

STRATEGY FOR ALBANIA

As approved by the Board of Directors on 4 April 2006

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I. EXECUTIVE SUMMARY

Albania continues to fulfil the conditions specified in Article 1 of the Agreement Establishing the Bank. The conduct of recent parliamentary elections, held on 3 July 2005, improved considerably compared to the previous elections although some irregularities still occurred and the elections had to be repeated in several electoral districts. The opposition Democratic Party won a relative majority of seats, but not enough to form its own government. After a lengthy process for the tabulation of the election results, a coalition government was formed in early September, with Dr. Berisha as Prime Minister. His Democratic Party holds 10 of the 14 Ministries, with the remaining four going to each of the four smaller coalition partners. The handover of power from the socialist government to the new coalition government in early September 2005 was peaceful and relatively smooth.

Albania maintains good relations with its neighbours and plays a constructive role in the region. The government has shown restraint in relation to sizeable Albanian minorities in Serbia and Montenegro and FYR Macedonia. Talks with the EU on a Stabilisation and Association Agreement (“SAA”) were initiated in 2003. The negotiations for the SAA have been concluded, and the agreed text was initialed on 18 February 2006. The text has now been proposed for signature to the European Council. Albania will continue to be required to show material progress of commitments, in areas such as the reform of the judiciary system and the fight against corruption. Albania is also pursuing accession to the NATO.

The macroeconomic environment has remained favourable in recent years although high trade and fiscal deficits remain significant risk factors. Economic growth is stable at around 5-6 per cent, driven mainly by construction, business services and transport. Official unemployment remains around 15 per cent of the labour force but underemployment is widespread. Annual consumer price inflation is subdued at 2-4 per cent. The exchange rate is relatively stable, subject to appreciation pressures and seasonal effect of uneven transfer of remittances peaking in summer and winter months.

Albania has made significant progress in transition reforms in recent years but significant challenges remain. Business environment suffers from a high level of corruption, serious shortcomings in the judiciary, and very weak institutional and law enforcement capacity. Despite sizeable investments in recent years, infrastructure is far from being adequate for private sector development, including substandard road network, lack of reliable power supply, and limited regard paid to environmental consequences of rapidly expanding economic activity. Poverty is also a significant issue, particularly outside the main Tirana – Durres area.

The main challenges for the new government are:

- substantial strengthening of the public sector, including an effective and systematic fight against corruption and organised crime; increased efficiency and impartiality of the judiciary and public administration, particularly the customs and the tax system; and resolution of land ownership;

- infrastructure improvements, including upgrades of the road system, modernisation and expansion of seaports and regional airports, progress in restructuring and privatisation of utilities to ensure reliable services, particularly in power and telecom sectors, and greater attention paid to environmental issues, including waste disposal and wastewater treatment as well as environmental issues related to expansion of the private sector; and
- improving access to finance, particularly for SMEs and enterprises outside the main Tirana – Durrës area, as well as improving the business environment for foreign direct investments (“FDIs”) that would contribute to the development of the industrial sector.

The Bank has played an increasing and important role in the transition process in Albania: 21 operations for a direct Bank financing of EUR 291 million and a further EUR 709 million from sponsors and co-financiers. The Bank, in close conjunction with other IFIs and donors, could substantially increase its role over the strategy period through focusing selectively on the identified challenges.

The Bank’s operations over the strategy period will focus on five main general 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. Specifically, the Bank will focus on the following sectoral priorities:

Infrastructure, Power and Energy, Municipal and Environment Sectors: supporting the rehabilitation and restructuring of the transport and energy sectors, particularly within a regional context, will remain the main focus of the Bank. Where possible, the Bank will endeavour to channel long term finance to private public partnership schemes, subject to open and transparent tender procedures. The Bank will pay a particular attention to the implementation of projects in the energy and transport sectors. The Bank will continue its policy dialogue on the privatisation of utilities and will make itself available to support viable privatisation schemes. The Bank will also explore the viability of financing structures specifically aimed at environmental and energy efficiency projects.

Enterprise Sector: Two priorities will be pursued in parallel: First, the Bank will continue to play a major role in promoting private sector development through financing existing as well as green field investments with a particular attention to inward investments to Albania. The Bank will continue to complement the local banks for larger deals and will concentrate its efforts to fill the gap in terms of available financing instruments in the market for local enterprises through specially designed products. Second, the Bank will support the privatisation and/or commercialisation of remaining large state owned companies.

Financial Sector: A prime objective of the Bank will be to renew its efforts to support and promote SME lending through local banks. The Bank will explore the

possibility of providing new financial products tailored to increase lending to SMEs and improve the skills of local banks. The Bank will continue to support the restructuring and consolidation of the banking sector through new equity investments in local banks and participation to possible mergers. In the non-bank financial sector the Bank will work to complete the privatisation of INSIG.

The Bank will continue to ensure that all EBRD operations in Albania are subject to the Bank's Environmental Policy and Procedures and incorporate, where appropriate, Environmental Action Plans.

Given the substantial transition challenges in Albania, the Bank will need more than ever the support of donors in terms of technical assistance, grant co-financing of critical infrastructures and subordinated investment resources. The Bank will work alongside with the EU, EIB and important donors, with a special reference to Italy, in the context of an increased policy dialogue and joint financing.

List of Abbreviations

| | |
|----------|--|
| AREF | Albania Reconstruction Equity Fund |
| ASC | Albanian Securities Commission |
| 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 |
| CEI | Central European Initiative |
| EIB | European Investment Bank |
| EC | European Commission |
| ECSEE | Energy Community of South Eastern Europe |
| ESAF | Enhanced Structural Adjustment Facility |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FEFAD | Foundation for Enterprise Finance and Development |
| GDP | Gross Domestic Product |
| GEF | Global Environment Facility |
| GRECO | Council of Europe Group of States against Corruption |
| GTZ | Deutsche Gesellschaft für Zusammenarbeit |
| 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 |
| IMF | International Monetary Fund |
| INSIG | Albanian Insurance Institute |
| INSTAT | Albanian Institute of Statistics |
| JBIC | Japan Bank for International Cooperation |
| KESH | Albanian Power Corporation |
| KFOR | Kosovo Force – NATO led international force in Kosovo |
| KfW | Kreditanstalt für Wiederaufbau |
| MEI | Municipal and Environmental Infrastructure |
| MTBP | Medium Term Budget Programme |
| MSME | Micro, Small and Medium Enterprises |
| NATO | North Atlantic Treaty Organisation |
| NBFI | Non-Bank Financial Institutions |
| NCB | National Commercial Bank |
| NSSSED | National Strategy for Social and Economic Development |
| PfP | NATO's Partnership for Peace Programme |
| PPP | Private Public Partnership |
| PRGF | Poverty Reduction and Growth Facility |
| PRSP | Poverty Reduction Strategy Paper |
| REPO | Repurchase Agreements |
| OECD | Organisation for Economic Co-operation and Development |
| OSCE | Organisation for Security and Co-operation in Europe |
| SAA | Stabilisation and Association Agreement |
| SDC | Swiss Agency for Development and Cooperation |
| SECI | South East Cooperation Initiative |
| SECP | South East European Cooperation Process |

| | |
|--------|--|
| SEEP | South Eastern European Programme |
| TC | Technical Cooperation |
| UNDP | United Nations Development Programme |
| UNEP | United Nations Environmental Programme |
| UNICEF | United Nations Children’s Fund |
| USAID | United States Agency for International Development |
| WB | World Bank |
| WHO | World Health Organisation |

Currencies

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

Exchange Rate

| | |
|-------|---------|
| 1 EUR | 122 ALL |
| 1 USD | 102 ALL |

1. THE BANK'S PORTFOLIO

1.1 Overview of Activities to Date

The Bank has provided active support to Albania in the country's efforts to move towards a free market economy. As of end December 2005, the Bank had achieved cumulative business volume of EUR 291 million – total project cost of EUR 1 billion – in sectors covering energy, transport, telecommunications, financial institutions, general industry, agribusiness and property (see Annex 5). The current portfolio amounts to EUR 233 million in 16 projects, of which 114.7 million are operating assets.

Over the last two years, the net portfolio grew by EUR 101 million or 77%, with growth mainly generated by projects in the energy and transport sector while operating assets have grown by 194%, reflecting fast implementation of private sector projects as well as faster implementation in previous infrastructure projects. However, net operating assets still stand at 49% of the current portfolio. The overall low disbursement factor is mostly due to the delays in the implementation of two large public infrastructure projects signed in 2004 and 2005: *Vlore Thermal Power Plant (EUR 40 million)* and *Fier-Tepelene Road Project (EUR 35 million)*. A long election process and the change of Government in 2005 accentuated the delays in the implementation of these projects.

Table 1.1 Bank portfolio in Albania as of end December 2005

| 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 | 6 | 52.8 | 24.2 | 8.3% | 5 | 19.0 | 8.2% | 18.7 | 98.4% |
| Banks | 4 | 35.1 | 16.1 | 5.5% | 3 | 12.4 | 5.3% | 12.4 | 100.0% |
| Equity Funds ¹ | 1 | 7.3 | 2.8 | 1.0% | 1 | 0.9 | 0.4% | 0.6 | 66.7% |
| Non Bank | 1 | 10.4 | 5.3 | 1.8% | 1 | 5.7 | 2.4% | 5.7 | 100.0% |
| Infrastructure | 8 | 660.0 | 168.5 | 57.9% | 6 | 155.0 | 66.5% | 43.5 | 28.1% |
| Power and Energy | 5 | 475.8 | 95.5 | 32.8% | 3 | 82.0 | 35.2% | 19.2 | 23.4% |
| Transport | 3 | 184.2 | 73.0 | 25.1% | 3 | 73.0 | 31.3% | 24.3 | 33.3% |
| Specialised Industries | 6 | 177.4 | 72.9 | 25.1% | 4 | 33.7 | 14.5% | 32.2 | 95.5% |
| Telecommunications | 2 | 113.4 | 33.0 | 11.3% | 2 | 26.0 | 11.2% | 26.0 | 100.0% |
| Agribusiness | 2 | 18.6 | 7.4 | 2.5% | 1 | 4.0 | 1.7% | 2.5 | 62.5% |
| Property, Tourism & Shipping | 2 | 45.4 | 32.5 | 11.2% | 1 | 3.7 | 1.6% | 3.7 | 100.0% |
| General Industry | 1 | 109.9 | 25.4 | 8.7% | 1 | 25.4 | 10.9% | 20.3 | 79.9% |
| | | | | | | | | | |
| Country Total | 21 | 1,000.1 | 291.0 | 100.0% | 16 | 233.1 | 100.0% | 114.7 | 49.2% |

The Bank's investment is concentrated mainly in the energy and transport sectors, which represent 33% and 25% of the cumulative portfolio, respectively. Other

¹ The Albania Reconstruction Equity Fund is an incorporated investment facility managed directly by the Bank, with the Bank making direct equity and quasi-equity investments in local enterprises. Since 1999, AREF has made eleven investments, bringing the total number of Bank's signed transactions in Albania to 32.

important sectors are telecommunications and property with 11% each. The portfolio is generally well distributed through all sectors in terms of number of projects. However, the concentration in volume terms is a result of the large size of energy and transport projects compared to those in other sectors: public projects account for 57% of the volume, but only 38% in terms of number of projects. Debt of EUR 262 million represents 90% of the approved Bank's operations and equity of EUR 29 million represents 10% (see Annex 5 for the full list of the Bank's projects).

Over the past two years, the Bank mobilised for its projects EUR 258 million of co-investment from sponsors, co-financiers and donors, representing a multiplier of 2.1. Total co-investment funds reached EUR 709 million. Working with various donors, the Bank has mobilised funding for 82 technical co-operation commitments in the financial sector, telecommunications, energy, transport, and manufacturing industries. Total TC funds committed amount to EUR 15 million, while disbursement of TC funds as of end 2005 stood at EUR 14 million (see Annex 6).

1.2 Implementation of the Past Strategy

The last country strategy, approved in April 2004, outlined three strategic priorities for the Bank in Albania. Overall, the Bank has been successful in meeting its objectives in the infrastructure and FDI private sectors, but it has faced difficulties in financial sector involvement and SME support. Over the review period (April 2004 – December 2005), the Bank has committed EUR 125 million in 5 new projects. In particular:

Priority: The promotion of private sector development through privatized and green-field enterprises, with particular focus on general industry and agribusiness, and support of the forthcoming larger privatizations in energy and telecommunications.

Results: In line with this strategic priority, the Bank committed EUR 29 million in two private projects. It provided a EUR 25 million loan to Seament Albania for the construction of a new cement production plant in central Albania. The project, once completed would substitute cement imports and meet a large part of cement demand from a fast growing construction industry. It carries important demonstration effect to other foreign investors interested in entering the country. The second project is a loan of EUR 4 million to Morpack Albania for the construction of a new plant in Southern Albania for the production of irrigation pipes and other plastic packaging materials, aimed at substituting imports with local production. Privatizations in energy and telecommunications did not materialize over the review period, however, the Bank has set the grounds to support and participate in these privatizations in the future.

Priority: The strengthening of the financial sector, as a key factor for the development of SMEs, and support for the privatization of the insurance company, INSIG.

Results: The Bank completed the acquisition of 20% of the shares of INSIG, the former state-owned insurance monopoly, and provided technical assistance funds for the restructuring of the company in order to prepare it for full scale privatization. The Bank was also instrumental in the successful completion of the privatization of Banca Italo Albanese and the attraction of a major international player as strategic investor

in it. The Bank found it once again difficult to utilize its standard products to support SME lending, mainly due to high liquidity in the market.

Priority: Further support for the development of key infrastructure projects in the energy, transport and municipal and environmental infrastructure sectors.

Results: The Bank provided significant support to infrastructure development over the review period through three different projects for a total of EUR 96 million. It signed a EUR 35 million guaranteed loan to the Albanian Government for reconstruction of the Fier Tepelene Road, part of the North – South Corridor. The second project was a EUR 21 million loan to Airport Partners Albania, a consortium composed of Hochtief Airport, Albanian-American Enterprise Fund and DEG to finance the Tirana Airport concession, one of the first public private sector partnerships in the region. The third project is a sovereign guaranteed loan of EUR 40 million to the Albanian Power Corporation for the construction of a new thermal power plant. The project aims to balance energy generation and improve power supply.

1.3 Transition Impact and Lessons Learned

Over the years, the Bank has managed to build up a presence in all main sectors of the Albanian economy, except for natural resources, MEI and energy efficiency sectors. The Bank has had a *significant* transition impact in power and energy, and telecommunications. On the other hand the Bank impact in agribusiness, general industry and property was *minimal*. Overall, the impact of the Bank over the entire period 1993-2005 is rated as *moderate*.

Private Corporate Sector

FDI – The Bank has played an important role in promoting and supporting the development of the private FDI sector. The Bank is a financing partner in almost all large FDI in the country. These investments have significant demonstration effect and provide encouragement to further much needed FDI in the country.

Agribusiness – The Bank has contributed to foreign direct investment with the Coca-Cola Tirana and Morpack Albania projects. Demonstration effects in the first project were reduced by corporate governance problems. The Bank learned that the interests of the major foreign sponsor might not be fully in line with the interests and priorities of the local sponsors. Morpack Albania, signed last year, has good transition impact potential through demonstration effect to foreign investors and transfer of know how to local staff.

Industry – In the last five years, the Bank signed one project, the financing of a new cement production line with a foreign strategic investor. Once fully implemented, the project is expected to have a significant demonstration impact on other foreign investors considering general industry investments in the country. Also, through its Albania Reconstruction Equity Fund (“AREF”), the Bank has made eleven investment in small to medium local enterprises in different sectors (see NBFi below).

Property and tourism – The Bank has been instrumental in the construction and operation of the first two international standards hotels: Hotel Tirana and Hotel

Rogner. The Hotel Tirana has faced restructuring problems originating partly from poor project design and partly from the fact that good governance was seriously impeded by government interference at management level. Drawing from this experience, the Bank should favour hotel projects with a strong international operator who should have full control of management and staffing decisions.

Financial Sector

Banking – The Bank’s major impact was achieved through the support and promotion of bank establishment and privatisation. The Bank’s participation has been key to the establishment of Banca Italo-Albanese (“BIA”) in 1994, the first private bank in Albania. Problems with the internal management of BIA hampered its development and transition impact. The Bank learned that a strong strategic investor does not exonerate the Bank from exercising diligently its monitoring responsibility. Continuous and diligent attendance to Board meetings is important and specific attention is required in the monitoring of good banking practice and corporate governance. The Bank’s participation in the Board has been crucial to resolving the management issues. The Bank’s involvement was also very important in the completion of the privatisation of BIA through the sale of 80% of the shares to Sanpaolo IMI of Italy: an important investor which has the potential to provide an important impetus to the development of the banking market in Albania.

In 2000, the Bank made an equity investment in the National Commercial Bank (“NCB”) to support the first major privatisation in the sector. The Bank’s participation as a shareholder has been instrumental to the good performance of NCB and its transformation into a well functioning commercial bank and important market player, which improved competition in the banking sector. Retrospectively, the Bank should have obtained a call on the sponsor’s ownership position and ring-fence the project entity to protect its assets from undue sponsor interference through strict portfolio investment criteria.

MSME – The Bank’s one clear success in the MSME sector has been through its equity participation in FEFAD Bank, afterwards renamed to Procredit Bank, a micro-finance bank owned by a number of IFIs. Both the quantity and quality of the sub-loans and its branch diversification have been impressive. However, there is still little competition to Procredit Bank in the MSME market. The Bank has also contributed to development in the sector through six TAM/BAS projects.

NBFI – The Bank made an equity investment (together with the IFC) in July 2004 in INSIG, the state owned insurance company, under a pre-privatisation scheme. The Bank’s participation has brought about important changes in the company’s operations and organization, including strengthening the management and technical skills of the company. Full privatisation is yet to be completed.

The AREF established by the Bank is Albania’s first and still only venture capital fund. Demonstration effects relate to the innovative nature of the product. It struggled to find suitable investments but managed to place 32% of the allocated capital to eleven investments. Despite a limited number of investments, the activities of the fund have been very visible and have successfully demonstrated the way risk investments could be implemented in a small market with extremely scarce exit options.

Infrastructure

Power – The Bank had an early involvement in the sector and focused on encouraging corporatisation, licensing and possible privatisations. Little progress was made, however, and Bank projects were unable to disburse due to the low levels of tariffs and collections. The Bank's involvement then moved from efforts aimed at emergency network rehabilitation to broader institutional reforms supporting tariff reforms and sector restructuring. Significant tariff increases were realised, together with strong reduction in commercial loss and improvements in collection rates. Subsidies were phased out throughout the lifetime of the projects. This allowed the Bank to start in 2004 the structuring of a new project with KESH to finance the construction of a new combined-cycle, oil fired power station at Vlore. The projects have contributed to the unbundling process of the power sector.

Telecommunications – The Bank has been instrumental in encouraging corporatisation, licensing and possible privatisation of the dominant operator and the strengthening of the regulatory framework through two Technical Cooperation Projects. In recent years, the Bank contributed to the successful introduction of competition in the mobile segment of the market.

Transport – For a decade, the Bank's only investment in the sector was the Road Rehabilitation project. In 2005, the Bank signed another road project and one recent airport concession during the review period. The road project includes policy covenants on road financing. The Tirana Airport Privatisation project supports one of the first major Public Private Partnership (“PPP”) project in the region, awarded competitively through an international tender, with the participation of a foreign and experienced strategic investor, and one of the few of this kind in the region in the transport sector. The Bank was instrumental in promoting changes to the tender process to lead to a more transparent evaluation and assisting in procuring comparable bids.

Overall in the public sector, the Bank has gained valuable experience in dealing with government bodies and understanding implementation and debt absorption capacities of public entities, which will help the implementation of future public sector projects.

TC projects – The Bank invested considerable resources in TC projects to help address institutional deficiencies, although none of them were part of the Bank Legal Transition Assistance Program. Projects in telecommunications implemented in the 1990s carry lessons on processes that are still valid today. First, when several TC funding components are simultaneously applied, an adequate level of co-ordination and monitoring should be organised by the Bank to ensure the optimal use of the funds. Second, the preparation of TCs involving large surveys may justify a feasibility study before the main operation can realistically start. A logical framework TC planning approach on a participatory basis can help identify potential implementation problems.

1.4 Portfolio Ratio and Quality

The private/public ratio of the cumulative portfolio stands at 43/57 per cent. The previous strategy approved in April 2004 acknowledged this as public projects in

infrastructure are significantly larger than private sector projects in the country. In terms of number of projects, however, the private/public ratio of the current portfolio stands at 62/38 per cent. Albania continues to require substantial investment for the rehabilitation and improvement of the energy and transport infrastructure. Due to the structural size difference between public infrastructure and private sector projects, the private sector share is unlikely to reach the 60% target in volume terms over the strategy period. Nevertheless, the ratio will continue to remain largely in favour of private projects in terms of number of projects.

2. OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

Albania continues to meet the criteria specified in Article 1 of the Agreement Establishing the Bank. It is a pluralist, multiparty democracy. Its human rights record is broadly comparable with that of established Western democracies.

Albania made a considerable progress in transition reforms in recent years but still faces a large number of fundamental transition challenges in all areas. The authorities need to address those challenges urgently, despite limited implementation capacity, to maintain macroeconomic and social stability and to ensure strong and sustainable growth performance over the medium term. Recent transition successes include progress in privatisation process and significant investments in infrastructure. Banking sector has benefited from the completion of the privatisation of last majority state owned bank and is developing fast, albeit from very low base. Infrastructure has been a target of significant investments, resulting in tangible improvements, although the gaps in infrastructure provision are still immense.

Significant reform challenges to be tackled in the short to medium term include strengthening of the administrative capacity of the state, lowering of the widespread corruption, fight against the organised crime related to human and drugs trafficking, formalisation of commercial activities supported by the resolution of land ownership issues, strengthening of the tax and custom system, infrastructure improvements to create basic country wide transport network up to international standards and to ensure reliable supplies of power and other utilities, fighting against widespread poverty and regional disparities in living standards, and creation of new jobs. Unlike corruption, especially in the tax and customs administration, general crime has declined from being the greatest constraint faced by enterprises in 1999 Business Environment and Enterprise Performance Survey (“BEEPS”) to being the smallest constraint in 2005 BEEPS survey. Racketeering schemes are not reported by businesses as an important issue and there is no indication of significant money laundering through the small local financial sector. However the scale of organised crime remains a serious concern and proceeds of organised crime related to human and drugs trafficking are likely to be laundered through local businesses, including companies active in the construction and real estate sector. Potential integrity issues are also a significant problem for legitimate businesses operating in the country, including foreign investors considering setting up operations in Albania.

The conduct of elections has improved in recent years although irregularities still occur and the July 2005 parliamentary elections had to be repeated in several electoral districts. The OSCE stated that the compliance of 2005 parliamentary elections with international commitments and standards for democratic elections was partial. The election process was open to abuse, voter lists were intentionally inaccurate, and there were instances of assisted voting and family voting. However, the OSCE also noted some positive developments in the election process, such as the high number of different political parties registered to participate, the transparent administration of the process and the free media coverage of the elections. The European Commission has also stated that the elections process generally corresponded to the requirements of democratic standards despite some minor incidents. The positive EC assessment of

the elections was critical for the progress in negotiations on a European Union Stabilisation and Association Agreement. The opposition Democratic Party won the most seats in parliamentary elections held on 3 July 2005 but not enough to form its own government. After a lengthy process for the tabulation of the results, a coalition government was formed, with former President Sali Berisha as Prime Minister. His Democratic Party holds 10 of the 14 Ministries, with the remaining four going to each of the four smaller coalition partners. The handover of power from Socialist government led by Fatos Nano to coalition government led by Sali Berisha in early September 2005 was peaceful and relatively smooth. Following the elections Fatos Nano resigned and was replaced as a head of the Socialist party by the Mayor of Tirana, Edi Rama. The local elections are planned for 2007.

2.1.1 Legal Environment

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

Albania is a parliamentary republic with a constitution which recognises division of powers, independence of the judiciary and human rights. Although the legal framework provides for an independent judiciary, major deficiencies regarding training, resources and low levels of pay for judges have made corruption in the courts a frequent phenomenon and have generated a lack of confidence from the business community.

The European Commission noted in its “Albania 2005 Progress Report” positive developments in coordinating Albanian legislative standards with those of the EU. Nevertheless, an overall assessment of Albania's commercial laws reveals that Albania still needs to take substantial further steps to establish a legal system that conforms to international standards. Some of the factors that have contributed to this poor performance include an urgent need for reform in the area of securities markets legislation, deficiencies in the standards of corporate governance legislation and concession laws as well as a weak enforcement regime in the area of secured transactions. Although Albania's new bankruptcy law compares favourably to those of other EBRD countries of operations, effective implementation of its insolvency regime remains a challenge. These factors, accompanied by the poor state of the judicial system and the lack of respect for the rule of law in the country, have served as deterrents for foreign and domestic investors.

There have been however some improvements in the legal framework: a new competition law, introducing European Union norms, was adopted in 2003 and an independent competition authority was established in 2004. A new law on state aid was adopted in 2005 and became effective on 1 January 2006. Several new measures to fight corruption and conflicts of interest were also adopted. Albania continues to move forward in developing legislation that will assist it in its transition towards a market economy. However, implementation, shortcomings in the judiciary and weak law enforcement capacity remain to be a serious problem.

2.1.2 Environment

In 2003, Albania's state budget allocations for the environment accounted for only 0.24% of the total state budget (the figure was as large as 1.8% in Hungary in 2004). Furthermore, insufficient environmental institutional capacities both at a national and local level are widely pointed out by the international community including EBRD, EU and UNDP. In 2005, Albania adopted a national plan to transpose all EU Environmental Directives into its environmental legislation. The Comprehensive Law on Environmental Protection (2002) and a law on Environmental Impact Assessment (2003) are, therefore, likely to be further strengthened. The real challenge will be whether this could reverse the country's dismal environmental record. Planning and budgeting for investing in priority environmental infrastructure and clean up as well as comprehensive environmental management systems to stimulate the industries and public to adopt environmentally sound behaviours are urgently needed. The country's environmental harmonisation with EU could possibly become a pressure point especially through the EU's regular assessment on the country's environmental progress (the UNEP Common Country Assessment for Albania 2004).

From an environmental perspective, EBRD projects will need to take into account both inadequacies in the current environmental management regime as well as pertinent environmental issues. The Bank is exploring the development of credit facilities to finance a range of environmental projects including the reduction of water pollution to the Aegean and Adriatic Seas, industrial and residential energy efficiency and small-scale renewable energy production. These credit facilities would build on the structures and success of the Bank's Slovenian EBRD/GEF Environmental Credit Facility and the Bulgarian Energy Efficiency Credit Lines. To assist in this process, a series of workshops have been held in a five countries, including in Albania, to gather local input from a range of stakeholders including government, local authorities, academia, financial institutions and industry. Building on the opinions and guidance received during this workshop the Bank will decide which issues are of most relevance to Albania (i.e. water pollution, energy efficiency or renewable energy) and which can generate sufficient demand to support a focused credit line for these specific purposes.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic Conditions Relevant to Bank Operations

The economic growth slowed down to 5.5 per cent in 2005, following 6.7 per cent GDP growth in 2004, with the slowdown due to energy crisis in the second half of 2005 (see Annex 3 with the Selected Economic Indicators table). The economic performance is driven mainly by construction, business services and transport, and has benefited from the rapid expansion in recent years of credit to the real economy, albeit from a very low base. Sustaining or even increasing current growth, expected at about 5-6 per cent a year in the medium term, will depend on improvements in business environment and infrastructure upgrades which could eventually allow Albania to expand its export markets and attract foreign investors. Political stability, continued support from abroad, and a successful conclusion of the Stabilisation and Association Agreement with the EU are key factors for the economic outlook.

The unemployment rate is estimated at 14.7 per cent of the labour force in 2005, but underemployment is widespread and usually unreported due to limited social safety net. Official estimate of the labour force is about 1.1 million people: 175 thousand work in the public sector, 215 thousand work in the private sector, and 550 thousand work in agriculture. The stock of emigrants, not included in the labour force, is estimated at about 500 – 700 thousand people, mostly in neighbouring Greece and Italy.

Poverty is also an important issue, especially outside the capital. A quarter of population lives below the poverty line of USD 2 per person per day. Average gross monthly wages in the state sector are about USD 260. Minimum wage is set at about USD 100 and unemployment benefits are on average around USD 40. Social benefits are around USD 20-30 per month and the informal social support from extended family is much more important than official social safety net.

Annual consumer price inflation has been within the Bank of Albania's 2 to 4 per cent target range in the last two years and is expected to remain subdued. In 2005, average inflation reached 2.3 per cent. The Bank lowered its main REPO rate to 5 per cent in March 2005. The exchange rate appreciated by about 5 per cent in nominal terms against the euro during 2004 and further appreciation pressure was noticeable in the first half of 2005 but subsided in the second half of 2005. The exchange rate is subject to significant seasonal fluctuations due to remittance flows peaking in summer and winter months. Foreign exchange transactions are now mostly done through official channels, compared to the past when the informal, unregulated foreign exchange market was substantial.

The general government deficit is estimated at 3.3 per cent of GDP in 2005. Together with growing tax revenues in the first half of 2005, government expenditure increased rapidly in the run-up to parliamentary elections in July. However 2005 was the first year in which the current government balance, i.e., excluding grants and capital expenditures, was positive. Total government debt declined slightly to 54.8 per cent at the end of 2005, from 55.9 per cent at the end of 2004, and is expected to continue its gradual decline in the medium term. A large proportion of new government debt contracted in recent years is from international institutions on favourable terms. The new government has implemented some minor tax changes, including the cut in the tax rate on income of small businesses to 1.5 per cent from 3 per cent and in the fee for registering small businesses, which varies with the nature of business activities and location, by 50 per cent, following the discussions with the IMF regarding the impact of proposed changes on macroeconomic stability. Further tax changes, most importantly lowering of the VAT and corporate income tax by 3 percentage points to 17 and 20 per cent, respectively, may be implemented in the near future, subject to the expected impact of such changes on fiscal stability.

The trade deficit remains above 20 per cent of GDP, reaching 22.1 per cent of GDP in 2005, but is mostly financed by large remittance inflows, estimated at 13.4 per cent of GDP in 2005. Total external debt (mostly official and long-term) is modest at about 20 per cent at the end of 2005. Foreign direct investment ("FDI") inflows reached USD 288 million in 2005. International reserves increased to USD 1.5 billion at the end of 2005, covering more than 4 months of imports.

Key macroeconomic challenges are the high trade deficit and high fiscal deficit. Sustainable lowering of fiscal and trade deficits would require significant structural changes. Narrowing of the trade deficit without adverse impact on macroeconomic stability could be achieved only by increasing export capacity. Fiscal consolidation coupled with better social provision, given despite inadequate financing of basic social services such as healthcare and education and limited social safety net, would require substantial increase in the efficiency of the public administration as well as widening of the tax base, including the move of illegal economic activities into official sector which is subject to taxation.

2.2.2 Transition Success and Transition Challenges

Enterprise Sector

Serious problems in general industry reform are related to weak law enforcement, corruption, and large share of GDP generated by informal economy, estimated at 30 per cent by the OECD. Enterprises are mostly family owned and managed, and prefer to work through informal channels. The inflow of foreign direct investments is small even compared to other SEE countries. Standards of corporate governance and business conduct are low. Unclear land ownership in major urban and coastal areas continues to hinder economic development, with only about 18 per cent of immovable property properly registered.

There is rapidly expanding private construction sector, to a large extent financed by remittances. The construction boom is now subject to greater regulation: illegally constructed buildings in central Tirana have been demolished over the last few years and planning requirements are being enforced to a greater extent than in the past. There is little progress in the restructuring and expansion of the tourism sector, including introducing new products and financing methods. The coastal areas suffer from pollution and unregulated construction activities. Lack of infrastructure provision hinders the development of the tourism sector.

Infrastructure

A co-management assistance contract to KESH with ENEL, the major Italian power utility, (2000-2004), contributed significantly to improving KESH's performance. Electricity prices have increased substantially over the past five years and tariff increases should continue for the following years as established in the Power Sector Action Plan 2005-2007. Significant progress has been made in terms of increasing collection rates and reducing transmission and distribution losses. Management improvements and investment in the power system have cut the number of large-scale structural blackouts but a combination of draught in the summer of 2005, a fire at one of the main hydropower generating company, and the lack of proper forward planning related to imports of electricity resulted in several weeks of blackouts of up to 20 hours a day throughout the country in November 2005. The situation has improved since then substantially as new power import contracts were signed and the water level in main hydropower plants increased. However, the reliability of the supply network remains well below international standards, localised blackouts are occurring frequently and large scale power cuts can be repeated again.

In June 2005, the Government approved the sale of the state-owned fixed-line telecommunications operator Albtelecom. Calik Energy Telecommunication won the right to acquire a 76 per cent stake in the company for EUR 120 million, with the state retaining 24 per cent. As part of the privatisation, Albtelecom was awarded Albania's third mobile telephone licence, allowing it to compete directly with the two incumbent providers. However, in mid-October 2005 the new parliament rejected the ratification of the privatisation contract and decided to hire an international consultancy to review the agreement and the tender procedure. As of mid-March 2006 the government is still tendering the contract for the review of the telecom privatisation.

Transport network is inadequate and requires substantial investments based on reform road financing mechanism, including upgrades of main roads connecting main urban centres to international standards. An important boost to the transport reform has recently been provided by the private concession to rehabilitate the Tirana international airport, achieved through a transparent international tender process. Also, a number of port terminals are operated by private companies.

Financial Sector

Privatisation of the banking sector has been completed. The credit to the private sector is growing by about 40 per cent per year, but still reaches only about 14 per cent of GDP as of the end of 2005, out of which credit to private enterprises accounts for about 10 per cent of GDP and lending to households for about 4 per cent of GDP. About 90 per cent of credit is secured by collateral and about 80 per cent of loans are denominated in foreign currencies. The share of non-performing loans is low at about 4 per cent of the total. Informal lending, particularly among the micro and small enterprises, is still prevalent. Increasing domestic bank lending to private sector, particularly to SMEs, is an important challenge in the financial sector. A microfinance bank has been lending for six years to micro and small enterprises.

The state-owned insurance company INSIG has been partly privatised through the involvement of EBRD and IFC and the new insurance law has strengthened the legal and regulatory environment. The stock exchange mainly consists of foreign currency trading and legislation and regulation needs substantial strengthening in the areas of disclosure obligations, accounting and auditing standards. The country has not yet developed a class of private equity managers with local expertise or investors willing to invest in private equity funds operating in the country. New leasing legislation is being prepared and may help develop a small leasing market.

2.3 Access to Capital

Remittances are a major source of financing for the Albanian economy, estimated at about USD 1.2 billion in 2005, equivalent to 13.4 per cent of GDP. Albania also benefits from official transfers, estimated at USD 130 million or 1.5 per cent of GDP in 2005. Commercial capital inflows are very limited at USD 57 million or about 0.7 per cent of GDP. Albania is not rated by major rating agencies, has not issued a Eurobond yet, and FDI inflows are small at USD 288 million, or approximately 3.3

per cent of GDP, in 2005. Record FDI inflows were achieved in 2004, at USD 343 million including privatisation proceeds from the sale of the Savings Bank.

The cumulative stock of FDI has reached USD 1,745 million at the end of 2005, equivalent to about USD 545 per capita, which is about half of regional average and less than fifth of per capita stock of FDI in Central Europe. Eventual privatisation of the fixed line telecom company and other utilities may contribute substantially to FDI inflows in the future, but these would be one-off flows and substantial increase in greenfield FDI inflows, particularly in tourism sector which has great unfilled potential subject to the resolution of land ownership and registry issues as well as infrastructure upgrades.

Wholesale trade, clothes and footwear manufacturing, agribusiness and construction accounts for about forty per cent of the stock of FDI. 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 almost half of FDI in the country, followed by Greece accounting for about one third of FDI stock. The majority of Italian investments tend to be small and medium size enterprises with a local partner, operating in textiles and shoes production, construction, trade and services, and agricultural processing. Greek investments have focused on telecom sector, banking and construction.

The current IMF programme, approved in January 2006, includes ceiling of Euro 70 million on contracting or guaranteeing of public and publicly guaranteed non-concessional external debt with maturities over one year by December 2006. The new programme is to ensure that macroeconomic policies are not relaxed and ongoing structural reforms are continued. The total government debt is estimated by the IMF to gradually decline from 54.8 at the end of 2005 to 52.6 per cent of GDP at the end of 2009.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

The Bank's priorities will reflect the current analysis of Albania's transition challenges. There are still quite a number of areas where the Bank's assistance will continue to be crucial in supporting the Government's efforts towards fostering reforms, improving the current level of infrastructure and the country's investment climate. However, the Bank will give a clear focus to its activities over the strategy period. Despite a strong private sector focus, with a number of large new public infrastructure projects in the pipeline, the portfolio ratio will likely move towards the public sector. Nonetheless, as was mentioned in Section 1 above, the number of projects in the private sector will remain substantially higher than in the public sector.

The Bank's operations over the strategy period will focus on five main general priorities:

- Development of transport and energy infrastructure, municipal and environmental projects;
- Privatisation and restructuring of remaining large state-owned enterprises;
- Further consolidation and restructuring of financial sector;
- Supporting FDI and local enterprises with a particular attention to SMEs; and
- Policy dialogue, especially in the areas of regulating and strengthening the markets for infrastructure including institution strengthening.

Policy dialogue will continue to be a crucial point for maximising the transition impact, and all EBRD operations in Albania will continue to be subject to the Bank's Environmental Policy and the Bank will incorporate where appropriate Environmental Action Plans.

Given the substantial transition challenges in Albania, the Bank will need more than ever the support of donors in terms of technical assistance, grant co-financing of critical infrastructures and subordinated investment resources. The Bank will work alongside with the EU, EIB and other important donors, with a special reference to Italy, in the context of an increased policy dialogue and joint financing.

Specifically, the Bank will concentrate on following priorities during the new strategy period.

3.2 Sectoral Challenges and Bank's Objectives

3.2.1 Infrastructure, Energy and Municipal and Environment Projects

Transition Goals

- Improvement of management and operation of the road transport network including institutional strengthening, reform of road sector financing and improved maintenance of the road network. An important area is represented by the commercialisation of port sector, encouraging, where possible, PPP structures.

- Reliable power services remain a major issue in Albania. With more than 90 per cent of its generation capacity in hydro, Albania needs to urgently diversify into other types of generation as well as invest in power transmission to access multiple alternatives and ensure security of supply. Distribution, which suffers from high losses, also needs to be upgraded.
- Albania should promote reforms and decentralisation and distribution in the Municipal Environment sectors. Improvement, privatisation and/or commercialisation of utilities have to be carried out, including the encouragement of private sector involvement in the transport and energy sectors.

Operational Priorities

Transport

- The Bank has been active in the road sector in Albania providing financing for the rehabilitation of a 30 km section of the East-West Road Corridor VIII, which was completed in June 2005. It has also provided financing for the upgrading of the North-South link from Fier (Levan) to Tepelene (leading to the Greek border). This project will be linked to improvements in road sector financing and institutional reform and may be extended to include the Fier (Levan) – Vlore section, which would provide an important link to the Port of Vlore. In addition, the Bank will consider other priority road projects, such as the Durres – Kukes road link towards Kosovo in the north of the Country also in the context of regional integration of the transport network.
- The Bank is considering providing co-financing alongside the EIB for the construction of a passenger ferry terminal and upgrading of bulk cargo facilities at the Port of Durres. As part of the next stage of development of the Port of Durres, the Bank will consider opportunities to develop other port terminals on a PPP basis, subject to development of an appropriate legal framework and restructuring of the Port of Durres Authority.
- The Bank will be responsive to Government requests to support economically viable transport projects that help the Country to improve its transport links and facilitate development of tourism, particularly in the South of the Country. Where feasible, the Bank will consider supporting PPP structures for developing transport infrastructure.

Energy

- Albania's domestic production relies almost exclusively on hydropower. Growth in demand, losses and dependence on rainfalls mean that the country's domestic power supply will continue to be erratic and significantly supported by imports. To address the major issues, Bank has already committed itself to three projects in the area of generation, transmission and distribution, two of which are disbursing regularly.

- While the implementation of existing projects will continue to be a key priority, the Bank will continue to initiate projects which address these technical problems but which also support the restructuring efforts of the electricity sector and its regional integration. Thus, the Bank will also focus on supporting the integration of Albania's electrical system into the regional electricity network and with the Energy Community of South Eastern Europe ("ECSEE"). In this context, the Bank is considering financing USD 20 million for the rehabilitation of transmission substations. In addition, the Bank will consider further transmission investments aimed at building a new regional interconnection with FYR Macedonia, a project that would also benefit the broader Southeast Europe region. A feasibility study for this potential project is nearing completion.
- To improve distribution, besides funding technical upgrades, the Bank is ready to support privatisation of that sub-sector to a qualified strategic investor based on appropriate timing following required reforms and an open and transparent international competitive tender. The Bank will consider investing debt or equity in distribution companies to support the success of the privatisation.
- In other private sector projects, the Bank will support viable BOO/BOOT concessions for the construction of new small and large hydropower plants in Albania if such projects meet the Bank's concessions policy requirements. Where possible, the Bank will work to create viable structures for finance in the areas of energy efficiency and renewable energy.
- In parallel, the Bank will continue to require appropriate technical assistance for KESH to support continued institutional strengthening and achievement of the goals set out above. The Co-Management Assistance Programme the Bank required for its existing commitments, carried out by ENEL of Italy following an international competitive tender, has demonstrated that such assistance programmes can be successful. Indeed, KESH has made good progress over the last three years in the areas of collections and losses, among other vital operating areas.

Municipal and Environmental Infrastructure

- The sector suffers from lack of investment and deferred maintenance. Specifically, municipal services such as water supply, wastewater, urban transport and solid waste have significant investment needs. However, much of the investment would need to be linked to institutional, legal and regulatory reform to ensure that municipalities have predictable sources of independent revenues against which it is possible to borrow and that local level principles of cost recovery are observed at the level of the operating company.
- The development of a viable project pipeline in the municipal and environmental infrastructure sector will be a key objective for the Bank during the strategy period. The Bank is considering financing a EUR 8 million sovereign loan for a road development project with the City of Tirana. This would be the first operation in the municipal sector in Albania and will serve as a pilot project.

- There are potential opportunities in the waste water treatment and water supply sector where cost recovery is typically possible through appropriate tariff reform. Urban transport and solid waste investments will also be considered on a case by case basis. The Bank will work to create viable structures for the decentralisation and corporatisation of utilities. At a later stage, depending on the quality of the companies and the nature of support from municipal or central government authorities, the Bank may consider financing on a sub-sovereign basis. The Bank will assess the creditworthiness of municipally owned utilities and on this basis determine project viability.

3.2.2 Enterprise Sector

Transition Goals

- Restructuring and privatisation of remaining large state-owned companies including Altelecom and state refinery Armo are crucial to increase competition and efficiency.
- Albania is one of the smallest recipients of FDIs in the region, therefore a key challenge for the country is to facilitate and attract more foreign investments.
- Albania should focus on the development of the tourism industry to help the country's potential materialise.
- Despite the rapid increase of lending by local banks there is still a gap between the supply and demand for financing. The range of financial products is limited to highly secured loans. It is therefore an important challenge to provide more flexible financial instruments to support the expansion of fast growing local enterprises.

Operational Priorities

- The Bank's focus will be directed towards the support and facilitation of forthcoming large privatisations of the few remaining viable state-owned companies through a possible financing for the fixed-line telecom operator Altelecom and state-owned refinery Armo. In view of the imminent privatisation of the fixed line operator, the Bank is working to provide technical assistance support to the Regulatory Authority, in order to update and improve the legal framework on telecommunications.
- The Bank will continue to play a major role in promoting private sector development and FDIs' inflows over the strategy period through financing of existing companies, greenfield, or acquisition projects such as a new oil and gas storage facility in Vlore. It will support projects in retail industry as well as other possible proposals in the agribusiness and tourism industry.
- The Bank will support viable local enterprises with a new equity driven financing facility, the EBRD – Italy Western Balkans Local Enterprise Facility (the "Facility"), approved by the Board on 7 February 2006. The Facility will supplement existing financing products available for local enterprises and would

target private, local enterprises, well placed to grow in the local markets and/or with export potential in all sectors, from agri-business to tourism. In addition, the Bank will seek to improve corporate governance and increase management skills in local companies through technical assistance under the TAM/BAS programme.

- The Bank will continue to develop the policy dialogue with the Government, aiming at offering technical assistance to support institutional building and private sector development, through targeted improvement of the administrative and legal and regulatory framework.

3.2.3 Financial Sector

Transition Goals

- Access to finance particularly for SMEs is a major challenge of the financial sectors. While lending has increased rapidly, competition between banks has focused on larger local companies. Including SME financing into their focus is an important challenge for the banking sector. Within this framework, given the limited lending experience, improving banking skills of local bankers is paramount to building a good loan portfolio.
- Enforcement of the new insurance law and achieving real full independence of the Insurance Supervisory Authority remains an important challenge for the insurance market, in order to create a level playing field for insurance companies. Another important challenge is evidence from the Government of the intention to fully privatise INSIG with the objective of selling to a bona fide insurance investor, and to ensure that the insurance sector operates in an environment of fair competition, which will be key in attracting such strategic investor.
- There are currently 17 banks operating in Albania with many of them embarking into aggressive branch expansion strategies throughout the country. Future consolidation in the market is important in order to rationalise and improve the efficiency of the banking sector and the capital base of individual banks.
- Albania receives significant remittances from emigrants leaving abroad. The majority of these remittances enter the country through channels other than the banking system. Drawing these funds into the banking system is an important challenge for the country, especially as they would provide important foreign currency funds to a system which is experiencing substantial currency denomination mismatch between deposits and loan portfolio.
- Although capital markets are still an infant stage, it is important to create a strong legal and regulatory framework, in order to create the basis for alternative ways of access to finance for local businesses.

Operational priorities

- A prime objective of the Bank will be to renew its efforts to better serve the SMEs through local banks. The Bank will explore the possibility of providing dedicated SME financing facilities utilising local expertise in project identification. Another area will be the establishment of SME facilities combined with technical assistance with local banks to support and enhance their lending activity and improve the skills of local bankers.
- Furthermore, the Bank will (i) work on the full privatisation of INSIG through a successful restructuring under the pre-privatisation investment scheme, with the objective for a full sale to a strategic insurance investor within a clearly defined timetable; (ii) promote and offer support to the consolidation of the banking sector through mergers and acquisitions among local banks; (iii) support new local banks through equity participation; (iv) explore different schemes aimed at supporting micro-enterprise lending; and (v) look at the possibility of providing support to newly created leasing companies.
- The Bank will support within its mission initiatives aimed at channelling remittance through the local financial system. A study on this topic is currently under implementation with the objective to define actions and possible new products to develop in co-operation with local and foreign banks.
- The Legal Transition Team of the Bank will work to provide technical assistance support to the Albanian Security Commission aimed at improving the capital markets legal framework and create legislation on new capital markets instruments.

4. COOPERATION WITH DONORS AND OTHER IFIs

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

The Bank has been actively co-operating with multi and bilateral donors in reaching a long term solution to the country's energy crisis. The Bank is co-financing with the World Bank, EIB, Japan Bank for International Cooperation ("JBIC"), Swiss State Secretariat for Economic Affairs ("SECO") and Governments of Austria, Spain and three major projects for the rehabilitation of Albania's power system. In addition, the Bank put in place and administered a co-management assistance contract with ENEL of Italy to assist the Albanian Power Company ("KESH") through grant funding from Italy.

Co-operation continues in the transport sector, with the Bank co-financing with EIB and EU the rehabilitation of the Fier-Tepelene road following the completion of Elbasan-Librazhd road segment co-financed with Italy through the Italian Development Cooperation and the Central European Initiative ("CEI"). Another transport infrastructure project with co-financing from EIB is in preparation.

The Bank, in its quality as principal lender, successfully co-ordinated and signed a major Public Private Partnership ("PPP") project for the modernisation of the Mother Teresa International Airport. Co-financing was provided by DEG-Deutsche Investitions und Entwicklungsgesellschaft GmbH of Germany and local commercial banks.

Besides co-financing physical rehabilitation projects, the Bank is actively working with other donors to co-ordinate policy dialogue in order to provide a stronger and more efficient thrust to the reform process in the relevant infrastructure sectors. While co-operation in the public sector is working well, more has to be done in jointly pushing forward the implementation of projects and improving implementation capacities, given the general weakness of the local institutions and past experience with public projects.

The Bank also takes active part in the broader policy dialogue in Albania. The long-term policy objectives of the Albanian government are set in the National Strategy for Socio-Economic Development ("NSSD"), expressed in the Poverty Reduction Strategy Paper ("PRSP"), whereas the medium term operational objectives are summarised in the Medium Term Budget Programmes ("MTBP"), covering three-year periods and updated annually. The MTBP is published by the Albanian Ministry of Finance, after consultations with IFIs, interested donors and international organisations, to ensure sufficient resources are earmarked for the proposed undertakings. It includes a list of priority projects and reforms, along with partners supporting their implementation. In order to create a single assistance management strategy with a single point of contact with donors, the Council of Ministers launched the Integrated Planning System ("IPS"). The system is intended to co-ordinate national and assistance investment resources around an integrated, prioritised and budgeted strategy, which focuses strongly on the European integration agenda, and is in line with medium-term economic possibilities. It is also intended to cover the

whole cycle of management of assistance, from strategy and planning, implementation and monitoring, to evaluation, thus integrating a number of functions currently split between various ministries. The IPS aims to allow the government to prioritise its expenditure priorities for the progress of European integration, economic and social development and other political goals, but will require considerable political commitment if it is to be effective.

The MTBP reflects the long-term goals of the PRSP and is co-ordinated with the strategy documents published by IFIs, including the World Bank / IDA Country Assistance Strategy, the EU Annual Programmes, the EU European Partnership and the Multi-Annual Indicative Programmes and Annual Action Programmes, which are based on it, and the EBRD Country Strategy. The EBRD also participates in regular sector coordination meetings with government representatives, the EU, the World Bank and bilateral donors. The budgetary debate and the regular consultations led by the IMF form an additional platform for dialogue with the government and other IFIs to set investment priorities, coordinate donor activities, and consult proposed sovereign guaranteed investment projects. The Donors' Roundtable, serves as a platform to share information on available donor resources and activity plans. Finally, high level political dialogue also takes place within the various initiatives of the Millennium Development Goals and the Stability Pact for South Eastern Europe.

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

- Maintain a close co-operation with the World Bank, EU, EIB and other institutions in continuing a policy dialogue with the government on issues concerning the improvement of the investment climate. The Bank will also work with the business community to identify the existing impediments to private sector and especially SME development and to gain direct feedback on government policy and actions.
- Co-ordinate with the World Bank and the EU, as well as with other agencies actively involved in policy dialogue with Albania's authorities, projects involving private investors in developing and operating key areas of infrastructure and the assistance in sectoral reforms.
- Continue its co-operation with the IFC where appropriate in the financial sector.
- Continue the co-operation with the World Bank and bilateral donors for the restructuring and rehabilitation of the power sector.
- Continue close co-operation with the EU, EIB, World Bank and other potential donors in the transport infrastructure sector (roads and ports).

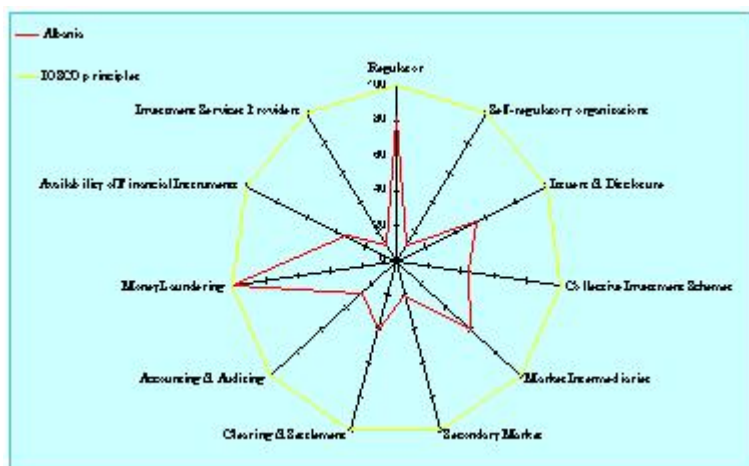
ANNEX 1 – Assessment of Albania’s Commercial Laws

The EBRD 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 the Albania, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Capital Markets

The main legislation governing the securities market is the Law on Securities of 1996, as last amended in February 2001 (the “Law on Securities”). The securities market regulator is the Albania Securities Commission (“ASC”), established pursuant to the Law on Securities. The ASC consists of seven commissioners, appointed by Parliament for a five-year term. The Tirana Stock Exchange was established in 1996. Since then it has had very limited trading activity - mainly treasury bonds and privatisation vouchers - and does not appear to be currently active. As a result, the Albanian financial system is currently centred on banks, while the equity market is remarkably underdeveloped.²

Quality of securities market legislation – Albania (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

The results of the EBRD’s 2004 assessment on securities markets legislations ranked Albania bottom out of all the countries in South-Eastern Europe. Albanian legislation rated “low compliance” when benchmarked against the IOSCO Principles, showing an urgent need for reform. The assessment was updated in 2005 and the results confirmed the low compliance rating.

In particular, the law does not contain adequate provisions concerning self-regulatory organisations and the regulation on market intermediaries and on secondary market was found to be weak in many respects. Clearing and settlement of securities is not well detailed in the law and the lack of implementing provisions renders the framework inadequate. When considering accounting and auditing, the assessment again revealed a framework in urgent need of reform. In this respect, a new law establishing auditing standards will enter into force in 2006 and should improve the framework.

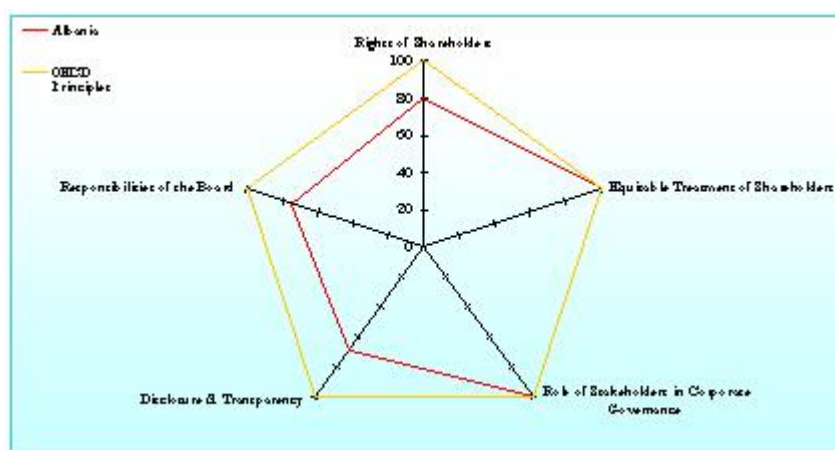
² In 2002, bank assets counted for 98.1 % of the assets of all financial intermediaries - the highest in South-Eastern Europe (SEE) - while the stock market capitalisation is the lowest in SEE (IMF Working paper “Early Birds, Late Risers, and Sleeping Beauties: Bank Credit Growth to the Private Sector in central and Eastern Europe and the Balkans” – 2003)

Finally the regulation of financial instruments is limited and there is no definition of investment service provider.

Company Law and Corporate Governance

The Law on Commercial Companies (the “Company Law”) was enacted in 1992 and most recently amended in 1996. According to the Company Law, a company can be established as a general partnership, limited partnership, limited liability company, joint stock company (JSCs) or a limited partnership by shares.

Quality of corporate governance legislation – Albania (2004)



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 approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2004

According to the 2004 results of the EBRD's Corporate Governance Sector Assessment Project, under which corporate governance related “laws on the books” were assessed, Albania was rated as having achieved “medium compliance”, when compared to the OECD Principles of Corporate Governance. As shown in the chart above, some weaknesses were found in the “disclosure and transparency”, “responsibilities of the board” and “rights of shareholders” sections.

Amongst other things, the assessment evidenced that financial and operating data are not prepared and disclosed in accordance with internationally recognised accounting standards, that the law does not provide a test to ensure the independence of the auditor and is silent on the Board’s functions and responsibilities to ensure the integrity of the company’s accounting and financial reporting systems and independent audit. Finally, the law does not require the Board to have separate committees for dealing with financial reporting, executive and board remuneration and board nominations or to include a sufficient number of non-executive and independent directors.

In 2005, the EBRD launched a survey to test 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 can be complex, especially if the company and/or the controlling shareholder refuses to spontaneously collaborate with the minority shareholder. The absence of case law offering guidance to the interpretation of the law negatively influences the clarity of proceedings. The time needed to obtain an executable judgement might be in the region of 18 months but it is easy for the defendant to delay the process. Enforceability of judgements is however not reported as a major problem. Turning to the institutional environment, the survey found that company information is

generally not reliable while 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. In conclusion, the effectiveness of corporate governance legislation in the country is generally low.

Concessions

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

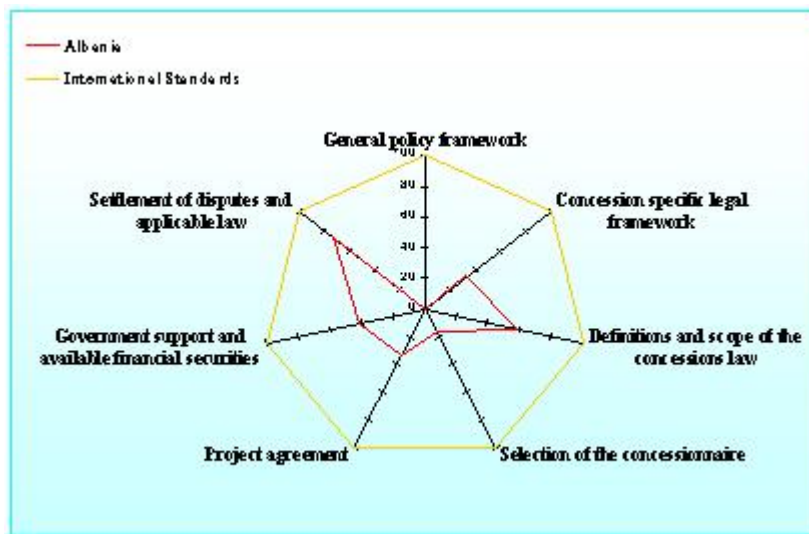
The Concessions Law clearly defines its scope of application and is one of few of its kind in the region to specifically regulate government support to concessions and provides for security to be provided by the concessionaire (e.g. mortgage of concession companies' properties), although the substance of such regulations need improvement. In addition, the Concessions Law clearly states that its aim is the participation of the private sector in public services and infrastructure. The Concessions Law provides for an exhaustive list of sectors that may be developed on a concession basis.

The Concessions Law lacks comprehensiveness, particularly where procedures are concerned. Specifically, it does not provide any detailed rules regarding tendering or concession agreements. Rules governing selection process are currently rather ambiguous and incomplete, there are no requirements for a pre-selection or shortlisting of bidders, publication of the criteria, evaluation of proposals or publication of the notice on the concession award. Furthermore, no reference is made to the publication/record of concession award, grounds for direct negotiations and regulation of unsolicited proposals are unclear, and no mention is made of possible review procedures. Provisions regulating the project agreement and lenders' rights need to be improved (termination/compensation provisions, possibility for "step-in" rights).

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

The recent EBRD Assessment of Concession Laws undertaken to evaluate applicable regimes throughout the EBRD's 27 countries of operations (the laws on the books only rather than how they work in practice), revealed that Albanian laws had “low compliance” with internationally accepted standards in this sector. As can be seen from the spider graph below, while rules covering definitions and scope of the law as well as those governing settlement of disputes in concession-related arrangements are regulated fairly extensively, most other areas, in particular, selection of a concessionaire, regulation of project agreement and availability of financial instruments and state support need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating private sector participation. One more dimension that will inevitably require the attention of the authorities is a policy framework, the absence of which makes any law, even an ideal one, extremely difficult to implement.

Quality of concession legislation –Albania (2005)



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.

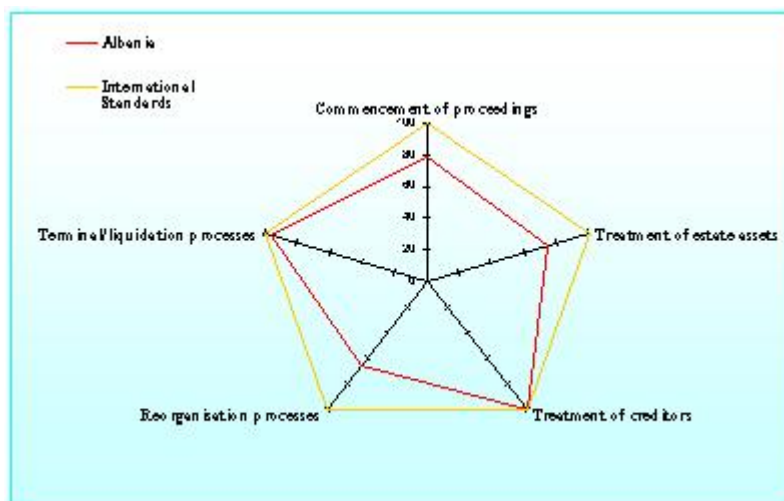
Source: EBRD Concessions Sector Assessment 2005

Notwithstanding numerous deficiencies, since its enactment, a notable number of concessions have been granted under the Concessions Law, in particular at a municipal level, including to foreigners. However, the practice of concession granting has been criticised in the country and its application for the past three years is regarded as controversial. This is possibly related to the actions of the former government, although the above analysis leaves an impression that both the PPP policy and legal framework require serious revision.

Insolvency

Bankruptcy and insolvency in Albania are governed primarily by the Law on Insolvency Proceedings of the Republic of Albania, (as last amended in 2002) (the “Insolvency Law”), one of the leading insolvency laws in the EBRD’s countries of operations. In the EBRD’s 2003-04 Sector Assessment Survey, which measured the compliance of insolvency legislation with international standards in 97 different areas, the Insolvency Law was one of only 6 laws in the Bank’s 27 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.

Compliance of the Albania’s Insolvency Law with International Standards Quality of insolvency legislation – Albania (2004)



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 Project, 2003/4

The Insolvency Law is one of few in the EBRD's countries of operations providing clear provisions, broadly consistent with international standards, to deal with the commencement of proceedings, the hearing and determination of initiating applications, involvement of creditors and avoidance of pre-bankruptcy transactions.

However, achieving a high score is not intended to suggest that a given law is perfect but, rather, that it substantially complies with a number of critical elements of international standards in insolvency. Even a law that achieved "full compliance" would still require improvement. Similarly, the Insolvency Law could be significantly improved in a number of ways. Among other things, the law could be clearer on what happens to the enforcement rights of secured creditors (under contract) when insolvency proceedings have been commenced. The law is also unclear as to how a debtor company is to be managed during an insolvency. The two types of management that are most often used are either debtor-in-possession management or management through an insolvency administrator. Both are consistent with international standards but it is critical to specify which system is being used under a given law. Finally, the law needs to impose much clearer obligations upon officers and directors of insolvent companies to turn over information about such companies (books, records, etc.) to the relevant court or functionary.

Assessing the state of insolvency legislation in Albania provides only part of the picture. It is also necessary to look at the practical functioning of the insolvency regime (the "effectiveness" of the regime).

The EBRD 2004 Legal Indicator Survey on Insolvency, which examined the effectiveness of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies, revealed that for debtors and creditors seeking to commence insolvency proceedings in Albania, it is relatively easy to determine which court such proceedings should be commenced in. For both parties, however, the process is too expensive and, for creditors, unacceptably slow. The survey also revealed that there is very little consistency between judges in the application of the law and that the rule of law is not often effectively applied.

In general, Albania suffers from a large "implementation gap" (the difference between the quality of the legislation and the effectiveness of the insolvency regime in practice). This gap suggests that Albania's legal system is not able to effectively implement such a good law and underscores the need for further reform work to be done to strengthen courts and other institutions that implement insolvency legislation.

Secured Transactions

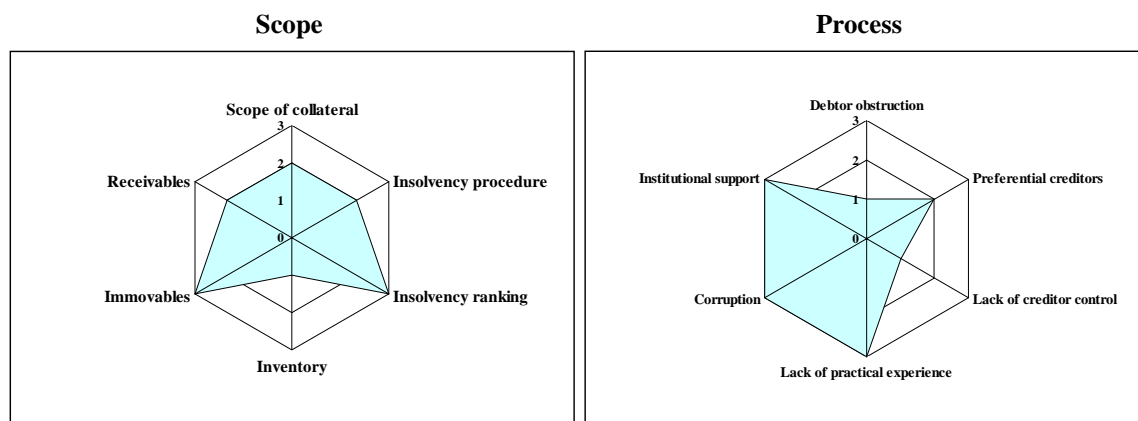
Security over movable assets in Albania is governed by the 1999 Law on Securing Charges, which was fully implemented in 2001. Taking security over immovable assets (mortgage) is governed by the Civil Code (art 560-607). Charges over immovable property must be registered in the local registry for immovable 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 agricultural machines, aircraft, aircraft engines, automobiles, boats, construction machines, motorcycles, motor vehicles, trailers and trolleys. 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 experiences 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 found in enforcement.

The legal provisions aimed at providing a fast and efficient system. According to those provisions, upon a debtor’s default, the chargeholder has an automatic right to obtain a court order, which will empower an execution officer (bailiff) to take possession of the charged assets. Realisation can then take place by way of a private sale or public sale, including public auction or closed tender, as a whole or in commercial units or part. However, as the EBRD-led survey conducted in 2003 showed, execution officers 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 risk of corruption issues.

However, this may be set to change as the World Bank is supporting an important overhaul of the judiciary in Albania, affecting the courts as well as the execution officers.

Obstacles to charge enforcement process – Albania (2003)



Note: The fuller the web, the more serious the problems are in each of the respective categories. “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

Source: EBRD Legal Indicator Survey 2003

Telecommunications

The telecom sector in Albania is currently regulated by the Telecommunications Regulatory Entity (“TRE”) and is governed by the Law on Telecommunications 2000. The TRE is accountable to the Albanian legislature and implements policies set by the Ministry of Public Works Transport & Telecommunications (the “Ministry”). The TRE was formed as an independent self-financing entity, designed to promote transparency and investment within the sector. The Law on Telecommunications 2000, drafted with assistance of the EBRD, provides a relatively modern framework for the implementation of the government policy and lays out the key requirements for development and minimum standards within the sector.

The telecom sector generally reflects the underdevelopment and underinvestment evident across utility infrastructure in Albania. With less than 10% fixed-line penetration, Albania is one of the lowest levels in Europe. This generally low fixed-line rate has, however, been somewhat offset by fairly vigorous growth in the mobile sector. That sector was kick started by the privatisation of the state-owned cellular operator AMC in 2000 and followed by the introduction of a second GSM operation (Vodafone Albania) in 2001. Recent figures show an approximate 45% market penetration rate in the mobile sector.

For its part, the Government of Albania (the “Government”) has been engaged in a programme of sector development for a number of years, with some early success achieved through the adoption of a forward looking sector policy and modern law in 2000. However its successes in mobile do not appear to have followed through to the fixed sector. Here reform and growth appear to have stalled on the back of efforts to privatise incumbent majority state-owned fixed line operator Altelecom. The

latest privatisation tender was administered shortly before the recent Albanian general election. While a winner was declared before the election, the new government has been reviewing the result of the tender and the outcome is currently unclear.

While policy and legislative reforms at the close of the 1990s brought Albania closer to modern standards, implementation of this policy and legislation has been painfully slow, with very little progress achieved in the passage of the necessary secondary legislation and regulatory mechanisms. In particular, appropriate mechanisms for interconnection and tariffing are notably absent. The market has also moved on from that reflected in the current policy and law and these documents need updating. While a regulatory authority formally exists, its capacity to implement and enforce the modern framework is severely constrained by absence of the necessary secondary legislation. Similarly, the limited resources of TRE impacts upon their ability to address the challenges facing the sector and support appropriate reform.

Although the Government and TRE appear to have begun making serious efforts to progress development of the legal, policy and regulatory environment, these efforts have yet to yield meaningful results. Allied to this, the uncertainty over the privatisation of Albtelecom is casting a shadow over the development of the sector. Accordingly, the authorities should re-double efforts to rapidly implement an appropriately updated legal and policy framework for the telecom sector, by providing TRE with full support and resources necessary to carry through with necessary reforms. Similarly, the Government should take immediate action to resolve the delays in completion of the privatisation of Albtelecom.

ANNEX 2 – Political and Social Issues

Political Background

Albania is a republic with a single-chamber parliament of 140 deputies – 100 elected directly and 40 by proportional representation from party lists. There is a President and a Prime Minister both elected by parliament. Albania's current Constitution was adopted in a referendum in November 1998 and replaced an interim document that had been in force since the abandonment in April 1991 of the previous Communist constitution. The 1998 Constitution gives the largest share of power to the Prime Minister and the government. The Presidency is largely a ceremonial position with limited powers. The Constitution provides for an independent judiciary, but corruption and political pressure have until now limited its power to act independently and efficiently. The political climate in the parliament has been volatile. Opposing political parties, the Socialists (successors to the Communists) on one side and the Democratic Alliance Party on the other, have often ended up being unable to agree on important laws, which has sometimes resulted in key legislative initiatives being slowed down or stalled.

Parliamentary elections in July/August 2005 led to the defeat of the Socialists who had been in power since 1997. Former President Sali Berisha's Democratic Alliance Party and its allies gained 80 seats compared with 60 for the Socialists and the other parties. On the basis of a comfortable working majority in parliament, the DAP-led government took office on 30 September 2005, following complaints that the losing parties had delayed the handover of power far too long. The new coalition government reduced the number of ministries from 17 to 14. Berisha's party took 10 ministries; the other four went to its small coalition partners.

The government announced as its top priority the fight against corruption and organised crime. Its predecessor, the government headed by Fatos Nano was generally regarded as very corrupt. Nano resigned from the leadership of the Socialist Party in the wake of the party's electoral defeat and the election at the party's congress in October of Edi Rama, the pro-active and popular Mayor of Tirana, as his successor. The local elections, due in 2007, will show the extent to which the notoriously fragmented Socialists have under their new leadership recovered their ability to challenge the Berisha government.

International Relations and Regional Cooperation

EU and NATO membership have been the central aims of Albanian foreign policy since the fall of Communism and will remain so under the new Berisha government.

Talks about a Stabilisation and Association Agreement ("SAA"), seen as the first step on the road to EU membership, began in January 2003, but in March 2004 the European Commission expressed numerous concerns about the slow pace of reform in Albania. In mid-September 2004, in its strongest criticism of the reform process until then, the EU made it clear that failure to hold in 2005 parliamentary elections, fully in compliance with international standards, would represent a serious setback to Albania's relations with the EU. That and numerous other warnings received

bilaterally from individual EU member governments were taken seriously not only by the Socialist government but also by the opposition. According to the European Commission's 2005 Progress Report, published on 9 November 2005, on Albania's bid to join the EU, the Albanian parliament had been acting as a real forum for political exchange. By the time of the 2005 elections, it had approved a number of significant laws such as a law on property restitution and compensation, amendments to the electoral code and a package of laws designed to fight organised crime and terrorism. Parliament also approved new rules of procedure in order to make its decision-making mechanisms more efficient and transparent. The establishment of Legal Reform Commission was an important step aimed at improving the quality and transparency of the legislative process. Held on the basis of a newly revised Electoral Code, the parliamentary elections, while in the view of independent observers (including those from the EU) lengthy and imperfect, were conducted in line with the Electoral Code and led to a smooth transfer of power to former President Sali Berisha's Democratic Alliance Party.

The negotiations for a SAA have been concluded and the agreed text was initialed on 18 February 2006. The text has now been proposed for signature to the European Council. Despite the more optimistic tone of the European Commission's 2005 Progress Report on Albania and the EU, it remains to be seen whether the government will be able to implement changes requested by the EU and do better than the Nano government in a number of areas, notably that of the fight against organised crime. The European Commission 2005 Report also noted that Albania had made progress in improving the oversight, recruitment and training of civil service and taken steps to enhance its legal framework. In a reference to the country's judicial system, the Report says that some progress has been made towards improving its functioning, in terms of its organisation and transparency and in some other respects. However, implementation of criminal justice remains weak; enforcement of judgements, while improving, is still low and transparency should be improved.

Albania has a close relationship with the US. It signed in 2003 an agreement with the US not to extradite US citizens to the International Criminal Court ("ICC") at The Hague. Also in 2003 it signed, together with Croatia and Macedonia, the US-Adriatic Charter. It supports the US war in Iraq and in October 2005 sent a fresh, 120-strong contingent of troops there, sixth since April 2003. The US backs Albania, which already belongs to NATO's Partnership for Peace Programme ("PfP"), for full membership of NATO. The 2004 NATO summit in Istanbul failed to name a date for Albania's membership but the matter is under constant review in the context of applications by two other countries: Croatia and Macedonia. NATO has 1,200 troops in Albania as a backup for its K-FOR troops in Kosovo. Turkish and Italian naval vessels are stationed around the Vlore and Durrës coastal areas. Albania's most important bilateral relationships are with Italy and Greece, its leading trade partners. The Italian army intervened in defence of the civil order both in 1991-92 and again as part of an international force during the civil unrest following the collapse of widespread pyramid schemes in 1997. Albania has a large number of citizens working in Greece and Italy and receives large amounts in remittances from them.

Albania has been playing a constructive role in the Balkans ever since the start of armed conflict there in 1991. In 2001 it supported the Ohrid Agreement which ended the conflict with ethnic Albanian guerrillas in neighbouring Macedonia (or the Former

Yugoslav Republic of Macedonia). At the start of talks about the future status of Kosovo in November 2005 the Berisha government expressed support for conditional independence for the province, but made it clear that it has no aspirations towards 'Greater Albania'. Albania has free-trade agreements with the Former Yugoslav Republic of Macedonia, Kosovo, Serbia and Montenegro, Bosnia and Herzegovina, Croatia, Bulgaria and Moldova. It takes part in the South-East European Cooperation Process ("SECP"), the Stability Pact, the South Eastern European Initiative ("SEEP"), the Adriatic Ionian Initiative, the Black Sea Economic Cooperation ("BSEC") the South-East Cooperation Initiative ("SECI") and the Border Security Initiative.

Integrity Issues

Corruption is widely perceived both by the population and outsiders as a serious problem. So much so that Sali Berisha's Democratic Alliance Party owed much of its success in the 2005 parliamentary elections to making the fight against corruption a central plank of its campaign. However, even before the elections and the subsequent change of government, some efforts have been made to fight corruption, according to the European Commission's 2005 Progress Report on Albania. For instance, the work of the Anti-Corruption Monitoring Group is continuing; Albania is participating in the Council of Europe Group of States against Corruption ("GRECO"); new laws dealing with conflict of interest have been passed; there has been an increase in the number of prosecutions of public officials for corruption (171 in 2004, up from 76 in 2003 and 58 in 2002) and in strong action against police corruption; a number of international anti-corruption conventions have been ratified. However, deficiencies in the implementation, enforcement and coordination of efforts have remained and the perception of the country in that regard remains poor. According to the Report, tangible results in the fight against corruption remain poor despite the active support of the international community for Albania's anti-corruption strategy.

Security has improved in many parts of Albania since the disturbances of 1997 as reflected in the relative lack of violence in the 2005 election campaign. Organised crime presents a serious problem in some areas. Some improvement in the law and order has been due to international pressure. However, Albania is largely a staging post for smuggling, mostly aimed at places farther afield. Trafficking in persons, particularly women and children, remains a problem, according to the US State Department's 2004 report on human rights practices in Albania, published in February 2005. Under the Criminal Code penalties are high for trafficking for sexual exploitation or forced labour. In October 2004, parliament approved a new law that mandates the sequestration and confiscation of assets if their source comes from organised crime and trafficking. During 2004, according to the Prosecutor's Office, there were 234 ongoing trafficking in persons cases and 362 individuals were convicted of trafficking in persons during the year. However, the prosecution of traffickers remains a problem. Some of them end up being let off for lack of evidence or, if prosecuted, get charged and sentenced for lesser crimes. The country is both a source and a transit country for women and children trafficked for the purposes of sexual exploitation and forced labour. Traffickers largely used overland routes such as Albania-Macedonia-Greece or Albania-Montenegro or falsified documents to transport their victims by plane or ferry.

Social Issues

Population. Albania ranks low in comparison with other Southeastern and Central European transition countries in terms of commonly used living standard and human development indicators. According to official statistics, Albania's resident population at the time of the official census in 2001 was 3,069,000, or 3.6% lower than in the previous 1989 census. It is estimated by the Albanian Institute of Statistics that the population has grown since then (by 1.1% in 2003). The decline in the 1989-2001 period reflected both falling birth-rates and large-scale emigration. The average life expectancy at birth is 74.3 years. There were 42.8% fewer births in 2003 than in 1990. Almost one million Albanians are believed to have emigrated since 1990 – mostly to Greece, Italy and the United States, according to the Albanian Ministry of Labour and the International Organisation for Migration. Emigration and lower birth rates have led to a marked decrease in the percentage of the population aged under 34 – from 69.2% in 1969 in 1990 to 59.3% in 2004. The domestic labour in February 2005 force was 35.1% of the total population in 2003. The majority of the population still lives in rural areas, but the share of the urban population has increased dramatically from 35.8% in 1990 to 44.5% in 2004. The population of the capital, Tirana grew by 41% between 1989 and 2001.

Constitutional protection under the 1998 Constitution applies to all of the country's minorities – Greek, ethnic Macedonian, Montenegrin, Vlach (Armenian) and Roma. However, according to the latest (2004) US State Department report on human rights practices in Albania published in February 2005, social discrimination persists against members of the minority populations – particularly against the Roma. To help deal with the problem the government established in March 2004 the State Committee on Minorities composed of representatives of various minority communities. The Greeks are the largest national minority followed by small groups of Macedonians and Montenegrins, Vlachs, and Roma and Egyptians. The ethnic Greek minority, led by the cultural association Omonia, pursues grievances with the government concerning electoral zones, Greek-language education, property rights and government documents. As a result of the official ban on religion imposed by the Enver Hoxha in 1967, Albanian society is highly secular. Religious affiliation has not been officially measured for decades but 70% of Albanians are estimated to be of Moslem origin, some 20% Orthodox and 10% Roman Catholic.

Civil society in Albania remains weak. Various actions have been implemented by civil society organisations in order to contribute to the development of the country. Initiatives have been undertaken to encourage collaboration between state institutions, ministries and civil society organisations, involved in the drafting of national strategies in relation to important social areas such as children and anti-trafficking. The greater pressure exerted by the civil society has been considered as a positive step influencing the public awareness and encouraging the civic engagement for more participation in governmental decision-making. In addition, this has been seen as an opportunity for the citizens to voice out their concerns and problems leading for the first time to not-politically motivated public protests. Two major trade union federations act as umbrella organisations for most of the country's unions: The Independent Confederation of Trade Unions of Albania (around 75,000 members) and the Albanian Confederation of Trade Unions (around 100,000 members). There has

been a drop in union numbers during transition. Some unions do not belong to either of the above bodies.

Education. Schooling is free and compulsory for children between six and fourteen and free until the age of 18. According to a UNDP report in 2004, the drop-out rate which was 1% in 1980 rose at the start of transition peaking at 6.3% in 1991. This was due to external and internal migration, increase in the cost of schooling and the weakening of government bodies enforcing compulsory education. The drop-out rate went down to 2% by 2003 but an INSTAT study in 2002 showed that only 63% of the 14-year-olds finished compulsory education on time. Illiteracy, eradicated during the Communist era, has reappeared. The main reason for the high level of incomplete schooling is poverty as families in rural areas are forced to use children as labour. The attendance rate for girls drops as they reach puberty. The average ratio of pupils per teacher in secondary education is 18.9, which is above the OECD average of 13.9. The enrolment ratio in tertiary was 15% in 2003. Public university education is free and admission is limited by testing. Two private universities exist in Tirana but the numbers attending are modest. Paying students account for about 10% of all students in public universities. An estimated 5,000 students study abroad each year, the majority never returning to Albania. Education has been made a priority in the national strategy for social and economic development launched in 2001. However, government spending on education fell from 3.4% of GDP in 1999 to 2.85% of GDP in 2003. Salaries of teachers have been increasing more rapidly than those of other public-sector workers in order to stop them from leaving. Strikes by teachers have been a factor in those rises.

Health. 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. The public health system suffers from lack of investment, loss of qualified medical staff to the private sector and a large-scale reduction in staff in remote areas. According to the Economist Intelligence Unit, Albania has 1.3 doctors for every 1,000 people, less than half the EU rate of 3 per 1,000 people. Recent improvements in health are partly due to assistance from WHO and UNICEF. Infant and mortality rates have fallen but remain high in comparison with other European states. Tuberculosis, eradicated during the Communist era, has re-appeared a result of poverty and overcrowding in major cities. Health services are financed by a mix of taxation, statutory health insurance and donor funding. Over the past decade Albania has spend an average of 2.2% of GDP each year on healthcare compared with an average of about 4% in other transition countries. Health, like education, is a priority for the authorities but budgeted health spending is often cut abruptly in response to revenue shortfalls.

ANNEX 3 – Transition Challenges

Albania faces a number of important transition challenges in all sectors. The assessment below is an updated version of the 2005 Assessment of Transition Challenges.

Specialised Industries

General industry: Serious problems in general industry reform are related to weak law enforcement, corruption, and large share of GDP generated by informal economy (estimated at close to 30 per cent of recorded GDP by the OECD). The government efforts to improve business environment, such as the introduction of new competition legislation and establishment of an independent competition authority, are hampered by the weak implementation capacity of the public sector. Many enterprises need to be restructured to improve their competitiveness, and standards of corporate governance and business conduct are low. Enterprises are mostly family owned and managed, and prefer to work through informal channels, using social networks for investments in new business ventures, procurement, marketing and sales activities and relying on trust and peer pressure to deliver goods and services according to unwritten agreements. The quality of the judiciary is low and there is little confidence in the system which is seen as corrupt, slow and complex.

Agribusiness: All agricultural producer and consumer prices have been liberalised and import tariffs are gradually being reduced. The comprehensive re-distribution of state agricultural land has been completed, but much of this land still lacks secure and unambiguous property rights. Legal and administrative procedures resolving ownership disputes remain weak. There has been limited foreign investment in the sector. The companies are hampered by outdated equipment, lack of credit, low quality standards and a weak understanding of competitive markets. Rural credit is slowly becoming available outside micro-credit type schemes, but access to credit for farmers remains limited. Agricultural sector accounts for about a quarter of GDP and is not taxed.

Natural resource sector: The natural resources industry in Albania is small and concentrates on chromium, bitumen, copper and nickel. Although a number of small foreign and domestic private companies operate in the sector, regulation is very poor and environmental protection remains a serious concern. The sector is in need of regulatory reform and further investment. The privatisation of the oil and natural gas extraction firm Albpetrol is progressing. The privatisation of Albanian Refining and Marketing Oil (“ARMO”), however, requires re-launching due to the lack of investor interest.

Property and tourism: Tradability of land is limited de facto. There is little state interference in terms of subsidies and regulatory control. Unclear land ownership in major urban and coastal areas continues to hinder economic development, with only about 18 per cent of immovable property properly registered. In contrast, registered land in rural areas accounts for 80 per cent of the total. A new law on the restoration and compensation of property was adopted in July 2004. Nevertheless, the implementation methodology was not approved until April 2005. In addition, law enforcement administration remains weak and under-funded, and the compensation

mechanism for owners who cannot reclaim their land is uncertain. There is rapidly expanding private construction sector, to a large extent financed by remittances. The law on the legalisation of recently-constructed unauthorised real estate, adopted in October 2004, is also being implemented. About 50,000 requests for legalisation were made by the March 2005 deadline. However, there have been an estimated 300,000 unauthorised buildings constructed in recent years. The construction boom is now subject to greater regulation: illegally constructed buildings in central Tirana have been demolished over the last few years and planning requirements are being enforced to a greater extent than in the past. There is little progress in the restructuring and expansion of the tourism sector, including introducing new products and financing methods. The coastal areas suffer from pollution and unregulated construction activities. Lack of infrastructure provision hinders the development of the tourism sector.

Infrastructure

Power sector: Unbundling of the sector has been recently implemented. A co-management assistance contract to KESH with ENEL, the major Italian power utility, which was in place from 2000 to 2004, contributed significantly to improving KESH performance. Electricity prices have increased substantially over the past five years to reach about 6 US cents/kWh by the end of 2004. Tariff increases should continue for the following years as established in the Power Sector Action Plan 2005-2007. Significant progress has been made in terms of increasing collection rates and reducing transmission and distribution losses. Management improvements and investment in the power system have cut the number of large-scale structural blackouts but a combination of draught in the summer of 2005, a fire at one of the main hydropower generating company, and the lack of proper forward planning related to imports of electricity resulted in several weeks of blackouts of up to 20 hours a day throughout the country in November 2005. The situation has improved since then substantially as new power import contracts were signed and the water level in main hydropower plants increased. However, the reliability of the supply network remains well below international standards, localised blackouts are occurring frequently and large scale power cuts can be repeated again. An independent regulator is in place, but is still very weak.

MEI sector: The control of many of the municipal services has been transferred to the local authorities. Urban transport is partially operated by private companies but most of the municipal services remain disorganised and require substantial reform, including tariff increases, commercialisation and adequate regulation. There are no wastewater treatment facilities.

Energy efficiency: The energy efficiency sector is at a very early stage of development. Security of supply, appropriate tariff structure, full commercialisation and adequate regulation appear necessary preconditions for the sector to operate.

Telecommunications: In June 2005, the government approved the sale of the state-owned fixed-line telecommunications operator Albtelecom. The Turkish Calik Energy Telecommunication won the right to acquire a 76 per cent stake in the company for EUR 120 million, with the state retaining 24 per cent. As part of the privatisation, Albtelecom was awarded Albania's third mobile telephone licence, allowing it to

compete directly with the two incumbent providers. However, in mid-October 2005 the new parliament rejected the ratification of the privatisation contract and decided to hire an international consultancy to review the agreement and the tender procedure. The tendering for the consultant to review telecom privatisation was ongoing as of mid-March 2006. Managing the increased competition in this sector, particularly interconnection between operators, will be challenging for a regulatory framework that is weaker than in other transition countries. Whereas an independent regulatory authority exists formally in Albania, its capacity to implement regulatory reforms is severely constrained by the absence of adequate expertise and resources and the lack of commitment from the government to address these issues and support the implementation of regulatory reforms (e.g. interconnection, tariff reform and universal access). Fixed line tariffs are low and unbalanced, both with respect to services and customers type. Fixed-line penetration is about 7.5 per cent, but the expanding mobile penetration is around 45 per cent.

Transport: Transport sector is inadequate and requires substantial investments. In railways, operating and policy setting functions are not separated and core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. In roads, the divestment and commercialisation of construction companies are in progress, but there is limited competition and privatisation. Road sector financing remains unreformed. An important boost to the reform has recently been provided by the private concession to rehabilitate the Tirana international airport, achieved through a transparent international tender process. Also, a number of port terminals are operated by private companies.

Financial Institutions

Banking sector: The country has a low level of financial intermediation, but the recent privatisation of the country's largest bank, the Savings Bank, puts the entire sector under private management. Financial supervision has been improved, but intermediation is impeded by the poor legal and regulatory infrastructure. There are, for example, still issues regarding excessive documentation by the central bank on credit applications which may impede the development of consumer finance, and excessive request of collateral. Following the completion of banking privatisation, the credit to the private sector is growing very fast. Total loan portfolio almost doubled in 2005, but still reaches only about 14 per cent of GDP as of end of 2005, out of which credit to private enterprises accounts for about 10 per cent of GDP and lending to households for about 4 per cent of GDP. About 90 per cent of credit is secured by collateral and about 80 per cent of loans are denominated in foreign currencies. The share of non-performing loans is low at approximately 4 per cent of the total. Interest rates on new loans have decreased substantially as a result of increased competition. Competition however, is mainly focused in the large enterprise sector lending, with local banks reluctant to lend to smaller businesses. Informal lending, particularly among the micro and small enterprises, is still prevalent. However, there is some evidence, based on surveys regularly commissioned by the Bank of Albania, of enterprises moving from informal credit providers, i.e., friends and family, to the formal sector. Increasing domestic bank lending to private sector, particularly to SMEs, is an important challenge in the financial sector.

Non-bank financial sector: Securities markets legislation and regulation need substantial strengthening in the areas of disclosure obligations, accounting and auditing standards, and the implementation of a strong framework for securities trading on the secondary markets. In the insurance sector, new insurance law has strengthened the legal and regulatory environment but effective implementation remains a challenge. New leasing legislation is being prepared and may help develop a small leasing market. The stock exchange mainly consists of foreign currency trading and insurance market is very small. The state-owned insurance company INSIG has been partly privatised through the involvement of EBRD and IFC. There are no restrictions on foreign entry into the non-banking financial sector.

Private equity fund sectors: The country has not yet developed a class of private equity managers with local expertise or investors willing to invest in private equity funds operating in Albania. The understanding of the equity funds as a tool to provide finance to enterprises is yet to develop.

MSMEs: Starting a business is costly: it takes 11 different procedures, an average of 47 days and over 32 per cent of average income to register a new company. Corruption, nepotism and political patronage represent serious constraints to MSME development, affecting entrepreneurs' willingness to register their businesses and raising the cost of doing business. The tax system is perceived as very non-transparent by MSMEs. No credit registry or private credit bureau exists. Bankruptcy legislation is in place but the lack of effective land registries and cadastres has often precluded firms from using property as collateral. As a consequence commercial banks traditionally require high levels of collateral, thus affecting the ability of firms to borrow from formal channels. A system of immovable property registration has been recently established. A microfinance bank has been lending for six years to micro and small enterprises. There is very little lending from other commercial banks to the MSME sector.

ANNEX 4 – Selected Economic Indicators

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 <i>Estimate</i> | 2006 <i>Projection</i> |
|--|-------|--------|--------|--------|--------|-------------------------|---------------------------|
| Output and expenditure <i>(Percentage change in real terms)</i> | | | | | | | |
| GDP | 6.5 | 7.1 | 4.3 | 5.7 | 6.7 | 5.5 | 5.0 |
| Private consumption | 5.3 | na | na | na | na | na | na |
| Public consumption | 7.4 | na | na | na | na | na | na |
| Gross fixed capital formation ¹ | 17.9 | na | na | na | na | na | na |
| Exports of goods and services | 5.8 | na | na | na | na | na | na |
| Imports of goods and services | 6.5 | na | na | na | na | na | na |
| Industrial gross output | 0.5 | 7.1 | -7.9 | 2.7 | 3.1 | 4.0 | na |
| Agricultural gross output | 4.5 | 2.2 | 2.1 | 3.0 | 3.8 | 3.0 | na |
| Employment² <i>(Percentage change)</i> | | | | | | | |
| Labour force (end-year) | -1.8 | -3.0 | -12.2 | -0.3 | -0.8 | 0.9 | na |
| Employment (end-year) | 0.2 | -13.8 | 0.0 | 0.7 | -0.4 | 0.9 | na |
| <i>(In per cent of labour force)</i> | | | | | | | |
| Unemployment (end-year) | 16.8 | 14.5 | 15.8 | 15.0 | 14.5 | 14.7 | na |
| Prices and wages <i>(Percentage change)</i> | | | | | | | |
| Consumer prices (annual average) | 0.1 | 3.1 | 5.2 | 2.4 | 2.9 | 2.3 | 3.0 |
| Consumer prices (end-year) | 4.2 | 3.5 | 1.7 | 3.3 | 2.2 | 2.0 | 3.0 |
| Producer prices (annual average) | 5.0 | -5.8 | 6.5 | 6.7 | 12.4 | 2.5 | na |
| Producer prices (end-year) | na | -4.0 | 11.2 | 5.0 | 12.3 | 2.4 | na |
| Gross average monthly earnings in economy (annual average) | 19.7 | 24.7 | 11.7 | 10.0 | 6.0 | 7.3 | na |
| Government sector <i>(In per cent of GDP)</i> | | | | | | | |
| General government balance | -9.2 | -8.5 | -7.2 | -4.3 | -5.1 | -3.3 | -4.1 |
| General government expenditure | 31.8 | 31.5 | 31.0 | 27.7 | 28.8 | 26.7 | na |
| General government debt | 71.1 | 66.6 | 64.7 | 59.1 | 55.9 | 54.8 | na |
| Monetary sector³ <i>(Percentage change)</i> | | | | | | | |
| Broad money (M2, end-year) | 10.4 | 15.4 | 5.3 | 9.2 | 10.8 | 11.4 | na |
| Domestic credit (end-year) | 8.6 | 4.1 | 6.7 | 11.0 | 7.7 | 13.2 | na |
| <i>(In per cent of GDP)</i> | | | | | | | |
| Broad money (M2, end-year) | 49.6 | 51.7 | 50.9 | 49.2 | 50.2 | 50.6 | na |
| Interest and exchange rates <i>(In per cent per annum, end-year)</i> | | | | | | | |
| Refinancing rate ⁴ | 10.8 | 7.0 | 8.5 | 6.5 | 5.3 | 5.0 | na |
| Treasury bill rate (3-month maturity) | 10.8 | 8.0 | 11.2 | 7.4 | 6.2 | 5.5 | na |
| Deposit rate (1 year) | 6.9 | 6.9 | 8.0 | 5.5 | 4.5 | 3.0 | na |
| Lending rate (1 year) ⁵ | 21.2 | 15.3 | 14.6 | 11.8 | 11.0 | 12.0 | na |
| <i>(Leks per US dollar)</i> | | | | | | | |
| Exchange rate (end-year) | 142.8 | 135.9 | 134.0 | 106.4 | 92.6 | 98.1 | na |
| Exchange rate (annual average) | 143.9 | 143.6 | 140.2 | 121.3 | 102.8 | 98.1 | na |
| External sector <i>(In millions of US dollars)</i> | | | | | | | |
| Current account | -273 | -261 | -435 | -470 | -460 | -621 | -662 |
| Trade balance | -821 | -1,027 | -1,155 | -1,336 | -1,579 | -1,933 | -2,055 |
| Merchandise exports | 255 | 305 | 330 | 447 | 603 | 766 | 932 |
| Merchandise imports | 1,076 | 1,332 | 1,485 | 1,783 | 2,182 | 2,699 | 2,987 |
| Foreign direct investment, net | 143 | 204 | 135 | 178 | 343 | 288 | 339 |
| Gross reserves, excluding gold (end-year) | 608 | 737 | 860 | 1,026 | 1,374 | 1,459 | na |
| External debt stock | 1,640 | 1,200 | 1,180 | 1,420 | 1,673 | 1,747 | na |
| <i>(In months of imports of goods and services)</i> | | | | | | | |
| Gross reserves, excluding gold (end-year) | 4.8 | 4.9 | 5.0 | 4.8 | 5.1 | 4.4 | na |
| <i>(In per cent of exports of goods and services)</i> | | | | | | | |
| Debt service | 4.0 | 4.1 | 6.8 | 5.0 | 4.1 | 4.3 | na |
| Memorandum items <i>(Denominations as indicated)</i> | | | | | | | |
| Population (end-year, million) | 3.1 | 3.1 | 3.2 | 3.2 | 3.2 | 3.2 | na |
| GDP (in billions of leks) | 533 | 590 | 631 | 714 | 776 | 857 | 937 |
| GDP per capita (in US dollar) | 1,190 | 1,312 | 1,409 | 1,858 | 2,359 | 2,730 | na |
| Share of industry in GDP (in per cent) | 8.2 | 7.8 | 7.7 | 7.5 | 7.3 | na | na |
| Share of agriculture in GDP (in per cent) | 32.2 | 32.2 | 28.4 | 27.6 | 26.7 | na | na |
| Current account/GDP (in per cent) | -7.4 | -6.3 | -9.7 | -8.0 | -6.1 | -7.1 | -7.0 |
| External debt - reserves (in US\$ million) | 1,032 | 463 | 320 | 394 | 299 | 288 | na |
| External debt/GDP (in per cent) | 44.3 | 29.2 | 26.2 | 24.1 | 22.2 | 20.0 | na |
| External debt/exports of goods (in per cent) | 232.4 | 142.9 | 128.9 | 121.7 | 104.2 | 86.7 | na |

1 Includes changes in inventories

2 Figures do not include emigrant workers abroad who accounted for an estimated 27.4% of the total labour force in 2000

3 Data up to and including 2001 are based on the previous reporting standard. The new reporting standard, in accordance with Monetary and Financial Statistics Manual, excludes blocked deposits from broad money

4 From 2001 the figures show the repo rate of the Central Bank

5 The figures show the weighted average monthly rate for new credits in Lek for maturities 6 month to 1 year in December each year

ANNEX 5 – Environmental Issues

Transition process in Albania is associated with significant environmental problems. The development of the market economy in Albania since 1990 has resulted in significant internal rural-urban migration under a largely unplanned context, and it is now estimated that appropriately 45% of the population live in the urban area. On top of the increasing urban population, sewage treatment continues to be virtually non-existent and poor urban solid waste management prevails. Urban air pollution has increased due to the growing number of private cars particularly imported second-hand cars with lower environmental standards (e.g. diesel engines). New urban dwellers who are often poor and illegal occupants tend to be exposed to such urban environmental hazards. Industrial pollution from key industries (the oil, copper and chromium smelting and cement industries) continues to be a concern. Five “hot spots” including abandoned industrial sites being transformed into housing for migrants remain a public health threat. Porto Romano near Durres, Albania’s main port on the Adriatic Sea, is one of the “hot spots” of an abandoned chemical plant that produced the insecticide Lindane and sodium chromate for use in the leather tanning industry. Preparation for the relocation of the settlers and clean-up has finally started in Porto Romano. In rural areas, due to the fragile topsoil, land degradation is considered one of the most critical environmental issues and erosion is a widespread problem. Approximately 25% of Albania’s land suffers from natural soil erosion (with an annual rate of 20 to 30 tons per hectare). Due to human factors such as “abandonment of land” the rates have increased to as high as 150 ton/ha/year. Overgrazing has also posed a significant threat to natural pasture areas (which can no longer support the national grazing flock of about 3 million sheep and goats) and has damaged forest regeneration. Illegal logging and excess hunting have also accelerated the loss of biodiversity as well.

Public Consultation and Environmental Organisations

In spite of the fact that Albania signed and ratified the Aarhus Convention (2000), access to information and public participation procedures are not implemented by the public authorities. The Ministry of Environment has recently started to implement the convention obligations through an appropriate legal framework and new practices. On the other hand the local authorities lack the capacity, knowledge and qualifications to practice public information disclosure and consultation in the environmental management context.

In Albania there are about seventy-five registered environmental groups, which operate at local and national levels. They are spread all over the country, but especially in big cities and near areas with specific natural values. Their main focuses are bio-diversity, urban problems, environmental education and protection of natural resources. Major non-governmental environmental organizations in Albania include *Shoqata e Ruajtjes dhe e Mbrojtjes se Mjedisit Natyror ne Shqiperi* (Association for the Protection and Preservation of Natural Environment in Albania) and *Shoqata per Ruajtjen e Shpendeve dhe Gjitareve te Shqiperise* (Albanian Society for the Protection of Birds and Mammals).

The environmental movement and NGO phenomenon are quite new aspects of Albanian civic society. The need for cooperation among environmental NGOs grew

along with NGO activity growth. A number of activities have been and are being achieved jointly by several NGOs, however the level of coordination within the community needs to be further strengthened.

Environmental Education

Environmental awareness and education is considered a key factor in mobilizing communities for environmental protection and adequate natural resource management. However, activities related to this field are still minimal especially in the rural areas and not structurally incorporated into the school curricula. The first attempts to develop educational materials and books on the environment are a recent phenomena mostly supported by international organizations.

Other Institutions

Among other organisations, the World Bank has been implementing several projects in the area of municipal water & waste water, water resources management, natural resources management and coastal zone management in Albania. UNDP has been supporting the Ministry of Environment for a Persistent Organic Pollutants (“POPs”) national implementation plan under the Stockholm Convention on POPs aiming to phase out POPs and clean up contaminated sites. The project will enable Albania to ratify the Convention. The EU will continue to monitor the country’s environmental progress in the context of EU environmental harmonisation. The Bank will continue to co-operate with other organisations to create synergies and avoid duplication.

ANNEX 6 – Approved Bank Operations

EBRD approved projects in Albania as of 31 December 2005

| Operation name | Debt | Equity | Trade Guarant. | EBRD Signed | Total Cost | Private / Public | Active / Complete |
|---|--------------|-------------|----------------|--------------|----------------|------------------|-------------------|
| Financial Institutions | | | | | | | |
| <i>Banking</i> | | | | | | | |
| Banca Italo-Albanese | | 11.5 | | 11.5 | 20.0 | Private | Active |
| ProCredit Bank | | 1.1 | | 1.1 | 4.8 | Private | Active |
| SME Recovery Credit Line | 1.2 | | | 1.2 | 1.2 | Private | Complete |
| National Commercial Bank | | 2.3 | | 2.3 | 9.1 | Private | Active |
| TFP: American Bank of Albania* | | | 2.5 | | | Private | Complete |
| TFP: Banca Italo-Albanese* | | | 2.0 | | | Private | Complete |
| <i>Non Bank</i> | | | | | | | |
| INSIG | | 5.3 | | 5.3 | 10.4 | Private | Active |
| Albania Reconstruction Equity Fund** | | 2.8 | | 2.8 | 7.3 | Private | Active |
| Infrastructure | | | | | | | |
| <i>Energy</i> | | | | | | | |
| Power Transmission and Distribution*** | 0.1 | | | 0.1 | 34.2 | Public | Complete |
| Drin River Cascade*** | 1.4 | | | 1.4 | 80.9 | Public | Complete |
| Power Sector Reconstruction | 30.0 | | | 30.0 | 63.2 | Public | Active |
| Power Distribution Rehabilitation | 24.0 | | | 24.0 | 190.4 | Public | Active |
| Vlore Thermal Power Plant | 40.0 | | | 40.0 | 107.1 | Public | Active |
| <i>Transport</i> | | | | | | | |
| Road Rehabilitation | 17.0 | | | 17.0 | 24.9 | Public | Active |
| Tirana Airport Terminal | 21.0 | | | 21.0 | 50.3 | Private | Active |
| Fier Tepelene Road | 35.0 | | | 35.0 | 109.0 | Public | Active |
| General Industry | | | | | | | |
| Fushe Kruje Cement Factory | 25.4 | | | 25.4 | 109.9 | Private | Active |
| Telecommunications | | | | | | | |
| Albanian Telecom | 8.3 | | | 8.3 | 40.9 | Public | Active |
| Vodafone Albania | 24.7 | | | 24.7 | 72.5 | Private | Active |
| Agribusiness | | | | | | | |
| Coca-Cola Tirana | | 3.4 | | 3.4 | 11.6 | Private | Complete |
| Morpack | 4.0 | | | 4.0 | 7.0 | Private | Active |
| Property, Tourism & Shipping | | | | | | | |
| Tirana Hotel | 10.1 | 0.8 | | 10.9 | 18.4 | Private | Complete |
| Hotel Rogner | 19.6 | 2.0 | | 21.6 | 27.0 | Private | Active |
| Country Total | 261.8 | 29.2 | 4.5 | 291.0 | 1,000.1 | | |

| | Amount | Weight | Number | Weight |
|---------|--------|--------|--------|--------|
| Private | 126.2 | 43.4% | 13.0 | 62% |
| State | 164.8 | 56.6% | 8.0 | 38% |

* - TFP guarantees are not included in the project number count

** - The Bank signed 11 investments under the AREF, bringing the total number of projects in Albania to 32 (24 in the private sector)

*** - Bank's financing was restructured and included under the Power Sector Reconstruction Project

ANNEX 7 – Bank Technical Co-operation Programmes

Cumulative summary as of 31 December 2005

| Commitment By Sector | € Committed | € Disbursed |
|---|------------------------|------------------------|
| Agriculture, Forestry | 154,013 | 154,013 |
| Community / Social Services | 511,816 | 511,816 |
| Energy | 4,614,231 | 4,313,452 |
| Extractive Industries | 243,090 | 243,090 |
| Finance, Business | 6,056,668 | 5,479,467 |
| Local Authority Services | 141,957 | 141,957 |
| Manufacturing | 41,216 | 41,216 |
| Telecommunications | 1,970,039 | 1,970,039 |
| Tourism | 222,763 | 222,763 |
| Transport / Construction | 1,191,506 | 1,028,454 |
| GRAND TOTAL (82 commitments) | 15,147,298 | 14,106,268 |

Detailed list of operations as of 31 December 2005

| Commitment Name | Euro Committed | Euro Disbursed | Fund Approved Date | Commit. Stage Name | Sector |
|--|----------------|----------------|--------------------|--------------------|---------------------------|
| Privatisation advisor for Tirana Hotel | 40,258 | 40,258 | 12/08/02 | Closed | Community/Social Services |
| Albania Reconstruction Equity Fund | 2,262,886 | 2,262,886 | 01/12/98 | Closed | Finance, Business |
| Albania Reconstruction Equity Fund | 141,678 | 141,678 | 26/11/03 | Closed | Finance, Business |
| Albania Reconstruction Equity Fund - Consultancy Contract Extension | 156,475 | 99,633 | 04/02/05 | Disbursing | Finance, Business |
| Albania Reconstruction Equity Fund | 25,359 | 0 | 18/11/05 | Committed | Finance, Business |
| Energy sector investment planning - Drin river (small hydro rehabilitation) | 47,267 | 47,267 | 15/11/94 | Closed | Energy |
| Albania Fier-Tepelene Road: Lenders Monitoring Consultant | 128,670 | 0 | 13/05/05 | Committed | Construction |
| Central European Initiative - transport information reporting project (design and supervision) | 156,621 | 156,621 | 10/04/94 | Closed | Transport, Storage |
| Co-financing advisory services | 22,827 | 22,827 | 10/07/95 | Closed | Community/Social Services |
| CEI Loans for Small Entrepreneurs in Albania | 268,586 | 268,586 | 13/07/00 | Closed | Finance, Business |
| CEI Insurance Privatisation Assistance for INSIG (Albania) | 495,000 | 0 | 15/07/05 | Committed | Finance, Business |
| Denmark environmental project financing | 130,593 | 130,593 | 22/12/94 | Closed | Local Authority Services |
| Institutional Development Programme - evaluation of management development requirements | 48,000 | 48,000 | 20/12/92 | Closed | Telecommunications |
| Institutional development programme - accounting and finance | 258,901 | 258,901 | 20/01/93 | Closed | Telecommunications |
| Institutional Development Programme - operation and maintenance | 390,660 | 390,660 | 20/01/93 | Closed | Telecommunications |
| Institutional Development Programme - Project Management and Implementation | 0 | 0 | 20/01/93 | Closed | Telecommunications |
| Institutional Development Programme - strategic and organisational diagnosis study | 49,000 | 49,000 | 12/02/93 | Closed | Telecommunications |
| Hydro-power plant upgrading and rehabilitation study | 161,437 | 161,437 | 12/02/93 | Closed | Energy |
| Institutional Development Programme - organisation and management implementation | 383,726 | 383,726 | 20/05/93 | Closed | Telecommunications |
| Institutional Development Programme - initial operation and maintenance - Component IV (i) | 0 | 0 | 20/05/93 | Closed | Telecommunications |
| Establishment of industrial parks - pre-feasibility study | 91,805 | 91,805 | 03/06/93 | Closed | Construction |
| Bank Training Centre | 127,923 | 127,923 | 20/12/93 | Closed | Finance, Business |
| Bank training centre | 60,320 | 60,320 | 17/12/93 | Closed | Finance, Business |
| Bank training centre | 31,715 | 31,715 | 17/12/93 | Closed | Finance, Business |
| Durres industrial park assistance to task force | 62,269 | 62,269 | 22/11/96 | Closed | Community/Social Services |
| Albania Road Rehabilitation Project | 679,410 | 679,410 | 14/12/98 | Closed | Construction |
| Detailed design of subscriber networks | 50,470 | 50,470 | 30/09/93 | Closed | Telecommunications |
| Accounting advisor for commercial banks | 131,231 | 131,231 | 08/10/93 | Closed | Finance, Business |
| Telecommunications Administrative and Regulatory Development Programme | 64,250 | 64,250 | 13/10/98 | Closed | Telecommunications |
| Privatisation of Albchrome - mining advice | 90,285 | 90,285 | 01/12/92 | Closed | Extractive Industries |
| Annual Meeting 1999 - Accommodation for Albanian Delegation | 1,306 | 1,306 | 09/07/99 | Closed | Community/Social Services |
| Legal assistance - on-shore oil | 61,839 | 61,839 | 28/06/93 | Closed | Extractive Industries |

| | | | | | |
|---|-----------|-----------|----------|-----------|--------------------------------|
| Institutional Development Programme - project management and implementation | 43,809 | 43,809 | 01/10/93 | Closed | Telecommunications |
| Albanian telecommunications - advice to project implementation unit | 31,025 | 31,025 | 23/06/95 | Closed | Telecommunications |
| Establishment of industrial parks - pre-feasibility study | 30,000 | 30,000 | 12/08/94 | Closed | Construction |
| Establishment of business promotion centre | 39,602 | 39,602 | 29/01/94 | Closed | Finance, Business |
| Forest industries feasibility study | 154,013 | 154,013 | 09/09/93 | Closed | Agriculture, Forestry, Fishing |
| Telecommunications privatisation - legal advice | 12,819 | 12,819 | 13/03/95 | Closed | Telecommunications |
| Power transmission feasibility study | 204,267 | 204,267 | 20/04/95 | Closed | Energy |
| Mortgage bank - legal advice | 25,654 | 25,654 | 21/12/95 | Closed | Finance, Business |
| Mortgage bank - market analysis | 25,654 | 25,654 | 21/12/95 | Closed | Finance, Business |
| Durres industrial park - technical assistance to the task force | 46,149 | 46,149 | 15/01/97 | Closed | Community/Social Services |
| Assistance to KESH Management | 1,896,862 | 1,896,862 | 30/06/00 | Closed | Energy |
| Assistance to Kesh Management | 578,368 | 578,368 | 14/03/03 | Closed | Energy |
| Kesh Management Assistance - second extension of Existing Contract | 810,407 | 810,407 | 20/04/04 | Closed | Energy |
| Kesh Management Assistance | 300,779 | 0 | 26/10/05 | Committed | Energy |
| Telecommunications master plan | 197,708 | 197,708 | 01/05/92 | Closed | Telecommunications |
| Commercial banking - establishment of accounting systems | 193,200 | 193,200 | 01/09/92 | Closed | Finance, Business |
| Preparation of tender specifications | 154,907 | 154,907 | 01/10/92 | Closed | Telecommunications |
| Development of banking system | 27,144 | 27,144 | 01/12/92 | Closed | Finance, Business |
| Training for commercial banks | 147,692 | 147,692 | 01/01/93 | Closed | Finance, Business |
| Tourism development advice | 63,430 | 63,430 | 01/07/93 | Closed | Commerce, Tourism |
| Drin river cascade rehabilitation - engineering and project management | 363,694 | 363,694 | 01/11/94 | Closed | Energy |
| Albanian Telecommunications - sector policy development | 44,972 | 44,972 | 01/02/95 | Closed | Telecommunications |
| Feasibility study for rural telecommunications development | 12,996 | 12,996 | 07/06/96 | Closed | Telecommunications |
| TAM Programme - Ajka | 11,226 | 11,226 | 20/07/01 | Closed | Manufacturing |
| On-shore oil - evaluation and negotiation of foreign bids | 130,223 | 130,223 | 01/09/92 | Closed | Energy |
| Turbine efficiency metering study | 79,741 | 79,741 | 01/03/93 | Closed | Energy |
| Energy sector rehabilitation | 16,964 | 16,964 | 01/09/92 | Closed | Energy |
| Bank restructuring techniques/training | 11,364 | 11,364 | 01/10/91 | Closed | Local Authority Services |
| Commercial banking accounting | 27,270 | 27,270 | 01/02/92 | Closed | Finance, Business |
| Briquetting plant | 24,223 | 24,223 | 01/02/92 | Closed | Energy |
| Utilisation container exchanges | 65,889 | 65,889 | 01/02/92 | Closed | Telecommunications |
| Tourism development - tourism studies | 103,422 | 103,422 | 01/04/92 | Closed | Commerce, Tourism |
| Chromium industry adviser | 90,966 | 90,966 | 01/04/92 | Closed | Extractive Industries |
| Environmental analysis | 49,187 | 49,187 | 01/04/92 | Closed | Community/Social Services |
| Tourism development - legal and institutional changes | 55,911 | 55,911 | 01/05/92 | Closed | Commerce, Tourism |
| Commercial banking - computer equipment for accounting systems (tied portion) | 149,466 | 149,466 | 01/07/92 | Closed | Finance, Business |
| Negotiations with external creditors | 77,364 | 77,364 | 01/10/92 | Closed | Finance, Business |
| Parliamentary workshop | 26,912 | 26,912 | 01/06/93 | Closed | Community/Social Services |
| Tirana Hotel | 245,000 | 245,000 | 27/06/01 | Closed | Community/Social Services |
| TurnAround Management Programme - Instituti I Sigurimeve | 29,990 | 29,990 | 01/05/96 | Closed | Manufacturing |
| TurnAround Management Programme - advisory services contract - Alb-Baker | 17,907 | 17,907 | 01/06/96 | Closed | Community/Social Services |
| Telecommunications Administrative and Regulatory Development Programme | 25,058 | 25,058 | 02/12/98 | Closed | Telecommunications |

| | | | | | |
|--|-------------------|-------------------|----------|------------|--------------------|
| Review of draft telecommunications law | 9,810 | 9,810 | 01/02/95 | Closed | Telecommunications |
| Telecoms administrative and regulatory development programme | 80,185 | 80,185 | 13/10/98 | Closed | Telecommunications |
| Telecoms Administrative and Regulatory Development Programme | 15,911 | 15,911 | 03/09/99 | Closed | Telecommunications |
| Assistance for the selection process of the 2nd GSM operator | 29,945 | 29,945 | 17/11/99 | Closed | Telecommunications |
| Road Rehabilitation Project - Lender's Monitoring Consultant | 105,000 | 70,619 | 20/03/00 | Disbursing | Construction |
| INSIG - Insurance Advisor to the General Manager | 23,542 | 23,542 | 22/04/03 | Closed | Finance, Business |
| FEFAD Bank - Branch Expansion | 1,041,163 | 1,041,163 | 22/08/00 | Closed | Finance, Business |
| FEFAD Bank - Support of Branch Expansion | 577,743 | 577,743 | 04/12/01 | Closed | Finance, Business |
| | 15,147,298 | 14,106,268 | | | |
| No of Commitments: | 82 | | | | |

ANNEX 8 – Multilateral and Bilateral Assistance

I. MULTILATERAL ASSISTANCE

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

EU – PHARE / CARDS

The EU assistance to Albania started in 1991 through the PHARE Programme. Between the period 1991-2005, total EU commitments in Albania has been over EUR 1.1 billion which includes the PHARE assistance and other programs such as ECHO (humanitarian aid), EDHIR (actions in democracy and human rights) etc. The EU support has covered a large number of sectors, including, infrastructure, public administration reform, agriculture, health, education, judiciary and law enforcement, humanitarian aid, democracy and human rights, and cross-border co-operation.

Since 2001, the Community Assistance for Reconstruction, Development and Stabilisation (“**CARDS**”) programme has been the main EC financial instrument for co-operation in the Balkan countries. For the period 2001-2005, commitments under the CARDS national programme for Albania were EUR 237 million.

The strategy of the CARDS Programme is expressed in the Country Strategy Paper (“**CSP**”) for Albania, 2002-2006, prepared by the European Commission and the Government of Albania.

The main priorities for financing under the CARDS programme as stated in the CSP for Albania are:

- Legislation;
- Administrative capacity building
- Economic and Social Development
- Environmental and Natural Resources
- Stability and democracy.

For 2006, CARDS has earmarked EUR 45.5 million for Albania.

The 2007-2009 National Indicative Programme is currently under preparation. As of 2007 Albania will, as a potential candidate country, benefit from the IPA (Instrument for Pre-Accession).

In April 2004, the European Council decided to provide macro-financial assistance (“**MFA**”) to Albania for a maximum amount of EUR 25 million, including EUR 16 million of grants and EUR 9 million of loans. The aim of this assistance is to ease Albania’s external financing constraints, to support its balance of payments and to strengthen its foreign exchange position. The focus of the conditionality attached to this assistance is on public finance management, public administration and financial sector reform, as well as on improving the business environment and private sector development. The first tranche has been partially released: the grant component of

EUR 3 million was paid in November 2005 and the payment of the loan component of EUR 9 million is currently being processed.

EUROPEAN INVESTMENT BANK

The EIB is a lead player in implementing the European Union's 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 Albanian economy, such as various infrastructure investments and the promotion of small and medium-sized enterprises in the productive and cooperative sectors through a global loan (credit line) to Albania's banking sector.

During 2000 – 2005, EIB has provided loans that include EUR 34 million for the rehabilitation of the North – South corridor, EUR 30 million for Power Transmission and Distribution (a project co-financed by the EBRD, WB, and other bilateral donors), EUR 17 million for the rehabilitation of the Port of Durres, and EUR 27 million for the rehabilitation of water facilities in five cities of Albania under a concessional scheme by EC and other donors, EUR 40 million to finance a thermal power plant in Vlore and EUR 35 million to co-finance another segment of the North – South Corridor.

The medium-term strategy of the EIB for the Western Balkans identifies as priority areas of investment transport and energy infrastructure. In accordance with these priorities the EIB is co-operating with the EBRD to co-finance a ferry terminal in the Port of Durres.

INTERNATIONAL MONETARY FUND

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

On 1 August 2005 the Executive Board of the International Monetary Fund completed the sixth review of Albania's performance under the three-year Poverty Reduction and Growth Facility ("PRGF") arrangement. The completion of the review will enable the release of an amount equivalent to SDR 4.0 million (about USD 5.8 million), which will bring the total disbursement under the program to SDR 28.0 million (about USD 40.5 million).

The three-year arrangement was approved on 21 June 2002 for a total of SDR 28.0 million (about USD 40.5 million).

The PRGF is the IMF's most concessional facility for low-income countries. PRGF-supported programmes are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper.

THE WORLD BANK GROUP / IDA

Albania joined the World Bank and the International Development Association (“IDA”) in October 1991. The Bank’s assistance to Albania continue to focus in the medium-term on poverty reduction through investments in key sectors, support for improved governance and anticorruption, deepening key structural and sector reforms, and improving management of infrastructure. Specific operations will help accelerate privatization of key sectors, restructuring of public utilities, and community-based development. IDA continues to provide assistance for improvement of public expenditure management and to ensure that public resources are allocated towards alleviating poverty and sustainable development in the country.

To date, the World Bank's loan commitments to Albania total some USD 820 million for 59 projects. Out of these, 14 projects are active and the rest are closed. USD 657 million have been disbursed so far under these projects. Currently, there are 20 projects ongoing that amount to a total credit of USD 283.5 million.

The World Bank is currently preparing its new Country Assistance Strategy (“CAS”) for Albania for fiscal years 2006–2009. The new CAS - the fourth CAS the World Bank Group has produced for Albania – envisages a lending program of up to USD 86 million from IDA (International Development Association) and USD 110 million from IBRD (International Bank for Reconstruction and Development). The preparation of the new strategy is benefiting from wide consultations with the Government, Parliament, civil society, private sector, donors, and other interested stakeholders. The CAS will support the country's development agenda articulated in its National Strategy for Socio-Economic Development (“NSSED”). Two pillars will constitute the building blocks of the new strategy: economic growth through support to private sector development and improved service delivery, particularly in the social sectors. Special attention will be paid to governance issues, which will be mainstreamed in all programs and projects.

THE WORLD BANK GROUP / IFC

Albania became a member of the International Finance Corporation (“IFC”) in 1991. 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%), general manufacturing (37%), infrastructure (33%), and oil and gas (23%).

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 EBRD have co-financed projects in the financial sector (ProCredit Bank, National Commercial Bank, INSIG) and in the private corporate sector in Albania (Vodafone Albania, Fushe Kruje Cement Factory)

II. BILATERAL ASSISTANCE

The largest bilateral donors in Albania listed alphabetically are:

GERMANY

The German government, as one of the most important partners of Albania in development co-operation, has committed to date a cumulative amount of about EUR 250 million, of which EUR 233 million in financial co-operation and EUR 16.4 million in technical assistance.

During the period of 2004 to 2005, Germany provided EUR 21.4 million for financial cooperation and EUR 4.75 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* – includes projects in several cities for both investment for rehabilitation of water supply systems and implementation of institutional support measures at municipality level.
- *Financial sector* - the main project is ProCredit Bank, Albania's leading micro-finance institution, where EBRD and IFC are also shareholders.
- *Energy sector* - the main project are the rehabilitation of Bistrica power plant and the 400 kV line from Tirana to Podgorica (Montenegro). Parallel institutional and financial improvements in the sector are being addressed in close co-ordination with other IFIs and donors.

- *Infrastructure* - one of the most important interventions in the sector has been the reconstruction of the Tirana's Airport runway.
- *Small-scale Social Infrastructure and Housing* – includes commitments for promoting labour-intensive approaches and participatory implementation.

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

Co-operation in 2006 will continue to focus on the energy and water supply sectors. Other priority areas will be small-scale social infrastructure development and environment protection.

GREECE

Besides being Albania's second largest trade partner and one of the main FDI originators, Greece has also provided grant assistance and technical co-operation funds mostly concentrated in agriculture, urban and rural housing infrastructure, and social services (health, education) for a total of USD 279 million over the 1997-2004 period.

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

ITALY

Italy is by far the largest bilateral donor to Albania with cumulative disbursed funds over 1991-2004 amounting to over EUR 600 million. Italy's assistance to Albania has evolved from emergency aid in the early stages of transition and crisis times, to a longer-run development approach. The 2002-2004 assistance programme for Albania envisages further support for a total of EUR 202 million. The main areas of assistance programme include:

- *Electric power sector* - this has been the main support area since 1994 where substantial funds were provided for emergency interventions as well as rehabilitation of several components of the power transmission and distribution system. Italy is one of the active players in the current international structural support for the energy sector in Albania along with EBRD, World Bank and other donors.
- *Water supply facilities* - the financing for this sector have been mainly focused on the area around Tirana and includes assistance for a structural programme to support the local utility company.

- *Transport infrastructure* - Italy has been actively involved in this sector through financing for the rehabilitation of several urban and national road segments, technical assistance for structural improvements in the Road Directorate and support for road maintenance and repair. Italy has co-financed the Emergency Road Rehabilitation project with EBRD.
- *Social services*, mainly health and education systems, have also benefited from Italian support. Reconstruction of schools, university exchange programmes, rehabilitation of health care centres and management support have been some of the main areas of assistance.

JAPAN

Japan is another important donor to Albania. The Japanese bilateral assistance started in 1990 and includes a number of programmes ranging from grant financing, credits and technical assistance through development cooperation agencies (OECD, JICA) and Trust Funds at the EBRD and the World Bank. The main sectors benefiting from the Japanese assistance are energy (including the Power Transmission and Distribution project co-financed with EBRD), agriculture and forestry, water supply and sewerage, education as well as support for the budget, balance of payments and enterprise reform.

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 Coordination Office for Cooperation and Humanitarian Aid, 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 framework agreement concerning the technical cooperation with Albania has been signed in February 2000 and it covers all the activities conducted by SDC and SECO in Albania. It remains into force until April 2006. 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 2005 – 2008. The contribution of Swiss assistance includes sectors of water supply and sewerage, energy production and transmission, health services, vulnerable groups etc.

The total Swiss assistance to December 2004 was CHF 146.5 million. For 2006, SECO and SDC have earmarked CHF 13 million.

USA / USAID

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 USD 386 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.

In 2005, Albania's program budget was nearly USD 28 million, of which USD 21.5 million is for implementation by USAID and USD 6.5 million is for transfer to programs of other US Government agencies and offices.

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, trafficking in persons, religious harmony.

USAID works in close partnership with private US based voluntary organizations, indigenous institutions, US businesses, and other national and international agencies.

The USAID current portfolio consists of 25 USAID-supported activities, some of which are listed below:

- Serving Micro Entrepreneurs in Albania (micro credit assistance) – *Opportunity International*
- Enterprise Development and Export Market Services (“EDEM”) (small and medium enterprise development) - *Development Alternatives Incorporated (“DAI”)*
- Democracy and Governance (civil society development) - *National Democratic Institute (“NDI”)*
- Local Government and Decentralization in Albania - *Urban Institute*
- Election Administration and Support - *International Foundation for Electoral Systems (“IFES”)*
- Rule of Law Program (anti-corruption) - *Casals and Associates*
- Pro Shëndetit (primary health care) - *University Research Corporation (“URC”)*
- Transnational Action Against Child Trafficking - *Terre des Hommes*
- Coordinated Action Against Human Trafficking - *Creative Associates International*

