011. Provision of efficient municipal services – transport, waste and water – depend on significant reform, including tariff increases, commercialisation and adequate regulation. Finally, in Tirana the city authorities plan investments in the primary road network, to improve circulation and decrease congestion levels in the city centre.

Financial sector development: The banking sector has developed strongly in the past few years, at least until the onset of the global financial crisis. As of end 2008, banking sector assets accounted for about 86 per cent of GDP although total bank credits are just 37 per cent of GDP, which implies significant room for lending growth. There are 16 commercial banks, of which 14 have a significant foreign ownership, and the remaining two have minority involvement from IFIs. The sector is dominated by a few large banks, including Raiffeisen International, Intesa Sanpaolo and Société Générale. The implementation of a new banking law in 2007 led to improvements in supervision, licensing and foreign branch regulations as well as risk and prudential management. Further improvement in the transparency of the banking system resulted from the establishment of a new credit registry, which came into operation on 1 January 2008.

The global financial crisis is affecting the sector, although to a lesser extent than in other countries of the region, due to Albania's lower level of integration and a

relatively high level of liquidity and capitalisation. The Bank of Albania has done a good job monitoring credit risks and in 2008 issued decrees which slowed growth somewhat, especially for loans in FX. The Bank of Albania also further developed the credit registry which is helping banks to monitor their borrowers. This will be vital as borrowers may be hit by the global financial crisis, which is already seen in the worsening of their repayment capacity, with non-performing loans (loans overdue by more than 90 days) doubling in the past 12 months. In response to the crisis, the deposit insurance ceiling was increased from Lek 700,000 to Lek 2,500,000 in March 2009.

The non-bank financial sector is still in its infancy, including the insurance sector where motor vehicle insurance constitutes a significant share of the total market. There has been progress over the past year in implementing measures to enhance the supervisory capacity of the Financial Supervisory Authority, where both the Bank and World Bank have provided assistance. The Bank and IFC exited their stake in INSIG ahead of planned privatisation. As this did not materialise, INSIG is once again 100 per cent owned by the government and may be put back up for sale at a later date. There is no market for raising funds or trading in bonds and/or shares.

In light of the issues discussed above, the **key challenges over the next strategy period** are to:

- Strengthen state institutions (public administration and civil service), particularly increasing efficiency and impartiality of the judiciary and conducting an effective and systematic fight against corruption;
- Further improve the investment climate for domestic and foreign companies, including resolution of land titling and ownership, and improvement of land registration procedures;
- Further investment in infrastructure, including upgrading the national, regional and local road networks, modernisation and expansion of seaports, and improving energy security;
- Increase efforts to commercialise water and waste utilities as well as urban transport, while giving greater fiscal autonomy to municipalities which could plan and invest in these sectors;
- Expand the independence and capacity of regulators of key utilities (power, telecoms and waste and water companies) to promote competition and investment;
- Further strengthen the banking system, support SMEs/MSEs and bank financing of these companies to improve competitiveness in order to reduce Albania's very high dependence on imported goods and enhance export opportunities; and support the development of the non-bank financial sector, including further enhancing the supervisory capacity of the Financial Supervisory Authority;
- Government and donors can work together to provide incentives to companies and individuals seeking to reduce energy usage; and
- Support the development of the non-bank financial sector, including further enhancing the supervisory capacity of the Financial Supervisory Authority.

2.3 Access to Capital

Albania benefits from a substantial inflow of official international assistance, equivalent to 3-4 per cent of GDP in recent years. FDI inflows are still relatively small at EUR 653 million in 2008, or about 7 per cent of GDP, mainly due to privatisations. The cumulative stock of FDI reached USD 3.2 billion at end 2008, equivalent to about 20 per cent of GDP, which is less than half of the average in South-eastern Europe. Wholesale trade, clothes and footwear manufacturing, agribusiness and construction accounts for almost half of the stock of FDI, while the manufacturing industry accounts for roughly 40 per cent. There are also some foreign investors operating in the mining and mineral processing sector under long term concessions. Italy is the major source of FDI, accounting for more than half, followed by Greece and Turkey.

In June 2007, Moody's assigned Albania the nation's first-ever sovereign rating of 'Ba1' for foreign currency bonds, which was confirmed in January 2009. Albania's three-year arrangement with the IMF expired in January 2009. For now the IMF is continuing to monitor Albanian economic developments and offer advice, particularly regarding the medium-term fiscal framework. In 2008 Albania was re-classified a middle income country according to ODA standards. Albania has not issued a Eurobond but has twice borrowed from international syndicate of banks – in early 2008 and in May 2009 (the latter for €250 million) in order to finance public investments.

No stocks are traded in Albania, and the exchange deals only with currencies and government bonds. A Bank's TC is underway to help improve regulations regarding issuance of corporate and municipal bonds. There is very limited interest from equity funds in local enterprises, although a few are now operating on a case by case basis.

Albania has benefited from significant remittances in the past few years, which have helped to finance small investments, particularly in the property sector. The global financial crisis may impact the financial sector and the wider economy through declining remittances, lower deposits and overall slower economic growth, although banks are not yet significantly worried about liquidity.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

As of mid 2009, Albania's economy continues to perform relatively strongly compared to other countries of EBRD operations despite the negative impact of the global financial crisis. However, during the current Strategy, the Bank should be prepared to address issues which emerge due to the crisis, including the impact of lower levels of remittances and investment, as well as a greater reluctance by banks to expand their lending to the real economy. The Bank may also encounter increasing demand from the banking sector and will remain one of the key sources of capital to international and domestic enterprises. Given the size of many investee companies, the importance of LEF will continue in the new strategy period. Supporting micro, small and medium size companies is vital to Albania's continued long-term growth

and in particular to reducing very high dependence on imports and improving export competitiveness.

Growth also is dependent on further investment in power, transport, municipal, environment and telecoms. However, given limited fiscal space, an increasing amount of this investment should be undertaken by the private sector, either independently or under PPP arrangements. The Bank will work in cooperation with other donors and IFIs to ensure the fullest impact and benefit for the economy.

In all its projects and policy dialogue, the Bank will promote competition, transparency and high standards of corporate governance and business conduct, as well as good environmental practice.

Given the above, the Bank's operations over the strategy period will focus on the following main priorities: (i) financing transport, municipal, energy and environmental projects; (ii) providing funding in the financial sector for on-lending; (iii) direct finance for foreign and local enterprises with a continuing effort to reach SMEs; and (iv) policy dialogue, particularly working with the new Government to address regulatory and infrastructure shortcomings. These priorities areas of operations are further outlined below.

3.2 Sectoral Challenges and Bank's Objectives⁷

3.2.1 Infrastructure and Energy

Transition Goals: Increase the country's regional integration within the Western Balkans, by focusing on critical regional projects in transport (especially on main pan-European road corridors) and energy (in view of the need to develop and execute the South-Eastern Europe Energy Community). Increase private sector participation in the sector and ensure sound implementation of recently awarded concessions for power generation in order to enhance energy security and reduce Albania's continued high dependence on energy imports. Support reform of electricity tariffs in order to reduce quasi-fiscal losses and facilitate the opening of the market. In the municipal sector, promote commercialisation of public utilities, the introduction of an adequate regulatory framework, and granting greater financial autonomy to municipalities under effective regulation. Further improve the road transport network, including through institutional strengthening, reform of financial management and maintenance of road networks. Where appropriate and feasible, develop further the involvement of the private sector in road management issues and port sector upgrades.

Operational Priorities

Energy: Thanks to investments in the transmission network, financed by the Bank, other IFIs and bilateral donors, the overall network has become more reliable. Following its purchase of the distribution company, CEZ is expected to invest to reduce losses and unbilled energy deliveries. More investment will be needed to further rehabilitate the system and help improve efficiency/reduce transmission losses.

⁷ A more detailed assessment of transition goals/remaining transition challenges per sub-sector can be found in Annex 3.

The Bank will work with the Government to improve implementation of existing projects, such as for the upgrade of power substations and transmission systems and to finance necessary investments to upgrade the distribution network, much of which will reduce waste and increase efficiency throughout the system

The Bank will consider working with private investors to develop new hydro power plant concessions. This includes much needed priority safety investments in dams on the Drin and Mat rivers, where the Bank is prepared to participate alongside other IFIs and donors. It will also consider supporting the implementation of other forms of renewable energy projects, e.g. wind, to improve energy security. Moreover, the Bank conducted an energy demand study for industrial companies in 2006, the findings of which will form part of the inputs to develop the WeBSEDF which is designed to improve energy efficiency throughout the business sector.

The Bank will look at climate change issues with regard to energy and other projects as part of its due diligence and monitoring.

Transport: The Bank will continue to support the upgrading of transport networks in Albania with emphasis on regional linkages and regional integration, in order to facilitate trade and economic growth and will also review opportunities to develop viable logistics activities linking key transport modes.

The Bank will continue to support upgrading and rehabilitation of priority sections of the national, regional and local road networks and will continue to coordinate closely with other donors and IFIs also active in the sector to help streamline implementation and increase overall funding available to the sector. The Bank may also provide further technical cooperation to support sector reform, for example strengthening the General Roads Directorate's planning and budgeting systems.

Where appropriate and feasible the Bank will support greater involvement of the private sector in the development of transport infrastructure, for example, through PPPs or other forms of concession financing in the port and road sectors. This could also include financing of public and/or private investments in facilities focusing on distribution and logistics associated with ports, road and rail terminals. Such logistics operations will be particularly relevant in Albania given its current heavy dependence on imports and need to support and expand export-oriented companies.

Building on the financing of the Port of Durres passenger terminal, the Bank intends to continue its dialogue with Government on strategies for Durres, Vlore, Porto Romano, Shengjin and Saranda ports, which should aim to commercialise port operations and expand the involvement of the private sector. Again, the port sector is an appropriate place to introduce commercial reforms and expand involvement of the private sector.

The Bank will also seek to widen its dialogue and explore opportunities to develop economically viable projects in the railway sector. This sector may potentially contribute to the overall economic development of Albania by supporting import and export activities.

Municipal and Environmental Infrastructure: Success stories, such as a KfW-funded water project in Korca and the Italian-funded upgrade of Sharra landfill in Tirana, are rare. Although the ability of the Bank and commercial lenders to finance municipal infrastructure is restricted due to project size and also financial strength of local governments and utilities (which do not have sufficient budgetary independence/revenues to achieve cost recovery), sub-sovereign lending to municipalities, permitted only since 2008, should be pursued.

Building on the first, sovereign loan with the municipality of Tirana, the Bank is developing a second municipal loan for urban road development. This loan could be made without a sovereign guarantee, which would be one of the first such examples in Albania. Investments in municipal services, such as water and public transport, can be pursued in tandem with regulatory improvements to allow for bankable structures on a sub-sovereign basis.

The Bank will again consider the potential to work with larger municipalities, Tirana, Shkoder, Vlora, Fier, with other smaller municipalities for priority projects – with particular attention to waste and water systems. Most likely, such loans would need to be supported by sovereign guarantees and also will be coordinated with key multilateral and bilateral partners, who are working in the sector, including UN, World Bank, EC, Austria, Switzerland, Germany, Italy and others .

Natural Resources: The Bank will continue to monitor the natural resources sector and consider private investments which adopt high standards of governance and business conduct as well as the transfer of skills and best practice mining methods and technology. Involvement of global mining players in the sector should be encouraged if it is seen to support significant and environmentally sustainable production. Extractive industry projects will be subject to environmental and social due diligence and monitoring, in accordance with Policy and Performance Requirements, EU and Albanian standards, and good international practice. The EBRD has committed to the Extractive Industry Transparency Initiative (EITI) to ensure transparency on payment of proceeds from extractive industry projects to the government.

3.2.2 Enterprise Sector

Transition Goals: Increase availability of debt and equity financing for local enterprises given the slowdown in domestic bank lending and contribute to a widening of the country's export base, including through an increased share of higher-value added goods. Support post-privatisation investments in the power, natural resources and telecoms sector and attract FDI into these and other industrial sectors. Support the expansion of the market for modern commercial property in all sub-segments and increase Albania's long-term potential as a tourism destination, including through further progress in land reform.

Operational Priorities

The Bank continues to be seen as the leading institution to support competitiveness in the economy and finance larger investments, both domestic and international. The Bank has supported large companies, such as Albtelecom, before and after privatisation. Further financing of privatised companies, including the DISCO which

has been sold to CEZ of the Czech Republic, will be explored. It is anticipated that the Bank's support will remain a key source of financing for larger investors interested to initiative operations in Albania. The Bank will promote the private sector through financing existing companies, greenfield developments and/or or acquisition projects. Given the low level of foreign direct investments, the Bank will further expand its efforts to reach small and medium size companies either directly, through LEF and the new EBRD Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDF) or in complement with local banks through products such as the Medium Size Co-Financing Facility (MCFF) and the Western Balkans Sustainable Energy Efficiency Credit Line Facility (WeBSEELCF). Another area for developing business will be amongst regional companies investing in Albania and in supporting Albanian companies expanding into neighbouring markets.

The Bank will seek to expand its investment activities in sectors where Albania has relative export advantages or where it is currently dependent on imports. These include agribusiness (including processing, logistics and retail distribution), textiles/processing, natural resources, property and construction materials. Again, LEF and WeBSEDF should be effective mechanisms to finance viable local enterprises. New products will be designed to provide financing of energy efficiency/sustainable energy and also to support companies which are developing in the IT sector.

The property sector is likely to see a shake-out as companies which were building speculatively due to cheap access to finance may be unable to continue operations. However, as the sector was not as overleveraged as in other countries in the region, the Bank should be able to continue some traditional property sector activities. Thus, the Bank will support projects that expand real estate infrastructure, particularly those that improve retail efficiency (retail and logistics) and enterprise efficiency (office). In the tourism sector, areas of potential support include holiday resorts and other projects in which experienced sponsors are coordinating with strong operators.

In Telecoms, the Bank will continue to support fixed and mobile operators, including potentially the fourth mobile operator, and will encourage further liberalisation of regulation to facilitate introduction of new technologies, including WiMax and broad band, which will offer new ways to deliver data and content. Moreover, the Bank is developing new products to support energy efficiency for mobile operators, based on models introduced in other countries of operations.

3.2.3 Financial Sector

Transition Goals: Improve the availability of risk capital and long term funding for private businesses, targeting in particular the MSME sector and energy efficiency and renewable energy projects. Further strengthening of the regulatory environment, including the credit registry, the deposit insurance agency and improve further the bankruptcy law and procedures. Expand the insurance sector, particularly for life products, and develop non-bank financial institutions, like leasing companies, as well as capital markets, including strengthening of the securities market regulator. In light of uncertainty arising from the global financial crisis and its possible impact on the banking system, provide appropriate policy and funding responses should banks require support.

Operational priorities

The Bank is actively monitoring its existing bank partners and remains in dialogue with the Bank of Albania to ensure that it can quickly respond should there be a greater need for funding and/or capital. In particular, the Bank may be called upon to extend equity, quasi-equity and debt investments to banks which until now have been able to rely on deposit growth to fund balance sheet growth.

Banks have become more risk-averse and are seeking greater diversification of portfolios. In this environment, the Bank will intensify its efforts to offer MCFF facilities and other risk sharing products which aim to ensure continued lending to the real economy while at the same time strengthening the banks' risk profile and their lending policies and procedures.

As one of the major challenges will be to maintain the level of lending and thereby ease the impact of the crisis, the Bank will seek to design adequate lending products, where possible coupled with donor funded subordinated resources, to support SME and MSME development as well as energy efficiency and renewable energy projects. Whenever needed, these investments will be coupled with technical assistance for a more efficient way of delivering the transition impact in the post crisis environment.

The Bank will contribute to development of the non-banking financial sector. The Bank has provided TC to the Financial Supervisory Authority on issues such as insurance and development of the legal and technical infrastructure for bond issuance. This project will be completed and the Bank could work with its municipal and corporate partners to test the potential to issue bonds. Finally, the Bank will work with the Bank of Albania, providing policy advice on targeted issues, such as deposit insurance and financial sector supervision.

3.2.4 Policy Dialogue

In all of the above mentioned sectors, the Bank will retain an active dialogue with the Government, the Bank of Albania, the donor community as well as the business community to further strengthen Albanian institutions and to enhance the environment for the private sector to flourish. This could include key issues such as land reforms and municipal and/or infrastructure planning. Improvement in the regulatory framework to enable infrastructure investment will continue to be a key objective of the Bank's policy dialogue efforts. Specific areas where the Bank could focus more fully in the forthcoming period are:

- Identify the existing impediments to private sector and especially SME development and gain direct feedback on government policy and actions;
- Ensuring that environmental and energy efficiency reforms are adopted at the Government and company levels;
- Ensuring requirements for transparency and accountability are included in projects, in line with EBRD policy and applicable commitments under international conventions;
- Expanding the use of private concessions in infrastructure (e.g. seeking to repeat the success example of the Tirana International Airport); and

- In the telecoms sphere, the Bank will continue TC support and will also examine scope for further specific assistance for the authorities, including institutional development, broadband roll-out, rural access and development of the regulatory framework (facilitating digital switchover and enabling Albania to benefit from innovations in digital media).

4. COOPERATION WITH DONORS AND OTHER IFIs

The Bank works closely with other donors to promote its Country Strategy in Albania. The Bank has worked with bilateral and multilateral institutions on key infrastructure, including transport, power and telecoms, as well as the municipal sector. Partners have included the World Bank, EIB, Japan Bank for International Cooperation (JBIC), the EC and bilateral governments.

After successful cooperation in the roads sector, the Bank is working with EC and EIB to co-finance a portion of the World Bank-led rural roads rehabilitation project.

After two successful operations to finance the PPP project for the modernisation and expansion of the Tirana International Airport, where the Bank worked with Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG), the Bank is prepared to consider further PPP infrastructure investments.

Besides co-financing physical rehabilitation projects, the Bank is working with other donors to co-ordinate policy dialogue in relevant infrastructure sectors. However, over the past few years, the government has had many offers of financing and has not adequately prioritised its investment requirements. Better coordination will help with implementation where, unfortunately, capacity of the Government remains quite weak.

The Bank, EC and EIB have cooperated particularly well in the road, port and power sectors and this cooperation can only benefit from creation of the WBIF, which aims to consolidate IFI financial instruments and resources available to pre-accession countries in the Western Balkans. Such a framework provides for a much improved co-operation among European donors, based on transparent sharing of respective pipeline, joint programming missions to countries, share of decision on priority projects eligible to receive IFI and donor financing, and joint/parallel financing from participating IFIs.

Donor funding also has been particularly important to support development of both TAM and BAS initiatives. Key donors which have funded one or the other of the two initiatives have included the Netherlands, Portugal, Canada, Japan, and the EC.

In line with the Bank's priorities and the government's National Strategy for Development and Integration 2007-2013, the Bank will pursue the below objectives:

- Implement the WBIF through co-financed projects and the attraction of grant resources to support them;
- Maintain close co-operation with WBIF participants, the World Bank and other institutions in policy dialogue on improvement of the investment climate;

- Co-ordinate with the World Bank/IFC and EU, as well as with other agencies actively involved in the dialogue to promote private investment in developing and operating infrastructure and working to assist sectoral reforms;
- Continue co-operation with the IFC where appropriate in the banking sector and to support important large FDI;
- Cooperate with the Albanian government on implementation of the Action Plan for the Aarhus Convention Compliance, as appropriate;
- Continue co-operation with the World Bank and bilateral donors e.g. USAID, SECO, KfW and Austrian Development Agency, for restructuring and rehabilitation of the power sector. Particularly, financing of priority investments in hydro power plant dam facilities; and
- Continue close co-operation with the EU, EIB, World Bank and other potential donors in the transport infrastructure sector (roads ports and rail for example).

More detailed information on other IFI and bilateral donors' activities in Albania can be found in Annex 8.

ANNEX 1 - Political Assessment

Albania is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement establishing the Bank.

Democratic institutions in Albania are robust, with a functioning separation of powers and checks and balances in the political system, although the culture of political dialogue requires further consolidation. Elections are generally conducted in a manner deemed by the OSCE and the Council of Europe to be largely free and fair. However, while a tendency towards improvement of the electoral process is evident in Albania, elections there are often marred by serious procedural irregularities and do not yet meet full international standards for democratic elections.

Over the last few years Albania has continued to make progress on key reforms, geared towards EU approximation. The government structures have been strengthened in order to meet commitments under the Stabilisation and Association Agreement with EU and coordinate work towards EU integration. Albania's political system has matured and the overall political stability increased. The last three elections (parliamentary in 2005, local in 2007 and parliamentary in 2009) were peaceful, in contrast with the not so distant past when political infighting between the centre-right Democratic Party (PD) and centre-left Socialist Party (PS) was often accompanied by street violence. These two large political parties have been alternating at the helm of the country for almost two decades, but the latest peaceful transfers of power give hope that this has now become an irreversible achievement.

Key weaknesses are in the areas of the rule of law, corruption and organised crime, and the overall administrative capacity.

Elections

The legal framework, which benefited from several waves of electoral reforms, enables a sound basis for democratic elections, provided political parties exercise sufficient will and ability to implement it. The latter was often absent in the past, as serious shortcomings repeatedly marred elections in Albania, including electoral violence and intimidation. The most recent elections, however, were conducted in a largely peaceful atmosphere and were generally better organized, although they were still not free from various procedural irregularities. In particular, the local elections in February 2007 were marred by serious irregularities and were assessed by the international Election Observation Mission as "only partly meeting OSCE commitments and other international standards".

The last general elections, which took place on 28 June 2009, were an important test for democracy and were particularly closely monitored by the international community due to the formal bid for EU membership, which the Albanian authorities had submitted shortly before these elections. According to preliminary assessment by the OSCE Office for Democratic Institutions and Human Rights (ODIHR) and the Parliamentary Assembly of the Council of Europe (PACE) the elections marked tangible progress with respect to procedural issues. Election day was overall calm and peaceful. Although the

final assessment by ODIHR will depend on the conduct of the post-electoral phases of the electoral process, its preliminary report assessed the entire process slightly more positively than during the previous elections. Nevertheless, a number of shortcomings were noted, including recurrence of so-called ‘family voting’, certain politicisation of the work of the Central Election Commission (CEC) by representatives of the two main political parties, lack of editorial independence and bias in some media outlets, and attempts by the political parties to use legal loopholes in order to circumvent the provisions designed to ensure representation of women. The vote count was protracted and marked by high level of mistrust among political parties, while CEC frequently chose not to intervene when problems arose at the local level. The leadership of the opposition PS announced that it would not recognise the final results of the elections and has so far boycotted the work of the newly constituted Parliament, which convened on 7 September 2009.

The parliamentary elections that took place on 28 June 2009 brought victory to a coalition led by the centre-right PD, which had led the country since 2005 and received a second mandate to lead a coalition government. The elections were conducted under a renewed system, which included constitutional amendments and the adoption of a revised electoral code in 2008. The new system, although not ideal and criticised particularly by smaller political parties, had a significant advantage of having been approved by the two largest political parties, the ruling PD and opposition PS. The electoral reform was largely positively assessed by the Council of Europe’s Venice Commission. The new electoral system envisages a proportional representation with 140 members of unicameral Parliament elected in 12 regional constituencies. This system favours big parties and effectively forces smaller political parties to seek pre-electoral coalitions with two dominant political parties, PD and PS, or even merge with them, paving the way to a more consolidated party system. During the 2009 general elections practically all among more than 30 political parties registered for the election joined forces with one of the four coalitions formed for this election.

Rule of Law

Comprehensive reform of the judiciary is making progress but is still at an early phase and much remains to be done to ensure its full independence, transparency and efficiency. Some important legislative acts have been adopted, including a new law on the organisation of the judiciary, endorsed in 2008, but their implementation remains slow. A major problem remains restitution of property confiscated during the communist regime, resolution of land titling and ownership, the problem which has for years affected economic development and foreign investment.

Corruption remains a serious problem. In 2004 PACE assessed in one of its Resolutions on Albania that corruption was “the single biggest threat to the functioning of democratic institutions and the rule of law in Albania”. The authorities have since undertaken various measures in order to fight corruption, organised crime, and trafficking. According to the latest report by the Group of States against Corruption (GRECO), Albania has implemented many of its recommendations. Albania’s rating has improved considerably in the annual Transparency International Corruption Perception Indexes (CPI) – from 105th place in 2007 to 85th place in 2008, although it is still among the weakest in South-eastern Europe. An overall anti-corruption strategy for 2007-2013 was adopted by the government, but its implementation remains to be seen.

Human rights

Albania is a signatory to all major international human rights instruments, including the European Convention on Human Rights and Fundamental Freedoms. The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status. The Constitution guarantees the basic freedoms and rights of citizens recognized in international law, while international treaties are directly enforceable by domestic courts and their status is superior to the domestic law. The constitutional guarantees of freedom of thought, conscience and religion are generally respected, and Albania continues to provide an example of religious harmony in the region. According to the Constitution of Albania, there is no official State religion and the rights of all religious communities (the main are Muslim, majority Sunni and Bektashi, and Christian, majority Orthodox and Catholic) are equally guaranteed.

During the last decade pluralism in the media has increased overall, but some question their independence from political influence. There are more than 250 broadcast outlets and newspapers operating in Albania, with electronic media dominating the market. The dominant media outlet is Albanian Radio-Television, which has still to transform from the state-controlled service into a public broadcasting service. The key broadcast and print media are generally considered to be aligned with one of the country's two main political parties. Given the high number of media competing in a limited advertising market and the lack of transparency in their funding, media observers raise concerns about excessive interference by business interests. Defamation remains a criminal offence in Albania.

Albania has a less diverse ethnic composition than most of its regional neighbours. Greeks, which make up the largest ethnic minority, are, according to estimates (the latest official census, conducted in 2001, did not include questions on ethnicity), only a few per cent of the population. The legislative framework for the protection of ethnic minorities is broadly in place, including the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expression, and they are guaranteed full rights under the Constitution. Ethnic minorities actively participate in political life, mainly through their own political parties. More efforts are needed for ensuring collection of reliable data on the size and existing vulnerabilities of minorities. Roma minority, as in many other neighbouring countries, is the most vulnerable and continues to face difficulties in access to education, housing and employment. Although a national strategy for improvement of the Roma living conditions is in place, Albania does not participate in the Decade of Roma Inclusion.

Although active at the grassroots level and having a few high-profile representatives at the national level, the role of women in Albanian political life remains limited. In the 2005-2009 Parliament only 7 per cent of MPs were women. Despite the provisions designed to improve women's representation, enshrined in the electoral code and other legislation, such as the Law on Gender Equality in Society, adopted in 2008, women often face difficulties in being selected as candidates and reaching leading positions in political parties and in public administration.

There is a favourable legal framework for civil society organisations. However, overall NGOs in Albania remain relatively weak and their participation in policy-making requires further strengthening.

The situation with human trafficking in Albania is comparable to that in other neighbouring countries of the region. Albania remains a transit and a source for women and girls trafficked for forced prostitution. The Government is making efforts to combat trafficking, as well as to protect the victims. In 2008, the 3-year national strategy to combat human trafficking and the relevant national action plan were adopted. However, some problems still have to be addressed, including additional efforts to effectively prosecute traffickers and to protect and reintegrate victims.

EU approximation and Euro-Atlantic integration

Albania's integration into the EU remains the main external anchor for reform and there is full consensus among all mainstream political parties that this is the country's top priority. Albania signed the Stabilisation and Association Agreement (SAA) with the EU in 2006, and, having been ratified by all member states (which made Albania the first in this respect among the countries that do not have a formal status of EU candidate), the SAA entered into force in April 2009. On 28 April 2009, Albania formally applied for EU membership. Albania also became a fully-fledged member of NATO in April 2009, the first, along with Croatia, among the countries of the Western Balkans. Tirana maintains good relations with its neighbours and plays a constructive role in regional cooperation, being an active member, *inter alia*, of the Regional Cooperation Council and Central European Free Trade Agreement (CEFTA). The government is keen to support further cross-border and regional projects.

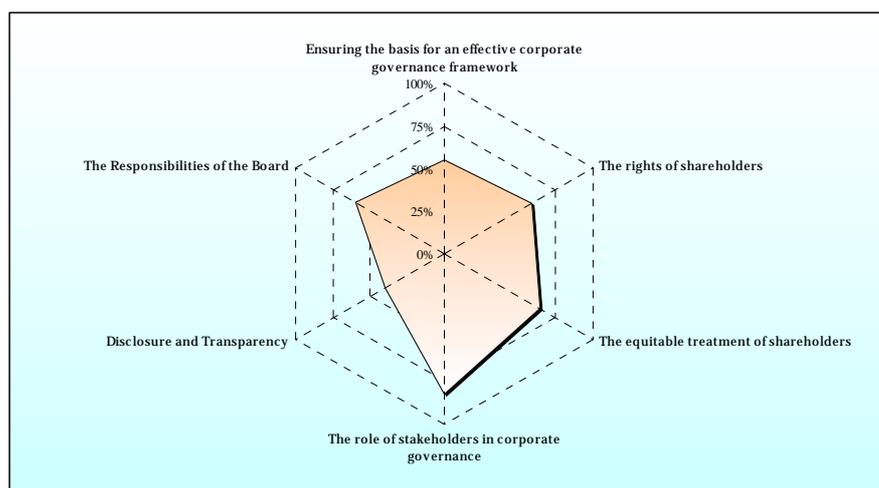
ANNEX 2 – Assessment of Albania’s Commercial Laws

The Bank has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Albania, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Company Law and Corporate Governance

The corporate governance framework in Albania is essentially regulated by Law no. 9901 approved by the Albanian Parliament on 14 April 2008 on “Entrepreneurs and Commercial Companies”, which entered into force on 21 May 2008 and replaced the previous legislation on business organisations in Albania (Laws no. 7632/1992 and no. 7638/1992). The new law regulates individual entrepreneurs and commercial companies. In contrast to the previous company law, the 2008 law also includes the definition of branches and representative offices of foreign companies and details provisions on group of companies. Companies incorporated under the old regime have a three-year transition period in which to align their organisational structure with the new law.

Quality of corporate governance legislation – Albania (2008)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximates these principles

Source: EBRD Corporate Governance Sector Assessment, 2008 assessment

According to the results of the Bank’s 2008 Corporate Governance Sector Assessment, (see chart above) which assessed the quality of corporate governance

legislation in force in November 2007, Albania was found to be in “low compliance” with the relevant international standards (the OECD Principles of Corporate Governance). The new 2008 law has addressed some of the shortcomings highlighted in the assessment and the framework has now improved.

In 2005, the Bank surveyed the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: complexity, speed, enforceability and institutional environment. The survey revealed several shortcomings in Albania. Procedures for obtaining disclosure and redress are complex, especially if the controlling shareholder refuses to spontaneously collaborate. Further, the absence of case law offering guidance on the interpretation of the law adversely affects the clarity of proceedings. The time needed to obtain an executable judgement is in the region of 18 months but it is easy for the defendant to delay the process. Company information is generally not reliable and statutory auditors are usually unable to act independently, which decreases the possibility of obtaining a successful disclosure. When considering redress, the case study reported a lack of experience and competence of courts in corporate law cases and highlighted their potential partiality, especially when the case is against a powerful defendant.

Following the recent extensive amendment of the Albanian corporate governance framework, authorities should now ensure that the resulting legal framework is perfectly harmonised and workable. Improving the capacity of institutions in effectively implementing the legislation through adequate training and skills upgrade programmes should be a priority.

Concessions

Although a clear written general policy framework for improving the legal environment and promoting PPP is still missing, the Government’s recent efforts in concessions framework reform demonstrates its interest in promoting and using PPP in its infrastructure and services. A Concession Treatment Agency has been set up to fill the gap in the institutional framework.

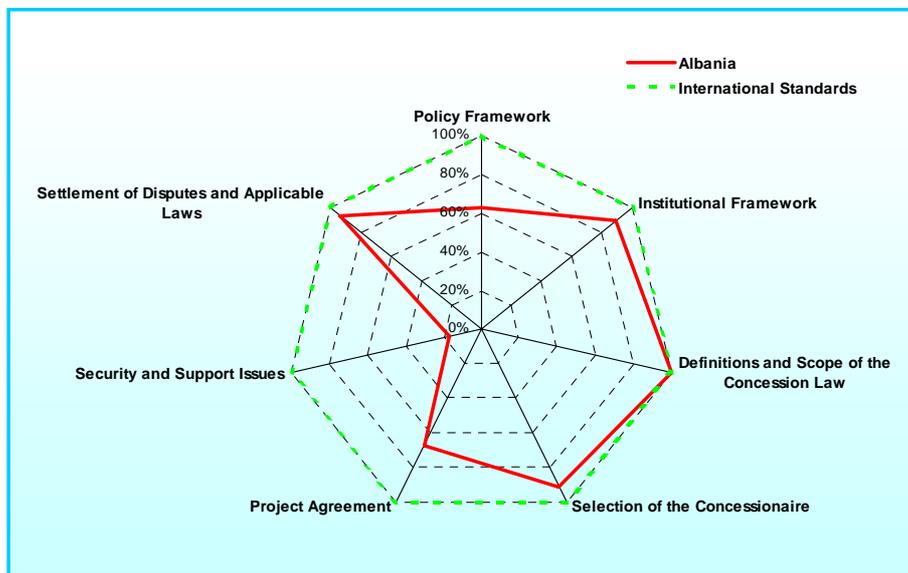
The Albanian Concessions Law 9663/2006 (“the Law”) is very close to the UNCITRAL PFI Guide recommendations, and contains very positive features. For example, the Law is one of the few concession-governing laws in the region that includes in its definition the transfer of risk to the concessionaire and the remuneration considerations. It also requires a value for money analysis. The entities involved and the sectors concerned are clearly identified. Sectors eligible for PPP include *inter alia* transport, electricity, water, waste water, solid waste, education, health care and prison sectors as well as any other sector approved by government resolution.

The Law contains provisions assuring a fair and transparent selection process including the pre-selection of bidders, procedure for requesting proposals with a

distinction drawn between technical and financial proposals, possibility of two-stage procedure, publication of concession award, limited exceptions to concession award without competitive procedure, existence of review procedures, parameters for the negotiation process, etc. The provisions regulating project agreements give clear guidance on the main issues to be covered yet remain sufficiently flexible, thus allowing the parties to freely negotiate its terms.

Amongst drawbacks there is a particularly important one: the Law is silent on government security and support issues. This may result from the fact that the Government is concerned with the level of public debt and the potential consequences of PPP projects on the state of public finance. Also, although very well drafted, the Law remains to be tested in practice. Among practical issues identified by the authorities is unsolicited proposals rules and how to deal with the inflow of these.

Quality of concession legislation – Albania (2007/8)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the ‘web’, the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2007/8

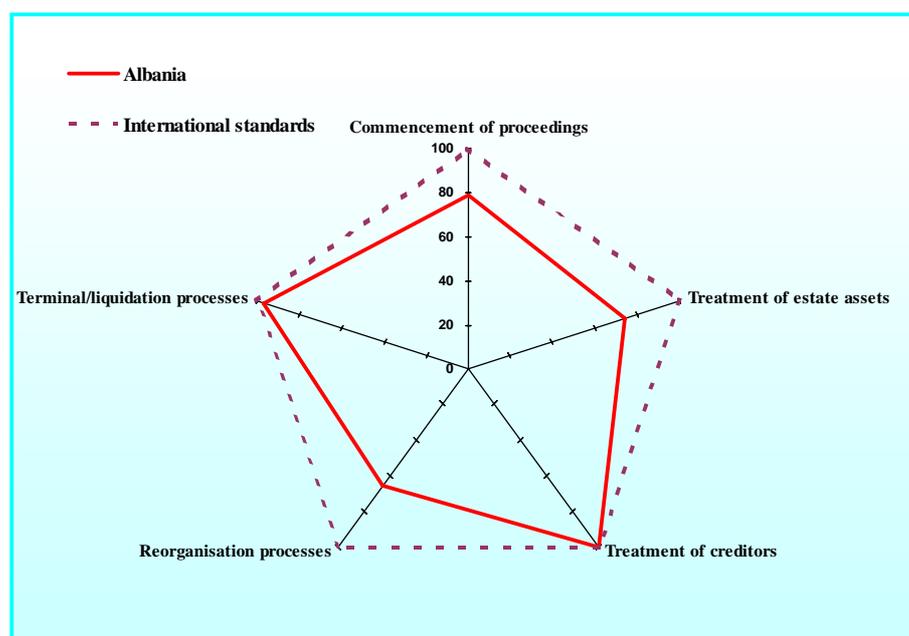
Insolvency

Insolvency in Albania is governed primarily by the Law on Insolvency Proceedings of 2002, as last amended in 2008 (the “Insolvency Law”). In the Bank’s 2006 Insolvency Assessment Survey, which measures the compliance of insolvency legislation with international standards, the Insolvency Law was one of the few laws in the Bank’s 30 countries of operations to receive an overall score of “high compliance”.

The graph below demonstrates the level of compliance of the Insolvency Law across five critical areas in insolvency legislation. The outside line of the graph represents full compliance with critical international standards and the inside line charts the Insolvency Law’s score.

Nevertheless, the Insolvency Law could be significantly improved in a number of ways: in particular, there is some uncertainty about the rights of secured creditors to enforce their security when insolvency proceedings have been commenced. The Law should contain more features allowing companies to be reorganised. For example the Law should prevent termination by the providers of operationally essential contracts (i.e. electricity and gas supply, telecommunications, etc.). Creditors would also benefit from more detailed rules regarding their review and approval of the reorganisation plan. Finally, the Law should strengthen the rights of creditors regarding the appointment and replacement of the insolvency office holder, to ensure better accountability.

Quality of insolvency legislation – Albania (2006)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank’s Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on “Legislative Guidelines for Insolvency Law”, and others. The fuller the ‘web’, the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment 2006

The Insolvency Law was amended in 2008 but it is still too early to judge of the effect of the reform.

Secured Transactions

Security over movable assets in Albania is governed by the 1999 Law on Securing Charges, which was fully implemented in 2001. Taking security over immovable assets (mortgage) is governed by the Civil Code (art 560-607). Charges over immovable property must be registered in the local registry for immovable property.

The Law on Securing Charges applies to “all transactions, 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 agriculture machines, aircraft, aircraft engines, automobiles, boats, construction machines, motorcycles, motor vehicles, trailers, trolley, etc. The Central Registry for Securing Charges started operating in February 2001. The Law is generally clear, comprehensive, and provides the right flexibility to accommodate relatively sophisticated transactions. Users report positive experience associated with the perfection of a charge at the Central Registry. A drawback lies with the priority of secured creditors as priority may be lost to some employee, social security and state claims. However the weakest point of the regime is in the enforcement of the charge.

The legal provisions by themselves aim at providing a fast and efficient system: they give the secured creditor upon debtor’s default, the automatic right to request from an execution officer upon order of the competent court, to take possession of the assets. Realisation can then take place by way of a private sale or public sale, including public auction or closed tender, where the collateral will be offered for sale either as a whole or piecemeal. However, as the Bank led Survey conducted in 2003 showed, execution officers (bailiffs) proved not to be as reliable and efficient as needed. Courts are also reported to be slow and not very experienced in handling enforcement cases, with a high danger of corruption.

The question of enforcement is even more acute as far as mortgages are concerned: banks have been denouncing the fact that they are unable to recover the secured debt at a satisfactory return level when enforcing the mortgage over the property. In fact, it is widely believed that the problems encountered during the foreclosure procedure are an important factor holding back mortgage loan development in Albania. The problem stems from the Civil Procedure Code provisions (arts 560-580) on the “Enforcement on immovable property, ships and airplanes”. The Bailiff (Executors) Office is in charge of organising the evaluation of the property’s value (which will be the starting sale price) and the public auctions at which the property will be sold. The law only allows for two auctions and if no buyer qualifies at the end of the second auction, the only option left for the creditor is to acquire the immovable at the offered price (that is, evaluation price reduced by 20 per cent) in repayment for the claim. If the creditor declines this option, the foreclosure procedure is deemed terminated and the creditor has to identify other ways to recover the claim. In case where the property has been appraised at a value higher than the claim, the creditor has to pay the difference to the debtor. Other mentioned problems are:

- Undefined time periods for the bailiff to notify the debtor so the process usually drags on;
- Subjectivity in determining the value of the property as there are no commonly set standards for real estate property valuation;
- Long and cumbersome auctions procedures.

Several initiatives to address the issues were launched, and late 2008, under the pressure of the Association of Albanian Banks, the government agreed to support a reform of the Civil Procedure Code by which the ceiling of the second auction would be lowered to 40 per cent.

However it is unlikely that this reform will be sufficient to address the problem at its core. The European Assistance Mission to the Albanian Justice System has studied the issue and published a full set of recommendations for the improvement of the Civil Procedure Code with focus on enforcement on immovable assets, mostly on how to improve the organisation and functioning of the bailiff service. In particular, the idea of privatising the Bailiff Office is seriously considered. The Bank has also put forward the recommendation to tackle the issue by considering providing legally efficient means by which mortgages can be enforced without requiring a public auction to be held and the involvement of the bailiff office.

Securities Markets

The securities market in Albania is regulated by the Law no. 9879, dated 21 February 2008 “on Securities”. The law defines the type of securities, conditions for their issuance, trading and registration procedures, requirements for brokers, conditions for the organization of the public trading of securities, rules on protection of investors and the securities holders, the organization and functioning of securities registries and of the stock exchange. This Law is a marked improvement from the former regime, which was deemed by the Bank not to reflect best international practices, as defined by the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO). In addition, three new bills on (i) pension funds, (ii) investments funds and (iii) corporate and municipal bonds are being prepared (the latter with the Bank’s assistance) are being discussed at the Parliament and should be adopted by the end of 2009.

The Albanian securities market is supervised by the Financial Supervisory Authority (the 'FSA'), established by Law no. 9572 dated 3 July 2006, replacing the Securities Commission. The FSA is also in charge for the insurance market, pension schemes and other non banking financial activities, while the Central Bank is competent for the banking sector. The Tirana Stock Exchange is the only market operator that has adopted internal rules concerning membership and listing, but it is inactive. As a result the Albanian financial system is currently centred on banks.

In order to assess how securities market legislation works in practice, the Bank carried out a Legal Indicator Survey (“the LIS”) on securities markets. Practitioners in the region were asked to comment on a hypothetical case study, advising an investor who lost his savings after buying shares in a national company’s Initial Public Offering (IPO), misled by erroneous information in the prospectus. In particular, the Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. Albania never experienced an IPO and the only prospectuses that were prepared were the Information memorandum during the privatisation process. These documents were not considered reliable. Now the legal requirements for disclosure have improved, but they have never been tested in practice. Since January 2008, financial reporting of listed companies needs to be in line with International Financial Standards (IFRS). Due to inactivity of the stock exchange, the effectiveness of this provision still remains to be tested. Private enforcement mechanisms allow for several course of action but their effectiveness is low: procedures are complex and the foreseeable recovery rate from legal action is very limited. Securities markets institutions are not

yet experienced for providing the necessary support to court action while the experience of courts and prosecutors in complex securities law cases still needs to be tested in practice.

Following the ongoing extensive revision of the Albanian securities markets legal framework outlined above, the government should ensure that the new financial instruments and procedures can easily be applied by companies and monitor implementation, in order to create a viable alternative to banking financing.

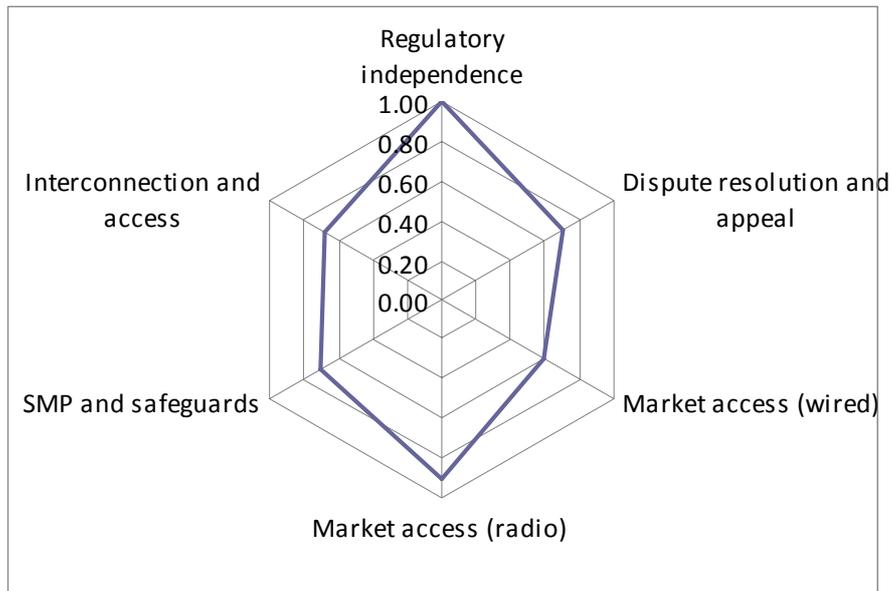
Telecommunications

Legal and institutional framework: A new European Union (EU) Consistent Law on Electronic Communications (the “2008 Law”) entered into force on 26 June 2008, defining the institutional framework of the sector. The Ministry of Public Works, Transport and Telecommunications is responsible for sector policy making, drafting legislation, preparing the National Radio Frequency Plan and approval of the tender procedures for the frequency assignment and designation of the universal service providers based on the proposals of the regulator. The 2008 Law establishes the Albanian Authority of Electronic and Postal Communications (AKEP) as a new regulatory authority, taking on the tasks and responsibilities of the previous regulator for telecommunications (the TRE). AKEP is a public, independent, non-budgetary, legal entity responsible for carrying out regulatory tasks defined under the 2008 Law.

Market access and authorisations: Liberalisation of fixed electronic communications networks and services was introduced gradually: starting with rural local networks in 1998, moving to domestic long distance networks in 2003 and international networks in 2005. The 2008 Law introduced a general authorisation regime where networks and services that do not require the use of limited resources can be provided without individual licences, subject to a general authorisation with a notification submitted to AKEP. The award of a fourth GSM licence is currently underway.

Assessment: In a 2008 assessment of the communications sector of the Bank’s Countries of Operation the sector regulatory regime in Albania was deemed to have “High Compliance” when measured against international best practice. However, in the light of a deterioration of governance within AKEP in early 2009, this assessment requires review and probably downgrading. Albania’s legal framework for telecommunications regulation is consistent with the EU 2003 regulatory framework but implementation is weak. There have been serious governance problems at the AKEP which have hindered its development into a fully effective professional body and paralysed decision making. The result is that serious weaknesses remain in the implementation of SMP and competitive safeguards. Additionally, the Albanian authorities have been slow to release spectrum for the development of third generation mobile and fixed wireless services.

Quality of telecommunications regulatory frameworks – Albania (2008)



Note: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications regulatory framework of the country approximates these standards.

Source: EBRD Telecommunications Regulatory Assessment, 2008

ANNEX 3 – Transition Challenges

Albania faces a number of important transition challenges in all sectors. The assessment below is based on the 2009 Assessment of Transition Challenges.

Corporate Sector

General industry: In recent years general industry reform in Albania has been hampered by weak law enforcement and slow progress in processing ownership claims and permits. However, in the last two years Albania has made important progress in improving the business climate. In June 2007 the creation of the new national business registration centre led to a substantial reduction in the amount of time required to register a business from eight days previously to only one day now. In January 2008 a 10 per cent corporate income tax replaced the 20 per cent rate on profits. Several high profile privatisations have been concluded in 2007 and 2008. However, many enterprises still need to be restructured and standards of corporate governance and business conduct remain low.

Agribusiness: Although prices are liberalised and trade controls are gradually being reduced (under the umbrella of the EU SAA agreement signed in 2006), the sector suffers from the very small size of average land holdings, a lack of infrastructure and skills, inefficient agribusiness producers, weak property rights, low quality standards and limited investment. The comprehensive re-distribution of state agricultural land has been completed, but much of this land still does not have secure and unambiguous property rights since legal and administrative procedures resolving ownership disputes remain weak. Most agri-processors have been privatised. There has been limited foreign investment in the sector. However, agribusiness companies are hampered by outdated equipment and low quality standards. Although access to credit is increasingly available through micro-credit type schemes, it remains limited since there is very little interest in investments into agricultural activities.

Property and tourism: Despite a rapidly expanding private construction sector since 2005, Albania's property market is characterised by a significant lack of supply for modern commercial property in all sub-segments. The residential mortgage market is underdeveloped and there is a lack of long-term construction debt finance. There is little state interference (subsidies etc.) in the sector. The government has made important progress with regard to property registration, and access to land is not seen as a major problem by the private sector. There is some evidence of progress in enforcing existing legislation and regulations, particularly in the capital, since the last review, but gaps remain with regard to the efficiency of the practical implementation of the legislative framework and dealing with construction permits. There is a lack of new products and financing methods in the sector despite significant construction activity by SMEs in main coastal regions. Tradability of land is limited de facto.

Telecommunications: The fixed-line incumbent Albtelecom was privatised in 2007 after a number of attempts. Although the market is liberalised, no serious competition exists, with Albtelecom holding virtual monopoly over the fixed-line and internet markets as well as broadband ADSL internet access services. Mobile telephony market is more developed and competitive, which improved with the entry of third GSM mobile network operator, Eagle Mobile, in March 2008, and mobile penetration

levels are growing rapidly, though mobile number portability has not been introduced yet. Internet and IT market, however, is underdeveloped and characterised by high prices, lack of strong competition and accessibility and broadband access is available in very few places. There has been significant improvement in market supporting institutions with the new Law on Electronic Communications (May 2008).

Energy and Infrastructure

Power sector: Progress has been made in improving the market structure by completing the unbundling of the power sector. In 2007, the transmission and distribution arms of KESH, the vertically integrated state-owned power utility, were spun off and reorganised as separate joint stock companies. In addition, in April 2009, the Albanian parliament approved the sale of a 76 per cent stake in the local electricity distribution company. While private sector participation in generation has been so far limited, it is expected to increase through a recent public tender procedure for awarding concessions for large, small and mini hydro plants. Market rules have been approved to ensure the necessary framework for the opening and functioning of the wholesale and retail market. From January 2008, all non-domestic consumers became eligible consumers and were granted the right to choose their own suppliers. However, effective competition has been limited so far. The quality of Albanian institutions needs to be further strengthened. An Energy Regulatory Authority is in place but its independence is limited and its institutional capacity needs further strengthening. In March 2008, electricity tariffs were increased by 15 per cent but they are still not cost-reflective.

MEI sector: Formally the control of municipal infrastructure has been transferred to the municipalities. However, a contradicting legal framework for land rights results in substantial central government interference into local infrastructure operations. The majority of municipal utilities and transport companies is not fully corporatised. Financial performance is generally weak and there seem to be little concern for generating commercial revenues as low tariffs, inadequate metering, and poor collection of tariff revenues is observed in a majority of municipalities around the country. This has led to municipal infrastructure operations based on grant driven investment and often subject to systematic underinvestment. Private sector participation in the water sector is minimal and the legal framework is sub-optimal. Still, there are a few exceptions in the form of one build-operate-transfer concession agreement and management agreements in the water sector. Urban transport is partially operated by private companies, with the lack of regulation and coordination among public transport services creating a situation of competition “in the market” rather than “for the market”, under a controlled tender process led by strong municipal transport departments as regulators. As car ownership continues to increase with rising income levels, investments in local roads and basic traffic management will become more pressing.

There is no independent regulator assessing or approving tariffs or business plans. In the absence of an established tariff formula or adequate contractual framework between municipal utilities and local authorities, the tariff setting and operational planning is often politicised and not transparent. The overall transition challenges for the municipal sector are large and include tariff reforms, commercialisation of public

utilities, the introduction of an adequate regulatory framework, and granting greater financial autonomy to municipalities under effective regulation.

Natural resource sector: The natural resources industry in Albania is small and concentrates on chromium, bitumen, copper and nickel. Oil has been extracted in Albania since 1918, but the domestically produced diesel is of low quality and meets only a fraction of domestic demand. Oil by-products are mainly imported from Greece and in lower quantities from Italy, Russia and other countries. A number of foreign oil companies operate in Albania both in exploration and in production but the sector remains dominated by Albpetrol, the state-owned oil and gas company which has been restructured and corporatised, with separate lines of activity operating as separate companies under a holding structure. The sale of an 85 per cent stake in Albania's second largest oil refinery, ARMO, was concluded in August 2008. Progress has been made in creating market supporting institutions and legislation, in particular in the field of the internal energy market. A law on the gas sector was adopted in June 2008. The country is a signatory of the Energy Community Treaty, together with Bulgaria, Bosnia and Herzegovina, the Republic of Croatia, FYR Macedonia, Montenegro, Romania, Serbia and Kosovo with the view to establishing an Integrated Energy Market Organisation in South-East Europe. However, the revised National Energy Strategy has not yet been adopted and environmental protection remains a serious concern. Despite having recently acquired the status of EITI implementing country, fiscal transparency and accountability remains low and revenue collection has been traditionally weak. Hydrocarbon licensing decisions and monitoring of contractual obligations are taken by the National Agency of Natural Resources, which is a subdivision of the ministry of energy, hence not fully independent.

Sustainable Energy: In 2005, a new Energy Efficiency Law was passed and an Energy Efficiency Fund established. The Albania-EU Energy Efficiency Centre (EEC) supported by EC is the only specialised institution in the field. A National Strategy for Energy, with a detailed action plan, was approved in June 2003, but the implementation record is mixed. Electricity tariffs have increased and are close to cost recovery but do not include environmental costs. Therefore price signals provide limited incentives to use energy efficiently and to invest in renewable energy sources (RES) projects. Theft of electricity and non-payment of power bills offer a viable alternative to investments in energy savings. Over 90 per cent of electricity production comes from large hydro. Regulatory incentives for the development of new renewable energy projects are not in place. Albania ratified the United Nations Framework Convention on Climate Change (UNFCCC) and Kyoto protocol where it holds the status of the Non-Annex 1 Party. No greenhouse gas (GHG) emission targets or policies were adopted. Albania's contribution to global greenhouse gas emissions is relatively low due to the large share of hydropower and the collapse of energy intensive industries. The key remaining challenges include to increase and better enforce energy tariffs, reduce commercial losses in the power grid (from 38 per cent in 2008), advance the climate change agenda and establish a legal and institutional framework to support small renewable projects.

Transport: Transport sector requires substantial investment to modernise the infrastructure and bring it up to European standards. In the railway sector, operating and policy setting functions are not separated and the core railway businesses

(infrastructure, passenger, freight, etc.) are operated by the same entity. In road sector, divestment and commercialisation of construction companies has been undertaken and contracts for construction and maintenance (with the exception of a small proportion on routine maintenance contracts) are contracted-out. An important boost to the reform was provided by the private concession to rehabilitate the Tirana International Airport, achieved through a transparent international tender process. This project has already successfully entered the second of extension due to faster traffic growth than originally forecast. A number of port terminals are also operated by private companies.

In roads, restructuring efforts have been made in recent years, and a restructuring plan for the General Roads Directorate (GRD) was approved in 2008. The divestment and commercialisation of construction companies are in progress and GRD has contracted out more than 50 per cent of periodic maintenance contracts to the private sector. However, competition and private sector participation remain limited. The financing of the road sector remains broadly unreformed. There is need for comprehensive institutional and financial restructuring, which explains the large gap in market supporting policies in institutions.

The Tirana International Airport (TIA) is run on a PPP basis. A 20-year concession contract was awarded to a consortium composed by some international and domestic institutions.

Financial Institutions

Banking sector: The financial sector has been completely privatised, with around 95 per cent of banking assets controlled by foreign investors. There are currently 16 commercial banks operating in Albania, out of which 15 are fully or partly foreign-owned. The commercial banking sector is dominated by few, large, foreign-owned banks. The sector has developed rapidly since 2005, though has slowed since the last quarter of 2008. As of end 2008, banking sector loans stood at 36.5 per cent of GDP. As of end year 2008, the loan to deposit ratio stood at a reasonably prudent 62 per cent.

The banking sector remains relatively liquid and well capitalised, though as elsewhere in the region corporate lending has slowed materially, with SME lending reduced from already low levels. Over 70 per cent of loans are denominated in foreign currency, exposing banks to risks from unhedged borrowers. The share of non-performing loans to the total loan portfolio deteriorated during 2008 but remains relatively moderate at 6.6 per cent. The regulatory environment strengthened considerably over the last years. Banking supervision was strengthened when a new law on the banking sector came into force in June 2007, bringing the country's legislation closer to EU standards. The law is expected to bring about much-needed improvements in surveillance and supervision, licensing, foreign branch regulations, as well as risk and prudential management. A new Credit Registry came into operation in January 2008.

Insurance and financial services: The insurance market remains small, and while the latest insurance law has strengthened the legal and regulatory environment, effective implementation remains a challenge. Further improvements would also be welcome in

the areas of accounting, disclosure and auditing standards. Privatisation of the state-owned insurance company, INSIG, undertaken with involvement of the Bank and IFC, is nearing completion, despite some procedural shortcomings. There are no restrictions on foreign entry into the non-bank financial institutions sector. Private pension funds are operating but the sector is small. The framework for the leasing sector has been established and the regulator is active in monitoring the market.

MSMEs: There are some banks and microfinance institutions offering credit to the MSMEs sector. Procredit Bank Albania provides micro lending even to the informal sector and stimulates companies in the grey economy to register before extending further loan tranches. A credit registry has been in operation since January 2008. Commercial banks are required by the central bank to upload the data on new loans on a daily basis, and on each loan's repayment status every month. The register contains information on borrowers (loan amount, repayments, amount of arrears, collateral used, data on credit lines where the borrower is a connected person, and loan status history over last two years) and data is retained for 5 years and made available to financial institutions.

Private equity fund sectors: Securities legislation showed a number of problems, and its effectiveness was relatively poor, though the legal situation is being reformed. The Financial Supervisory Authority (FSA) has recently drafted several laws (i.e., law on private pension funds and on corporate and local government bonds), which should bring a positive impact on the securities market development in the country and bring it closer to EU standards. Disclosure requirements in public prospectuses were found to be poor. The securities market regulator may not be in a position to pursue all cases, and still needs to establish sufficient authority. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector.

ANNEX 4 – Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 <i>Estimate</i>	2009 <i>Projection</i>
Output and expenditure							
	<i>(Percentage change in real terms)</i>						
GDP	5.8	5.7	5.7	5.4	6.0	7.2	1.2
Private consumption	11.1	9.4	6.0	7.2	11.5	na	na
Public consumption	-1.9	7.4	2.6	1.4	7.2	na	na
Gross fixed capital formation	18.0	2.7	4.9	9.3	6.5	na	na
Exports of goods and services	19.5	16.6	18.1	14.9	15.8	na	na
Imports of goods and services	12.7	6.4	14.0	7.0	18.5	na	na
Industrial gross output	29.0	14.1	14.4	12.1	8.6	3.8	na
Agricultural gross output	2.9	6.3	0.9	3.0	-1.9	2.5	na
Employment¹							
	<i>(Percentage change)</i>						
Labour force (end-year)	-0.3	-0.1	-0.3	0.0	-0.2	3.1	na
Employment (end-year)	0.7	0.5	0.1	0.3	3.3	0.9	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year)	15.0	14.4	14.1	13.8	13.2	12.7	na
Prices and wages							
	<i>(Percentage change)</i>						
Consumer prices (annual average)	2.4	2.9	2.4	2.4	2.9	3.4	2.0
Consumer prices (end-year)	3.3	2.2	2.0	2.5	3.1	2.2	3.0
Producer prices (annual average)	6.2	10.8	5.1	0.1	4.1	6.5	na
Producer prices (end-year)	4.4	12.3	1.5	0.2	6.6	4.3	na
Gross average monthly earnings in economy (annual average)	12.0	2.8	5.0	9.2	25.2	12.0	na
Government sector							
	<i>(In per cent of GDP)</i>						
General government balance	-4.9	-5.1	-3.5	-3.3	-3.5	-5.7	-6.3
General government expenditure	29.0	29.6	28.5	29.0	29.1	33.0	na
General government debt	60.7	57.7	58.2	56.1	53.2	55.9	na
Monetary sector							
	<i>(Percentage change)</i>						
Broad money (M2, end-year)	7.6	12.0	8.9	12.1	5.3	10.3	na
Domestic credit (end-year)	8.7	8.8	16.1	19.6	24.1	18.0	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	50.4	52.1	52.3	53.6	51.3	52.2	na
Interest and exchange rates							
	<i>(In per cent per annum, end-year)</i>						
Refinancing rate ²	6.5	5.3	5.0	5.5	6.3	6.3	na
Treasury bill rate (3-month maturity)	7.3	6.2	5.4	6.4	6.3	6.3	na
Deposit rate (1 year)	7.6	6.0	5.6	5.5	6.0	6.9	na
Lending rate (1 year) ³	10.5	13.7	12.2	11.2	13.6	11.1	na
	<i>(Levs per US dollar)</i>						
Exchange rate (end-year)	106.4	92.6	98.1	94.1	82.9	87.9	na
Exchange rate (annual average)	121.3	102.8	98.1	98.1	90.4	83.5	na
External sector							
	<i>(In millions of US dollars)</i>						
Current account	-398.0	-427.0	-726.0	-1,024.4	-1,147.8	-1,923.8	-1,680.5
Trade balance	-1,336.0	-1,583.0	-1,821.0	-2,089.5	-2,899.6	-3,551.9	-3,537.0
Merchandise exports	447.0	601.0	656.0	792.9	1,078.7	1,355.6	1,125.2
Merchandise imports	1,783.0	2,184.0	2,477.0	2,882.3	3,978.3	4,907.5	4,662.1
Foreign direct investment, net	178.0	324.0	258.0	314.7	647.4	843.7	578.1
Gross reserves, excluding gold (end-year)	995.3	1,340.4	1,386.5	1,748.7	2,080.2	2,289.3	na
External debt stock	1,253.5	1,519.4	1,752.1	1,807.6	1,950.8	2,600.6	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	4.6	5.0	4.3	4.4	4.2	3.8	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	3.1	3.1	2.8	3.1	2.4	4.2	na
Memorandum items							
	<i>(Denominations as indicated)</i>						
Population (end-year, million)	3.1	3.1	3.1	3.2	3.2	3.2	na
GDP (in billions of leks)	694.1	750.8	814.8	891.0	980.1	1,064.0	1,110.0
GDP per capita (in US dollars)	1,844.7	2,341.7	2,648.7	2,883.0	3,422.8	4,005.9	na
Share of industry in GDP (in per cent)	8.7	10.0	10.6	11.0	10.3	10.4	na
Share of agriculture in GDP (in per cent)	23.5	22.3	20.7	19.8	21.0	21.5	na
Current account/GDP (in per cent)	-7.0	-5.8	-8.7	-11.3	-10.6	-15.1	-14.5
External debt - reserves (in US\$ million)	258.2	179.1	365.6	58.9	-129.4	311.3	na
External debt/GDP (in per cent)	21.9	20.8	21.1	19.9	18.0	20.4	na
External debt/exports of goods and services (in per cent)	107.4	95.0	94.7	80.4	64.5	67.8	na

¹ Figures do not include emigrant workers abroad.

² The figures show the repo rate of the central bank.

³ The figures show the weighted average monthly rate for new credit in leks for maturities between 6 months and 1 year in December each year.

ANNEX 5 – Environmental and Social Issues

5.1 Environment

Since the transition process began in 1990s, Albania's economic progress has been considerable. The National Strategy for Social and Economic Development (NSSED) has built mechanisms for a market economy and improvement is observed in areas such as privatisation and trade liberalisation. Accordingly, Albania submitted its formal application for EU membership on the 28th of April 2009. In the environmental arena, good progress can be reported within horizontal legislation although improvement is needed in enforcement and administration capacity, especially at the regional and local levels. Albania also faces important environmental and social challenges associated with sustained economic growth, namely poverty reduction, deforestation, biodiversity conservation and land ownership reforms.

Environmental Legislation, Policies and International Commitments

In 1998 the country carried out a major constitutional reform in order to align its legislation with the EU. An important part of this reform was the introduction of environmental and social components within its directives. In 2001, the National Environmental Agency was reorganised to become the Ministry of Environment, Forests and Water (MoEFW) in response to the need for planning and investment in environmental infrastructure, waste and environmental management systems, and ultimately to raise awareness of industries and the general public of the importance of environmentally sound practices. The MoEFW oversees a comprehensive range of activities such as land ownership; resettlement; forestry and climate change; air quality; solid, medical and dangerous waste; water and noise pollution as well as ensuring that Albania is aligned with international environmental standards. Implementation of the Law on Environmental Protection (2002) and that on Environmental Impact Assessment (2003) is also core in MoEFW activities, with the Law for the Ombudsman and the Law for Civil Emergencies also touching upon some environmental issues. Finally, in response to the Compliance Committee Recommendations Report of the Aarhus Convention, the MoEFW has recently undertaken a series of steps to develop and implement an Action Plan specifying the mechanisms for public participation in plans, programs and strategies, and within its Environmental Impact Assessment process.

As part of the legislative and policy reforms, the 1994 National Environmental Action Plan (NEAP) was updated in 2002, followed by the development of a national Biodiversity Action Plan (BAP). In 2005, the third report for the National Strategy for Social and Economic Development (NSSED) was completed and Albania began to implement the Integrated Planning System (IPS): a national strategy designed to incorporate EU Environmental Directives into its environmental legislation through rationalisation of the process of policy development and the implementation of planning frameworks such as the Millennium Development Goals (MDG) and NATO Partnership for Peace. The IPS further contributes to synchronized decision-making within government and long-term investments, helping to consolidate donor coordination. Despite these early signs of progress, coordination with civil society still requires significant improvement.

Regarding international agreements, Albania is party to:

- Air Pollution: Protocol to the 1979 Convention on Long-Range Transboundary Air Pollution Concerning the Control of Emissions of Nitrogen Oxides or Their Transboundary Fluxes
- Biodiversity: Convention on Biological Diversity
- EIA: Convention on Environmental Impact Assessment in a Transboundary Context (Espoo, 1991)
- Climate Change: UN Framework Convention on Climate Change
- Climate Change-Kyoto Protocol: Kyoto Protocol to UN Framework Convention on Climate Change
- Desertification: UN Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification
- Endangered Species: Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES)
- Hazardous Wastes: Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
- Law of the Sea: United Nations Convention on the Law of the Sea (LOS)
- Ozone Layer Protection: Montreal Protocol on Substances That Deplete the Ozone Layer
- Public Participation: UNECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (Aarhus)
- Wetlands: Convention on Wetlands of International Importance as Waterfowl Habitat (Ramsar)

Other state offices with environmental implications in Albania are the Directory of Environmental Impact Evaluation and Permits, Directory of Pollution Prevention Policies, Legal Environmental Sector and Directory of Support Services.

General Environmental Setting

Albania is strategically located in South-eastern Europe with Montenegro and Kosovo to the north, Greece to the south and Macedonia to the east. Sitting along the Strait of Otranto, it enjoys direct links to the Adriatic, Ionian and Mediterranean Seas. Geographically, it is divided into 12 counties: Berat, Diber, Durres, Elbasan, Fier, Gjirokaster, Korce, Kukes, Lezhe, Shkoder, Tirane, and Vlore. With only 362km of lowlands coastline along the Adriatic and Ionian Seas, the remaining 70 per cent of the country is mountainous, rugged and predominantly inaccessible.

As a general rule, Albania has a continental climate with cold, cloudy, wet winters and hot, clear, dry summers. However, with its lowlands on the coastline and its highlands on the Balkan landmass, it does indeed enjoy varied weather patterns and a high number of climatic regions for so small an area (28,748 Km² of total surface).

Over one third of the country's territory is forested with over 3000 different species of plants at a density of 113 species per 1,000km². According to the World Wildlife Federation, Albania is subdivided in three ecoregions: the Illyrian deciduous forests, the Pindus Mountains mixed forests and the Dinaric Mountains mixed forests. The

country is also well known for its high diversity of ecosystems and habitats, ranging from sensitive coastal zones, maritime ecosystems, alpine and sub-alpine pastures and meadows and high mountain ecosystems.

As for wildlife, numerous rare, sensitive and/or endangered species exist in Albania, including but not limited to wolves, brown bears, wild boars, chamois, lynx, deer, wildcats, pine martens and polecats; lizards and reptiles such as the African chameleon, the Nile crocodile and the sand boa. Wild birds such as the golden eagle, the rock partridge and the eagle owl can also be found, with 4 endangered species amongst the bird population: the Dalmatian pelican, the greater spotted eagle, the pygmy cormorant and the white-headed duck.

The Biodiversity Strategy and Action Plan in Albania recognises 15 National Parks, 5 Protected Landscape Areas, 4 Strict Nature Reserves, 26 Managed Nature Reserves and other protected areas.

In addition to the MoEFW, the National Agency of Environment and the Directory of Environmental Impact Evaluation and Permits, the Albanian Society for the Protection of Birds and Mammals (ASPBM, 1999) is very active in the safeguard of endangered animal species. As for vegetation, the Ministry of Agriculture and Food leads the way with its Order No 20 (20-05-97) “for the protection of the threatened and rare species of Albanian flora”.

There are 2 major UNESCO sites in Albania: Butrint and the Historic Centres of Berat and Gjirokastra. Inhabited since prehistoric times, Butrint has been home to a Greek colony and a Roman city; created by the Albanian Ministry of Culture and UNESCO, ICCROM and ICOMOS, it was intended as a sustainable cultural heritage resource combining local communities and national institutions to serve as a model for other parks around Albania. Berat and Gjirokastra are rare examples of Ottoman architecture, mostly from the 13th C though its origins date from the 4th C, featuring many Byzantine churches and several Ottoman mosques. Albania has 3 designated RAMSAR sites with a total surface of 83,062 hectares: Butrint, Karavasta Lagoon, and Lake Shkodra and River Buna, with another 7 potential sites pending designation.

Albania’s natural resources are petroleum, natural gas, coal, bauxite, chromite, copper, iron ore, nickel, salt, timber and hydropower. Another important economic driver in Albania is the tourism sector, which is expanding rapidly. That said, an organised restructure of this sector is badly needed as coastal areas suffer from heavy pollution and unregulated construction activities. Moreover, the serious lack of infrastructure (e.g. roads, water, and power generation) further hinders the development of sustainable tourism.

Environmental issues of concern are deforestation; soil erosion; air pollution; water pollution from industrial and domestic effluents and the loss of sensitive biodiversity. Natural disasters also occur, including destructive earthquakes, tsunamis along the south-western coast, floods and severe drought.

Climate change

Albania joined the United Nations Framework Convention on Climate Change (UNFCCC) in 1995 as a non-Annex I country, taking, with UNDP-GEF support, significant steps towards its implementation, such as completion of the First National Communication document (FNC-1998/2002) and preparation of the Second National Communication paper (SNC), implementation of Technology Needs Assessment (TNA-2000/2004), preparation of the Project on Improving Quality of GHG Inventories for eastern Europe and CIS (2003/2006) and compilation of the National Action Plan (NAP) to address climate change. On those lines, the Climate Change Unit Program (CCUP) was structured with focus on three main areas: GHG inventory, Vulnerability and adaptation, and GHG mitigation and carbon financing. Albania also signed the Kyoto Protocol in 2004.

The future scenario for Albania regarding climate change includes rising average temperatures, increased risk of heat waves, random heavy downpours as well as decreased rates of annual average precipitation, reduction of water resources and arable land. The area most exposed is the coastline, while affected sectors comprise water resources, tourism, agriculture and energy. Albania is already experiencing serious challenges in its energy sector such as recurrent power cuts, outdated and inefficient existing energy assets, decreasing river flow/rain water sources and declining energy supplies due to the limited generation capacity of hydro-power plants. The National Communication exercise has proven to be instrumental to initiating other projects and programs on mitigation and adaptation to climate change, as well as to increasing the level of awareness on climate change issues. The FNC (2002) drew attention to key vulnerabilities in the energy sector including energy demand for space heating/cooling and water heating/refrigeration, estimating that by 2025 higher temperatures could reduce energy demands by 12-16 per cent for residential heating, while in the opposite way, demand for cooling will raise as the patterns shows summers grow increasingly hotter. However, energy demands are not just affected by temperature but also by precipitation levels, wind speed and cloud cover; since a good part of the country's energy is sourced by hydropower, supplies will still be conditioned by expected decrease in rain volume and wind speed variations.

Albania has made good progress in integrating many findings and recommendations from FNC and TNA into its NES, as well as into the Energy Efficiency and Renewable Law adopted by the parliament in 2005. In early 2009, the World Bank and the Government of Albania, with grant funds from the Energy Sector Management Assistance Program and the Trust Fund for Environmentally and Socially Sustainable Development, also organised a series of workshops on climate change and the vulnerabilities of the energy sector to consider options for adaptation mechanisms, their costs and benefits. Despite recent progress in mainstreaming climate change issues, the need to bring it into national planning and policy still stands strong. In addition to GHG reduction measures, it is imperative to address adaptation, mainly in the most vulnerable sectors such as water resources, agriculture, biodiversity conservation and tourism. The institutionalisation of the National Communication process is crucial to ensuring a sustainable and qualitative reporting course of action.

Areas of Environmental Concern and Priorities

Albania's progress on key political reforms is considerable, with the EU interim agreement being implemented without interruptions. The major challenges remaining are focused on the rule of law and the proper functioning of state institutions, with administrative and enforcement capacity being the weakest points. The country's EU harmonisation program on environmental legislation could become a useful tool to channel reform in order to accelerate improvements, specifically through mechanisms for regular assessment of environmental progress. Priority areas include:

- **Institutional Capacity Building:** further efforts are required to strengthen administrative capacity of environmental policy making and enforcement, together with inter-institutional cooperation and coordination. Staff training programs in parallel to increased staff resources within government offices was highlighted as a fundamental point by many IFIs' reports.
- **Air quality:** air quality is a major point of concern especially in urban areas where pollution has one of the highest rates in Europe. Although additional technologically-advanced equipment was provided for monitoring and emissions from large industries have also been slightly reduced, there is no clear sustainable long-term policy for air pollution within government. Existing legislation on industrial pollution is poor, and enforcement remains weak, with issues around domestic/transport vehicle emissions and fuel quality requiring urgent attention.
- **Biodiversity conservation and protection:** increasing unstructured urbanisation is adversely affecting ecosystems, particularly the coastal and littoral areas which are indeed the most fragile. For example, the coastal habitat loss is estimated at 200 meters of coast land for every 20 years. Recent data suggests that during the last 25 years, approximately 122 species of vertebrates (27 mammals, 89 birds, and 6 fish) and four species of plants are expected to have lost more than 50 per cent of their population. Moreover, 2 species of plants and 4 species of mammals have become extinct, and 17 bird species no longer nest in the country. Further implementation of international agreements and stronger legislation are required to decrease the rate of loss of biodiversity and protect endangered species.
- **Natural Disasters Impact Plan:** the national policy on disaster risk reduction was approved in 2000. Mechanisms of enforcement are based on the creation of a Department of Civil Emergency Planning and Response within the Ministry of Local Government and Decentralisation. With strong support from the UNDP Disaster Management and Emergency Preparedness Programme (DMEP) the priority has been focused on two plans: the Disaster Risk Reduction (2002) and the National Civil Emergency Plan (yet to be approved as of 2007). Progress on this initiative remains slow.
- **Waste Management:** apart from the implementation of some regulations for the rehabilitation of certain landfills (e.g. the 2001 Sharra landfill program was upgraded in 2007), and the remediation of toxic hotspots, in particular for the Copper Smelter in Rubik, the Nitrate Fertilizer Plant in Fier, the Chemical Plant in Durres and the Ballshi oil refinery, limited progress has been evident on waste management. Current disposal methods and burning practices represent significant environmental and health hazards, and modern systems of waste collection, disposal and recycling processes still do not exist.
- **Water Management and Conservation:** although general access to drinking water and water supply systems has improved, surface waters are severely

affected by urban, domestic and industrial pollution. Water supplies and sanitation schemes remain seriously outdated. As of 2007, a National Strategy for Water supply and Sewerage has not yet been approved.

- **Urban Development and Tourism:** rapid unorganised urbanisation and the ever increasing demand for industrial development and tourism carry environmental concerns that need to be addressed promptly, including urgent investment in environmental infrastructure. For example, there is little progress in restructuring and expansion of the tourism sector, albeit some progress is seen, general infrastructure –roads, water, power generation- lags behind and hinders tourism development. Coastal areas also suffer from high levels of pollution and unregulated construction activities.
- **Spill Response Arrangements:** a national contingency plan and national system for accidental marine pollution, preparedness and response was adopted in 1993. Local authorities and the oil industry are encouraged to establish local contingency plans coordinated with the national plan, though there is no enforcement scheme, no defined response policy and no specialised pollution equipment available in the country.

Environmental Issues Associated with Albanian Operational Priorities

The Country Strategy identifies four high-level operational priorities of Bank’s activities in Albania for the strategic period 2009-2011. The table below identifies in a non-exhaustive manner some potential environmental and social issues associated with each of these priorities:

Priority	Potential Environmental and Social Issues
Financing infrastructure, energy generation and environmental projects.	<ul style="list-style-type: none"> o Labour Health and Safety. Lack of capacity and low standards in occupational health and safety has been reiterated by many IFIs. o Lack of resources and poor willingness in FIs/SMEs to handle environmental and social issues of key businesses such as effluent and solid waste activities. o Unsustainable use of water sources to increase water production/supplies. o Ecological consequences of indiscriminate use of resources (water, wind, land, biodiversity) o Lack of regulation / capacity to manage displacement / retrenchment during land acquisition activities for infrastructure development (treatment facilities, wind farms, etc) o Increase in tariffs of basic services in detriment of the poorest sector of the population. o Increase production of effluents (infrastructure) and its environmental impacts. o Water contamination associated with agriculture intensification, use of fertilisers and pesticides. o Occupational H&S, potentially in construction industry. o Public consultation processes, Aarhus convention.
Funding in the financial sector for on-lending towards the consolidation/restructuring of the sector.	<ul style="list-style-type: none"> o Food processing waste treatment and all related environmental impacts. o Labour issues such as child labour and minimum wages. o Soil conservation issues. Biodiversity loss. o Occupational H&S
Direct finance for foreign/local enterprises with a continuing effort to reach SMEs;	<ul style="list-style-type: none"> o Lack of capacity in FIs and SMEs to manage environmental, social and labour issues.

	<ul style="list-style-type: none"> o Land acquisition/displacement -dams, reservoirs, treatment facilities o Retrenchment in the public services sector
Policy dialogue (new Government to address regulatory, infrastructure shortcomings)	<ul style="list-style-type: none"> o Strengthening of National Action Plans (e.g. Biodiversity, Natural Disaster, Spills Response etc.) o Poor consultation with civil society, Aarhus convention. o Occupational H&S, potentially in construction industry.

The Bank will continue to work across a variety of sectors, and where applicable identify areas for environmental enhancement and development opportunities that are in line with the Bank’s priorities. For example the Bank is currently working on setting priorities for remediation of environmental “hotspots” in the Patos Marinza Oilfield as part of an inter-ministerial Working Group. The Bank is also working on the Technical Cooperation project on Retrenchment with the AlbPetrol State Oil Company, and will continue to offer training programs for financial intermediaries who are required to implement the Bank's environmental and social risk management procedures and thus support environmentally sound development within the SME sector. Bank staff members have participated in training for regional environmental authorities and private sector companies on public participation and implementation of the Aarhus Convention, and will continue to assist the Albanian government, where appropriate on these issues.

All of the Bank’s operations in Albania are subject to the relevant environmental policy (either the 2003 Environmental Policy or the 2008 Environmental and Social Policy) and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank’s mandate to actively support environmentally sound and sustainable development through its investment projects.

5.2 Social Issues

Human Development and Migration. Albania ranks low in comparison with other South-eastern and Central European transition countries in terms of commonly used living standard and human development indicators. According to official statistics, in 2008 Albania’s resident population was 3,170,048, or 3.5 per cent higher than at the time of the official census in 2001. The average life expectancy at birth is 76.2 years. Emigration and low birth rates have led to a marked decrease in the percentage of the population aged under 34 – from 69.2 per cent in 1969 to 58.2 per cent in 2007. According to the International Organisation for Migration, almost a quarter of the Albanian population has left the country since 1990, mainly to neighbouring Greece and Italy, along with a large urban to rural migration. Much of Albanian migration is circular in character, economically driven, and located in the low-skilled and informal economy sectors (male Albanian emigrants are mainly engaged in construction or agriculture, whereas women are employed in domestic work). However, migration is also widespread amongst higher educated Albanians. Studies show that nearly 45 per cent of professors and researchers at universities and institutions have left Albania after 1990, and between 2,000 and 4,000 Albanian students leave the country every year to attend universities abroad. To address this problem of “brain drain”, the government started in 2006 a so-called Brain Gain Programme (<http://www.braingain.gov.al>), which supports the creation of the necessary incentives

and national policy mechanisms effectively engage the Albanian diasporas in the scientific, administrative, and economic development of the country.

Poverty and Unemployment. Albania's high GDP growth over the past 10 years, along with an average increase (in real terms) of wages of 36.5 per cent between 2005 and 2008, and of 17.5 per cent of pensions between 2005 and 2007, has contributed to a significant reduction in poverty between 2005 and 2008. Results of a study conducted jointly by a team of INSTAT, UNDP and the World Bank indicate that in 2008 12.4 per cent of the population were poor – defined as having less than Lek 5,722 per capita per month – compared to 18.5 per cent in 2005 and 25.4 per cent in 2002. This means that nearly half of the poor in 2002 have been lifted out of poverty by 2008. As a result, average real consumption per capita has increased by about 7 per cent since 2005. While rural poverty declined by about 47 per cent, indicating that poverty may no longer be essentially a rural problem. For instance, although Tirana has the lowest poverty level among regions, there was no further reduction in comparison to 2005. The domestic labour force in 2008 was 35 per cent of the total population. The level of unemployment fell to 12.68 per cent in 2008 compared to 13.78 per cent in 2006, according to official statistics. The sectors with the largest increase in the number of employees were industry, transport, telecommunications, trade, hotels and restaurants. In July 2008, the government increased the minimum monthly wage to 17,000 Lek (about EUR 130), among the lowest in the region.

Gender equality. While women and girls enjoy the many freedoms and rights brought about by the political changes of the last 17 years in Albania, many women became heads of households owing to mostly male migration. The Gender Development Indicator (GDI) for Albania is 0.80, giving it a rank of 68th out of 177 countries. During the transition period, women experienced continuing difficulties with violence and trafficking for sexual exploitation. Many women bear the burden of poverty and lack adequate health and social services. Women's salaries are between 20 and 50 per cent of those of men, while the latter own 92 per cent of all property and receive approximately 84 per cent of the Gross Domestic Product (GDP). Only 7 per cent of Albanian Parliamentarians are women. Some issues of concern include access to basic education for girls, especially those living in rural areas, as well as marginal political participation of women, at both central and local levels.

Property rights, compensation and restitution. The reform in the area of property rights have taken important steps forward. The Agency of Restitution and Compensation of Property continues the process of restitution and compensation and is already in the final stage of compiling the land value map, on the basis of which compensation will be made. In the mean time, the Agency for Legalisation, Urbanisation and Integration of Illegal Construction Zones is completing the digital map for the entire country. These two agencies have also signed a cooperation agreement to coordinate the two processes and to accelerate reform.

In 2006 the Albanian Parliament amended the law on property compensation and restitution, which aims to resolve competing land ownership claims resulting from communist-era expropriation of land. The successful implementation of the restitution process is an important challenge for the government and is key to future economic development. In 2007 and 2008, Government distributed a total of EUR 7 million for financial compensation. In 2009 EUR 15 million has been budgeted, which may still

be inadequate given the large number of compensation requests. The entire set of restitution compensation claims is not expected to be resolved before 2014.

Education. Schooling is free and compulsory for children between six and fourteen and free until the age of 18. However, Albania has the lowest secondary school enrolment rate among the countries in the region (55 per cent in 2006). The main reason for the high level of incomplete schooling is poverty as families in rural areas are forced to use children as labour. Increasing secondary education enrolment rate, especially in rural areas and particularly among girls, is a priority in the framework of the European Partnership. Public spending on education were falling during the transition period, reaching 3.1 per cent of GDP in 2004, but have recently started to rise as a reflection of the priority that the government has assigned to education in the National Strategy for Development and Integration 2007-2013. Schools in cities and suburban areas operate above their capacity. By contrast, some rural areas have very low student-teacher ratios but poor transport infrastructure does not allow the consolidation of schools. Over a two-year period, the government managed to establish information technology laboratories in all secondary schools and it is expected that they will be provided with internet.

The Government has in the last years opened new universities in Albania which along with the new private universities increases everyone's chance to attend university. In addition, the number of students who receive graduate degrees abroad has increased significantly, establishing a generation of skilled professionals. The new law on higher education opens up opportunities for important developments. In particular, universities have academic and organisational freedom as well as financial autonomy. However, higher education institutions have to make this autonomy work in practice. They have neither an internal governance framework nor an external accountability mechanism. There are no regulations for managing university performance. The quality of the infrastructure needs to be further improved as some buildings, equipment and libraries do not meet international standards. There is little transparency in the use of university revenues. The mechanism supporting students with low income (bursaries) is not well targeted. The coverage and quality of vocational education do not respond to market needs and continue to have weak links with the labour market and social partners.

Health. The public health system suffers from fragmentation, lack of investment, loss of qualified medical staff to the private sector and a large-scale reduction in staff in remote areas. During the early 1990s Albania's centralised healthcare system based on free provision at the point of service (including for people in remote areas) broke down under pressure from uncontrolled migration from rural to urban areas. In 2007 the financing of primary health care has been transferred to the Health Insurance Institute (HII). However, payroll tax-based health insurance results in further inequity in access to health care. Coverage of the insurance system remains limited to less than 40 per cent of the population, mainly concentrated in urban areas and the upper income quintiles.

Infant and mortality rates have fallen but remain high in comparison with other European states, and maternal mortality still remains a problem. Tuberculosis, eradicated during the Communist era, has re-appeared a result of poverty and overcrowding in major cities. The health care system is facing new challenges, as the

epidemiological profile of the population is changing. Non-communicable diseases, mainly cardiovascular diseases and cancer, are becoming the leading cause of death. Among new health risk factors are the high tobacco consumption and changing diets. Therefore, the health care system needs to adjust to the lengthy and costly treatments associated with these diseases and shift to preventive health care and public health campaigns. Public expenditure on health has increased in recent years to around 6 per cent of GDP, which however remains below other countries with similar income levels. Health, like education, is a priority for the authorities but budgeted health spending is often cut abruptly in response to revenue shortfalls.

ANNEX 6 – Bank Technical Co-operation Projects 2006-2009

Donor Source	Contract Type	Fund Source	Contract Title	Cont. EUR Amt	CSU Sector
	Call-Off	Bank Budget	Integrity Due Diligence	28,490	Finance (General)
	Board Nominee	Bank Budget	EBRD External Board Nominee for Procredit Bank Albania	5,128	SME
	Standard	Bank Budget	Study of Demand for Environmental Credit Facility Covering EBRD Countries of Operation Affecting the Mediterranean Sea - Albania and Project Coordinator - Phase 2	42,400	Environmental and Social Reform
GRE	Standard	TC (Non-EU)	Advisory Support to the Albanian Securities Commission on drafting the new law on bonds	159,978	Legal Reform
	Call-Off	Bank Budget	Review of Tender Documents Kamza Interchange	5,823	Transport
	Standard	Bank Budget	Economic Evaluation and Reform Overview	15,151	Transport
	Standard	Bank Budget	Levan-Vlore Road Rehabilitation Project - Economic Due Diligence	31,349	Transport
ITA	Standard	TC (Non-EU)	Technical Due Diligence on BI-INVEST Sh.p.k.	750	Industrial and Manufacturing
ICFF	Standard	TC (Non-EU)	Banka Popullore	499,684	Finance (General)
ITA	Standard	TC (Non-EU)	BI Invest, LEGAL DD, WBLEF	15,000	Industrial and Manufacturing
	Standard	Bank Budget	Marketing Study on the Cement Market of Albania and neighbouring countries	10,487	Industrial and Manufacturing
	Standard	Bank Budget	Operations and Risk Management Assistance	39,700	Finance (General)
	Standard	Bank Budget	Levan - Vlore Road Assessment of Biodiversity	5,000	Transport
	Standard	Bank Budget	WB LEF - AGROTAL - Legal Due Diligence	20,000	Agribusiness
ITA	Standard	TC (Non-EU)	WB LEF - AGROTAL - Legal Due Diligence	10,000	Agribusiness
CEI	Grant	TC (Non-EU)	Tirana Creditworthiness Enhancement Programme (CEP)	336,116	Finance (General)
	Standard	Bank Budget	Levan - Vlore Road Assessment of Biodiversity	3,968	Transport

	Call-Off	Bank Budget	Albania: Tirana - Big Ring Road, Section from Kavaja Road to Elbasani Road	6,554	Transport
	Grant	Bank Budget	Levan-Vlora Road Project - Assistance with Environmental Mitigation Measures & Environmental Management Plan	19,328	Transport
	Standard	Bank Budget	Tirana International Airport - Phase B of the Development - Feasibility Study	12,000	Transport
	Standard	Bank Budget	Consultation on Fishing and Tourism activities in Vlore	500	Environmental and Social Reform
	Standard	Bank Budget	Assessment of Implementation of Resettlement Action Plan	6,928	Transport
	Lender	Bank Budget	Lender's Technical Monitor	154,000	Environmental and Social Reform
	Standard	Bank Budget	Tirana Outer Ring Road : Assessment and Monitoring of Implementation of Resettlement Action Plan	49,930	Environmental and Social Reform
	Standard	Bank Budget	Assistant to NPD	9,789	SME
	Standard	Bank Budget	National Programme Director	21,395	SME
	Standard	Bank Budget	Project Officer	14,302	SME
	Standard	Bank Budget	Programme Director	53,939	SME
ICFF	Call-Off	TC (Non-EU)	Energy Audit at Fushe Kruje and Elbasan, Albania	36,630	Industrial and Manufacturing
ICFF	Grant	TC (Non-EU)	Tirana Municipal Roads Sustainable Transport Strategy	273,450	Municipal Infrastructure
	Call-Off	Bank Budget	Vlore Coastal Terminal - Integrity Due Diligence	18,676	Transport
ITA	Standard	TC (Non-EU)	Legal Assistance	20,000	Finance (Bank Equity)
	Standard	Bank Budget	Tirana Outer Ring Road Project Financial Analysis of the City of Tirana	13,935	Municipal Infrastructure
ECAL	Standard	TC (EU)	Telecom Regulatory Development Programme (Albania III)	770,950	Legal Reform
	Standard	Bank Budget	Business Advisory Services Programme Marketing and PR Campaign	5,879	SME
	Call-Off	Bank Budget	Tirex - Integrity Check	13,778	Natural Resources
ITA	Standard	TC (Non-EU)	Technical and Commercial Due Diligence	32,355	Industrial and Manufacturing
ITO3	Grant	TC (Non-EU)	Pre-Feasibility Study on Water Resources in Southern Albania	692,020	Municipal Infrastructure

ITA	Standard	TC (Non-EU)	Legal Due Diligence	30,000	Industrial and Manufacturing
WEBF	Grant	TC (Non-EU)	Albanian Financial Supervisory Authority (FSA): Management Information System Development	388,813	Finance (General)
	Board Nominee	Bank Budget	EBRD Nominee to the Board of Directors - INSIG	17,900	Finance (Bank Equity)
	Standard	Bank Budget	Tirana Shopping Mall - Technical Due Diligence	7,000	Property and Tourism
	Standard	Bank Budget	Tirana Shopping Mall - Market Due Diligence	14,000	Property and Tourism
WEBF	Grant	TC (Non-EU)	Tirana Outer Ring Road - Development Study	386,850	Municipal Infrastructure
	Standard	Bank Budget	Provision of "Food Safety Management System" Training Programme	7,076	SME
ITA	Standard	TC (Non-EU)	Corporate Bond RIA on the Draft Law on Corporate and Municipal Bonds	24,750	Legal Reform
ITA	Standard	TC (Non-EU)	Albania: Municipal RIA on the draft Law on Corporate and Municipal Bonds	12,389	Legal Reform
ICFF	Grant	TC (Non-EU)	Tirana Municipal Roads Sustainable Transport Strategy	26,550	Municipal Infrastructure
	Standard	Bank Budget	Design and Promotion of a web based Consultancy Web Portal.	15,920	SME
	Standard	Bank Budget	Assistance with Albania Power Sector Reconstruction & Distribution Rehabilitation Projects - Operation Performance Evaluation Review (OPER)	15,148	Power and Energy
ITA	Standard	TC (Non-EU)	Municipal RIA on the draft Law on Corporate and Municipal Bonds	12,361	Legal Reform
WEBF	Grant	TC (Non-EU)	Union Bank - Assistance with Implementation of Institutional Building Programme ("IBP")	205,865	Finance (Bank Equity)
CEI	Call-Off	TC (Non-EU)	Development of Model Low-Cost Solutions for Energy Efficiency Up-grade of Tirana's Municipal Educational Facilities	44,850	Power and Energy

ANNEX 7 – Multilateral and Bilateral Assistance

I. MULTILATERAL ASSISTANCE

INTERNATIONAL MONETARY FUND

Since becoming a member in 1991, Albania has been engaged in five IMF-supported programs, which have been successful in achieving and maintaining macroeconomic stability. In the absence of other policy anchors, the IMF arrangements have been seen as a “guarantor” for economic stability, including by the other multilateral and bilateral institutions that have assisted Albania. Over the last 18 years, Albania has also benefited from IMF technical assistance to strengthen its policy design, develop implementation capacities, and improve the compilation of statistical data.

The latest three-year PRGF/EFF arrangements expired in January 2009. At that time, the government decided not to seek a successor arrangement with the IMF, arguing that the country is now mature enough to preserve macroeconomic stability while the impact of global financial crisis in Albania is seen as limited.

THE WORLD BANK GROUP / IFC

The Republic of Albania has been a member of the World Bank⁸ and the International Finance Corporation (IFC) since 1991. Since then, the World Bank Group has provided strong support to Albania, including 73 loans mostly in IDA commitments totalling about US\$1021 million, IFC commitments of US\$125 million, and MIGA guarantees totalling US\$8.6 million. The quality of the active portfolio has continued to improve, with an increasing focus on long-term capacity development and implementation through Government structures.

The World Bank's Board approved the Country Assistance Strategy (CAS) for Albania for FY06-FY09 in January 2006. The CAS presented a program of support to build on the improved macro-economic management and progress in structural reforms that has occurred since 2002. It aimed to support Albania's National Strategy for Social and Economic Development (later the National Strategy for Development and Integration) and the European Union Stabilization and Association process (SAP) with the ultimate objective of EU integration and the attainment of the Millennium Development Goals. The World Bank Group is in the process of preparing a new Country Partnership Strategy for Albania for 2010-13.

Reflecting Government priorities, the CAS (2006–09) program sought to support Albania's efforts in strengthening governance, sustaining a private sector-led growth and improving service delivery. The CAS recognized that more coherent efforts need to be made to address the challenge of poor governance in Albania, and introduced a 'Governance Filter' to ensure that governance considerations are mainstreamed into all of the Bank's interventions. The CAS program focused on two pillars:

⁸ The ‘World Bank Group’ generally refers to the IBRD, IDA, IFC and MIGA, while the ‘World Bank’ generally refers to IBRD and IDA, only.

I. *Continued Economic Growth through Support to Private Sector Development*, with expected outcomes including (a) macroeconomic stability; (b) improved business climate through better quality of business regulations and improved public-private sector dialogue; (c) improved public infrastructure; (d) increased operational efficiency of financial institutions; (e) improved functioning of the land market; (f) improved corporate governance; (g) increased transparency and efficiency in the management of public spending and stronger institutions for planning, tendering and providing infrastructure and services; (h) better accountability in public administration; and (i) better management and planning for Albanian coastal resources.

II. *Improving Public Service Delivery, particularly in the Social Sectors*, with expected outcomes including: (a) improved educational attainment and quality of basic education; (b) improved efficiency and equity of health financing; (c) better quality of health care; (d) improved fiscal sustainability of the social insurance system and increased access to well-targeted, sustainable, and effective assistance; and (e) improved access to safe rural water supply and sanitation.

Under the 2006–09 CAS, the World Bank delivered approximately \$260 million in new lending operations, around half IDA and half IBRD. In June 2008, Albania graduated from IDA and is now creditworthy for full IBRD lending. The current lending portfolio under implementation is approximately \$300 million (excluding a Partial Risk Guarantee of \$78 million) includes 18 operations (including 2 full sized Global Environmental Facility grants). The portfolio is distributed across sectors as follows: 10 per cent in agriculture and environment, 15 per cent in social services, 20 per cent in land management and business environment (with some infrastructure), and 55 per cent in infrastructure, mainly roads, energy, water and wastewater. The World Bank and the Bank have collaborated on a number of projects in the energy sector.

IFC's strategy in Albania is to support private sector development and improve business environment. Its efforts focus on the need to increase the flow of foreign direct investments in the country and help introduce public private partnership concept (PPP) in infrastructure and social sectors. IFC is stepping up its involvement to: (i) Increase support for the financial sector and strengthen the financial market; (ii) Help restructure and seek opportunities for investments in key strategic sectors: transportation, energy, water supply and telecommunications; (iii) Assist, strengthen related strategic markets by providing technical assistance to improve performance of regulatory bodies in telecommunications and energy; (iv) Provide advisory services for Public Private Partnership in strategic and social sectors; (v) Provide financial and technical assistance to small and medium-sized enterprises.

IFC commitment in Albania is USD 125 million. Investments include sectors such as the financial sector (7 per cent), general manufacturing (37 per cent), infrastructure (33 per cent), and oil and gas (23 per cent). In addition, IFC carried out 10 technical assistance projects including insurance, leasing, access to information for SME's, preparation of domestic companies for EU accession, administrative barriers to investors, and housing finance. The IFC and the Bank have co-financed projects in the

financial sector (ProCredit Bank, National Commercial Bank, INSIG) and in the private corporate sector.

EUROPEAN INVESTMENT BANK

The EIB is a lead player in implementing EU priority objectives in the Balkan area. Active in Albania since 1994, the EIB has contributed over EUR 240 million towards projects of key importance for the economy, such as various infrastructure investments including energy and transport.

During 2000-2008, EIB provided loans including EUR 34 and EUR 35 million, respectively, for two rehabilitation projects on the North-South road corridor, EUR 30 million for Power Transmission and Distribution (co-financed by EBRD, WB, and other bilateral donors), EUR 17 million for rehabilitation of the Port of Durres, and EUR 27 million for rehabilitation of water facilities in five cities under a concessional scheme, implemented with the EC and other donors, EUR 40 million to finance the Vlore thermal power plant.

The medium-term strategy of EIB for the Western Balkans identifies as priority areas of investment national, local and municipal infrastructure and support of small and medium-sized enterprises. In accordance with these priorities the EIB is co-operating with the EBRD to co-finance a ferry terminal in the Port of Durres.

EU

EU assistance began in 1991 through the PHARE Programme and has included:

- CARDS+OBNOVA (1991-2000): EUR 528 million
- CARDS (2000-2006): EUR 316 million
- IPA (2007-2011): EUR 401 million
- ECHO (1991-2000): EUR 135 million
- Other (1991-2000): EUR 249 million

Since March 2002, the EC has reported on progress by countries of the Western Balkans. The report describes relations between Albania and the EU, analyses the situation in Albania in terms of the political and economic criteria for membership, and reviews Albania's capacity to implement European standards, that is, to gradually approximate legislation and policies to the *acquis*, in line with the Stabilisation and Association Agreement (SAA) and European Partnership (EP) priorities.

Albania is a potential candidate for EU membership. The Stabilisation and Association Agreement (SAA) was signed in June 2006. Albania is participating in the **Stabilisation and Association Process** (SAP). The **European Partnership** helps ensure progress on reform priorities via political and economic dialogue.

Following the entry into force of the EC/Albania **agreement on visa facilitation** in January 2008, the first meeting of the joint committee was held in April 2008. The visa facilitation agreement simplifies procedures for issuing visas to certain categories of citizens of Albania, including students, scholars, businesspeople, journalists and tourists. Under the terms of this agreement, citizens of Albania either pay a reduced visa fee or receive a visa free of charge.

Implementation of the readmission agreement that entered into force in 2006 is proceeding smoothly. This agreement sets out clear obligations and procedures for the authorities of both Albania and EU Member States on when and how to take back people who are illegally residing on their territories.

Since 2007, pre-accession **financial assistance** to Albania is provided under the Instrument for Pre-Accession Assistance (IPA). The EC allocated a total of €70.7 million in 2008. The Multi-Annual Indicative Planning Document (MIPD) for 2008 - 2010 for Albania under IPA was adopted in September 2008. Main focus areas continue to be justice and home affairs, administrative capacity-building, economic and social development and democratic stabilisation. Ongoing CARDS and IPA assistance is implemented by the EC Delegation in Tirana. The management of aid on a decentralised basis is a medium-term objective for Albania. The IPA Framework Agreement was signed on 18 October 2007. The Financing Agreement for the National Programme for 2007 under the Transition Assistance and Institution Building Component was signed on 22 January 2008 and the implementation of the programme has started. The Financing Agreements for the cross-border cooperation programmes were signed in April 2008.

As regards support for **civil society**, EUR 4 million has been earmarked for projects to enhance the role of civil society and the media in the European integration process over the period 2008-2010. Albania received support from EU member states through the EU Monitoring and Information Centre for Civil Protection (MIC) to help deal with the immediate aftermath of the Gerdec explosion in March 2008.

As regards **Community programmes**, Albania is participating in the 7th Research Framework programme for which a memorandum of understanding was signed in December 2007. The country is also participating in the Entrepreneurship and Innovation Framework Programme, following the signature of the memorandum of understanding in June 2008.

Key dates in Albania's path towards the EU

- **28 April 2009** - Albania submits its application for EU membership
- **April 2009** - Entry into force of the SAA
- **March 2008** - Visa liberalisation dialogue launched
- **February 2008** - Council decision on a revised European Partnership for Albania
- **January 2008** - Albania and EC sign Financing Agreement for IPA 2007 Programme
- **January 2007** - Entry into force of new instrument for Pre-Accession Assistance (IPA).
- **December 2006** - Entry into force of the Interim Agreement
- **June 2006** - Signature of the SAA
- **May 2006** - Entry into force of the EC-Albania readmission agreement
- **January 2006** - Council decision on revised EP for Albania
- **June 2004** - Council decision on a first EP for Albania
- **June 2003** - at Thessaloniki European Council SAP is confirmed as the EU policy for Western Balkans. EU perspective: countries participating in SAP are eligible for EU accession and may join the EU once ready.

- **2001** - First year of Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme
- **November 2000** - Zagreb Summit launches Stabilisation and Association Process (SAP) for five countries of South-eastern Europe, including Albania
- **June 2000** - European Council states that all SAP countries are "potential candidates" for EU membership.
- **2000** - Extension of duty-free access to EU market for products from Albania.
- **1999** - Albania benefits from Autonomous Trade Preferences with the EU.
- **1999** - The EU proposes the Stabilisation and Association Process (SAP) for five countries of South-eastern Europe, including Albania.
- **1997** - Regional Approach. The EU Council establishes political and economic conditionality for development of bilateral relations.
- **1992** - Trade and Co-operation Agreement between EU and Albania. Albania becomes eligible for funding under Phare programme

II. BILATERAL ASSISTANCE

The largest bilateral donors in Albania listed alphabetically are:

Germany

The German government, as an important partner in development co-operation, has committed a cumulative amount of EUR 476 million, of which EUR 424 million in financial co-operation and EUR 52 million in technical assistance.

During the period of 2008/2009 Germany has provided EUR 86 million for financial cooperation and EUR 4.5 million for technical cooperation.

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 and waste management* – includes projects in cities and in rural areas for both investment for rehabilitation of water supply and sewerage systems and implementation of institutional support measures at municipality level.
- *Financial sector* – one of the main projects is ProCredit Bank, Albania's leading micro-finance institution, where EBRD and IFC are also shareholders.
- *Energy sector* – main projects are the construction of the 400 kV line from Tirana to Podgorica (Montenegro), 400 kV line Albania – Kosovo and 110 kV ring line South Albania. Parallel institutional and financial improvements in the sector are being addressed in close co-ordination with other IFIs and donors.

Technical assistance programs are being implemented by the GTZ on behalf of the Federal Government and focus on the promotion of sustainable economic development, e.g. vocational training, private sector development and strengthening of the legal system as well as on institutional support in the water sector. Regional cooperation is fostered through the Open Regional Funds by GTZ.

Co-operation in 2008/2009 continues to focus on energy, water supply and sewerage and sustainable economic development. One environmental project of Financial Cooperation also supports regional cooperation in the Prespa region.

Italy

Italy is the largest bilateral donor to Albania with cumulative disbursed funds over 1991-2004 amounting to over EUR 650 million. Italy's assistance has evolved from emergency aid implemented in early stages of the political and economic transition of Albania, to a longer-term development approach, and during the last 15 years, three bilateral protocols have been signed. The last, signed in 2002, envisages Italy's commitment of EUR 202 million (42 millions on grant basis and 160 millions on soft loans basis). Soft loans of EUR 25 million have been allocated to the water and power sector. EUR 120 million have been allocated for initiatives implemented by NGOs, agencies, Albanian institutions and Italian Cooperation. At present, there are 93 initiatives which are still in course, the main areas of intervention include:

- *Power sector* - this has been the main support area since 1994 including emergency interventions as well as rehabilitation of the transmission and distribution system. Italy is working in the sector along with EBRD, World Bank and other donors.
- *Water supply* - financing for this sector has been focused around Tirana and includes support the local utility company.
- *Transport* - Italy has been involved through financing rehabilitation of several urban and national road segments, TC for structural improvements in the GRD and support for road maintenance. Italy has co-financed the Emergency Road Rehabilitation project with EBRD.
- *Social services*, health and education - this includes reconstruction of schools, university exchange programmes, rehabilitation of health care centres and management support.

Italian assistance has been adjusted in account of growth of the economy and changes in the development priorities set by the Government. In coherence with European Union support programs of pre-accession and with international standards, Italian Cooperation is shifting priorities from disbursement of soft loans for infrastructure to disbursement of aid aimed to support the **social sector** and the **SMEs**.

Japan

Japan remains an important donor to Albania. Japanese bilateral assistance started in 1990 and includes a number of programmes including grant financing, development loans and technical assistance through the Japan International Cooperation Agency (JICA) as well as through Trust Funds managed by the EBRD and the World Bank. The main sectors benefiting from Japanese assistance are social and economical infrastructure development such as energy (including the Power Transmission and Distribution project co-financed with EBRD), water supply & sewerage, agriculture & forestry, education and health services.

A major initiative in 2008 was the signing of a loan agreement for 11 billion Japanese Yen (EUR 81.7 million) for the Tirana Sewerage System Development project. Total

Japanese assistance to Albania through 2008 reached Yen Loans of 18 billion Yen (EUR 133.7 million), Grant financing of 4 billion Yen (EUR 29.7 million Euro) and Technical assistance equivalent to 1.6 billion Yen (EUR 11.9 million).

The Kingdom of the Netherlands

The main activities and strategies of the Kingdom of the Netherlands for the period 2008-2011 have been laid down in a Multi-Annual Strategic Plan. In 2008-2011 the Netherlands will phase out bilateral development co-operation and transform its relationship with greater emphasis on EU-integration/political affairs/human rights issues, trade and economy and culture. Until 2012 funds will remain available to support private sector development.

The decision to phase out development co-operation in Albania was accompanied by the decision to give Albania access to the 'Matra' fund in support of transformation processes in society, using twinning arrangements between Albanian organisations and European organisations.

In its co-operation activities EKN has focused and will continue to focus for the remaining period of its programme on the environment (hotspot remediation, environmental awareness, institutional development), democratisation (strengthening of the NPO-sector), good (local) governance (e.g. Public finance management), decentralisation (e.g. Strengthening Local Governance in Diber Quark). Specific interventions have been initiated in support of gender equality and the rights of sexual minorities and children.

Switzerland

Albania has been supported by Switzerland since the inception of cooperation with the eastern European countries. Swiss assistance has been implemented since 1991 through the State Secretariat for Economic Affairs ("SECO") and from 1995 through the Swiss Agency for Development Cooperation ("SDC"). At the beginning of 1997, the Swiss Cooperation Office (as part of the Swiss Embassy) which is financed jointly by SDC and SECO was opened in Tirana. This latter is in charge of supervising and monitoring the Swiss cooperation programme in Albania.

A new framework agreement concerning the technical cooperation with Albania has been signed in May 2007 and it covers all the activities conducted by SDC and SECO in Albania. Its duration is undetermined and can be terminated at any time by any one of the two Governments. Each project is subject of a specific agreement with the line ministries.

Swiss assistance's strategy is outlined in Swiss Cooperation Strategy with Albania that covers the period 2006 – 2009 and will be renewed for the period 2010 - 2013. The contribution of Swiss assistance includes sectors of democratisation and decentralisation, social inclusion, vocational education, private sector development, water, energy and environment.

The total Swiss assistance for the new strategy period 2010 – 2013 is CHF 56 million.

USA

The U.S. Government's Agency for International Development (USAID), has been implementing America's foreign economic and humanitarian assistance programs since 1961. USAID has been operating in Albania since 1992. During this time USAID/Albania, through the Support for Eastern European Democracy (SEED) Fund, has delivered more than \$438 million in assistance to support Albania's transition and long-term development.

The USAID assistance program is aimed to help Albania progress toward a place within the community of democratic and market-oriented nations, and to become a force in promoting peace, stability, and prosperity throughout Southeast Europe.

USAID/Albania implements a wide-ranging program aimed to promote economic growth and poverty reduction, strengthen democratic institutions and civil society, improve the legal system and reduce corruption, increase the efficiency of the primary health care system, and target special initiatives including energy and trafficking in persons.

USAID/Albania has a staff of 31 people: 8 U.S. staff and 18 Albanian staff. USAID works in close partnership with private U.S.-based non-governmental organizations, indigenous institutions, U.S. businesses, and other national and international agencies.

The current portfolio consists of 24 activities, some of which are listed below:

- Albanian Agriculture Competitiveness Program (agriculture development)
- Competitive Enterprise Development Program (small and medium enterprise development)
- Local Government Program in Albania
- Rule of Law Program (anti-corruption)
- Pro Shëndetit (primary health care)
- Transnational Action Against Child Trafficking
- Coordinated Action Against Human Trafficking
- Millennium Challenge Albania Threshold Agreement

Information about the USAID/Albania is available at <http://albania.usaid.gov> or via the U.S. Embassy, Rr. Elbasanit, No. 103, Tirana, Albania, Tel. +355 4 224 7285.

ANNEX 8 - TAM/BAS Activity in Albania

Previous experience in Albania

The TAM/BAS Programme supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises in the Bank's countries of operation. To date, four TAM/BAS assisted companies in Albania have attracted 5 investments from the Bank or related financial intermediaries mobilising a total project value of over EUR 17 million. Further, TAM/BAS energy efficiency training qualifies companies for the Bank's energy efficiency credit lines, which are in process of being established.

TAM supports the introduction of international best practice in SMEs with the potential of becoming future leaders in their market through placement of experienced advisors. The Programme also carries out seminar and training activities promoting international best practices by disseminating successful case-studies to entrepreneurs.

Since inception in 1996, TAM has undertaken a total of 37 projects in Albania, across industry sectors and with a fairly even distribution of micro and SMEs. Projects have been distributed between the capital, Tirana, and the rest of the country.

BAS acts as a facilitator for the use of local, private consultants by MSMEs to obtain services. BAS works on both the demand and the supply side. By assisting individual enterprises to engage with local consultants on narrowly-based, specific projects with a rapid payback, it stimulates demand and understanding of the benefits of using external consultants. It also directly increases the supply and quality of local advisory services, through targeted market development activities.

The BAS Programme was established in June 2006 with funding from the Netherlands, and later received funding from the Bank, ESSF, Luxembourg and Portugal. As of June 2009, BAS has undertaken a total of 121 projects with MSMEs, engaging 66 local consultants. In addition to standard BAS projects, the Programme also carried out training for local consultants.

MSMEs in a gradually improving business environment

Important drivers of Albania's growth since 1997 have been the rapid expansion of private consumption on the demand side and buoyancy in construction from a supply perspective. However, the country's growth and competitiveness remain constrained by low levels of exports and private and foreign investment, weak governance, and structural bottlenecks in the infrastructure sectors.

There are very few large enterprises in Albania. In fact, the MSME sector (employing less than 80 people, under the definition of the Albanian Institute of Statistics) accounts for 99.6 per cent of private enterprises, 70 per cent of total private enterprise turnover and 58 per cent of private enterprise employment. However, their distribution across size classes and regions is highly disproportionate. The MSME sector is characterised by low export activity, low FDI inflows and low business sophistication.

Albania's Government is implementing ambitious reforms to support MSMEs and needs to ensure transparent and efficient implementation. MSMEs are concerned about lengthy and non-transparent judicial procedures, corruption and inadequate infrastructure. Very few financial intermediaries have yet engaged in sustainable and profitable MSME lending. Although a specific tax regime has been introduced for small enterprises, tax compliance continues to be burdensome. Finally, low skill and education levels of workers cause serious problems for enterprises; training relies heavily on donor support, resulting in a risk of lack of sustainability upon withdrawal of donor interest.

Strong need for TAM/BAS

A change in attitudes and business orientation is required for Albanian businesses to become competitive. Advisory assistance is particularly important in the areas of human resource management and organisation, international best practices, quality management and certification, product development and marketing. Various international donors provide support for pilot projects aimed at the MSME sector, several providers focus on competitiveness and enterprise learning development with mixed success. However, the sustainability of these programmes is not ensured after withdrawal of donor interest.

There is furthermore a need to improve dialogue mechanisms with the private sector. Although the private consultancy market is growing, improvements are needed with respect to provision of information, quality assurance, pricing and availability of an appropriate range of services. Overall, the business support infrastructure is fragmented and relies heavily on donor support.

Recommendations for future TAM interventions

Based on interviews with local stakeholders, there is strong interest in continued operating in Albania in 2009-2011. The main impediments faced by MSMEs, which could be addressed by TAM programme assistance, relate to poor organisational and management skills, business planning, marketing techniques and lack of exposure to international best practices. TAM should particularly target the food-processing industry, manufacturing and tourism that were identified as key industries with high growth potential. TAM should also target recycling, water supply and water sewage companies with regard to environmental issues and help identify companies with the potential of becoming leaders in the EU's business innovation centre. Companies classified as "large" and MSMEs carrying on TAM projects past the average of 18 months and the average budget of EUR 57,500 should pay for services.

Recommendations for future BAS interventions

Stakeholders in the enterprise sector believe that Albanian entrepreneurs could benefit strongly from business advisory services. The main advantage of BAS is its contribution to creation of a viable infrastructure of business support by operating on both the demand and the supply side. The BAS grant should remain a key component of BAS assistance. However, targeted market development activities should be an important component of BAS assistance in Albania.

A Grant Guideline Matrix is proposed in order to prioritise intervention to avoid duplication of efforts from international donors. Higher grants should be given to: smaller enterprises; those located outside of the capital; projects aiming to improve quality management, introduce human resource management and financial and strategic planning and finally; projects in the agro-processing and tourism sector with the aim of improving environmental management

Additional Market Development Activities

It is recommended to complement TAM/BAS assistance with the following market development activities in order to maximise transition impact:

- *Visibility and dissemination:* Further steps to promote the use of business advisory services. TAM may organise international best practices orientated seminars and trainings;
- *MSME and consultancy training:* BAS should continue to address existing gaps in the supply of services by providing trainings and seminars covering industry specific skills and production advice, improving understanding of the importance of HR policies, helping companies to prepare loan applications, and enhancing exposure to international best practices and GMS/certification;
- *Support to and development of existing local institutions – particularly in relation to the market for local business advisory services.* Although business service providers have proliferated in recent years, only few have a serious capacity to provide specialised services targeted at the enterprises' specific needs. There is a strong need to help Albania's local consultancy market to reach international standards. The creation of an Association of Consultants, however, needs to come from the bottom up in order to be sustainable. BAS can assist consultants in this endeavour.

In order to address cross-cutting issues that are pertinent to Albania's MSME sector, the TAM/BAS Programme should promote measures to increase energy efficiency in production and reduce environmental pollution. TAM should start projects with water sewage and water supply companies. As the respect of environmental standards enhances chances of businesses to be marketed in the EU, TAM should also push forward clean technology for water treatment facilities in tanneries. BAS should furthermore encourage long term strategic planning and development taking into account EU environmental standards and regulations. However, such measures will only be successful if entrepreneurs start understanding the potential future payback for their enterprise and do not only act under donor pressure. TAM/BAS should also devote efforts to supporting women entrepreneurs and encouraging women's access to middle management and executive positions, especially in Albania's mountainous Northern area. Reaching areas outside of the capital should remain a high priority for TAM/BAS. Entrepreneurship should be encouraged through internship and mentoring programmes providing students or young consultants the opportunity to work closely with BAS consultants or TAM experts.

By thoroughly analysing the business environment and clearly identifying the challenges faced by the MSME sector, this brief further strengthens the EBRD's policy dialogue toolkit. Future challenges for the government (among others) are identified as improving law enforcement, reducing inequality of treatment and

administrative corruption, improving tax administration and improving the educational system.

In line with TAM/BAS Strategic Plan 2008-2010, TAM/BAS should continue to assist the Bank to meet its objective of generating a commercially viable project pipeline for direct investments by the Bank that will be transitional in three ways:

i) identifying potential pipeline (pre-investment); ii) providing “consulting and business” services for the preparation and support of Bank private enterprise financing projects and for the enterprises themselves; iii) providing candidates for non-executive board member positions. In addition, the Programme should link MSMEs in need of finance with local financial institutions supported by the EU/EBRD SME Finance Facility and the EBRD Local Enterprise Facility (LEF). This will strengthen the Bank’s impact in the enterprise sector and in the financial sector, as outlined in the EBRD Country Strategy for Albania.