

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

STRATEGY FOR ALBANIA

As approved by the Board of Directors at its meeting on 11 December 2012

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EXECUTIVE SUMMARY

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

In the period since the adoption of the previous Strategy in 2009 progress in further democratic transition has been uneven. The main opposition political party did not recognise the outcome of the 2009 general elections. There has been considerable improvement in the political dialogue following the November 2011 political agreement between the government and the opposition. Albania applied for membership in the European Union in 2009, and the EU approximation process remains an important anchor for democratic reforms.

Albania was the only country in the south-eastern European region that avoided a recession in recent years. However, while GDP growth is still above the regional average, a slowdown is increasingly apparent, and growth in 2011 of around 3 per cent was lower than in previous years. The deceleration in economic activity in the past year is largely due to weakening performance in some key EU markets. Exports have continued to grow, but at a slower pace, and growth in imports has slowed down as well. Remittances from Albanians working abroad have also been hit by the crisis. Inflation has been low for many years but total public debt is high by regional standards at just below 60 per cent of GDP. The scope to take on extra public debt is therefore limited. In the banking sector, credit growth remains positive but well below pre-crisis levels. The level of non-performing loans is high and it has been increasing over the past year, reaching nearly 19 per cent by the end of 2011.

The short-term outlook for the Albanian economy is highly uncertain. GDP growth is currently forecast by the Bank to fall to about 1.2 per cent in 2012, with a modest increase to 1.8 per cent in 2013. Under the Bank's baseline scenario, growth is expected to be around 3-4 per cent in 2014/2015. Significant short-term vulnerabilities remain due to Albania's close trade, investment and remittance linkages to Greece and Italy. The lack of fiscal space is an additional source of vulnerability, highlighting the need for further efforts to broaden the tax base, improve the efficiency of public spending and intensify efforts to improve the business environment and attract greater inflows of investment.

Albania has made steady progress with structural reform over the past two decades, despite having to overcome serious institutional weaknesses and one of the most difficult starting points for transition. However, the country faces significant challenges across the board. Key transition challenges that can be addressed with the support of EBRD financing and assistance include:

- **Moving towards a more balanced energy sector.** Albania has the potential to become a regional player in the renewable energy market, but achieving this goal will require improved efficiency and viability of distribution and generation, a substantial increase in private sector participation in power generation, and an improved regulatory framework.

- **Upgrading infrastructure including through increased participation of the private sector.** The implementation of PPP projects and other concession financing will be critical for addressing this transition challenge. The development of railways and port infrastructure will also be a key factor in advancing Albania's regional integration and sustainable transport.
- **Developing a more vibrant corporate and agribusiness sector.** In a difficult international economic environment the Albanian private sector will need financial and technical support to promote greater vertical integration, innovation, competitiveness and improved corporate governance. Further challenges include the reduction of the administrative burden facing businesses, the completion of privatisation and greater enforcement of the rule of law.
- **Deepening financial intermediation.** Financial intermediation is still low by regional standards and its development was slowed down by the negative impact of the crisis. Challenges ahead include enhancing the flow of credit to the real economy in the face of more stringent capital requirements and boosting the development of non-bank financial services.

Strategic directions

The Bank's priorities for the next three years will focus on sustainable development of the private sector, building on the strong entrepreneurial spirit in the economy. The Bank will also invest in high-priority public sector projects in infrastructure where such investments can address important transition gaps. In light of the transition challenges identified above, the Bank's activities in Albania will focus on the following areas:

- **Promoting Sustainable Energy Policies and Environmentally Sound Investments.** The Bank will work closely with the Albanian authorities and the independent regulators to enhance the regulatory and administrative framework for private sector investments, particularly in the renewable energy sector. The Bank, through its dedicated facilities, will finance energy efficiency and renewable energy projects and, in cooperation with other IFIs and commercial banks, will support the upgrading and financial viability of energy generation and distribution. Interconnection lines and gas pipeline will also be of key importance to improve competitiveness and regional integration.
- **Enhancing commercialisation, competition and private sector involvement in infrastructure, alongside targeted public projects.** The Bank will assist the Albanian authorities, both at the national and local level, to increase private sector involvement in transport and municipal services, including in road maintenance. Financial assistance will be complemented by technical advice, capitalizing on the Bank's experience to successfully structure and implement PPP and concession financing. The Bank will also work closely with the Government on advancing transition in the seaport and railways sectors.
- **Supporting the development of a more competitive private sector.** The Bank will continue to be a strong partner for foreign investors and for local corporates, both directly and through the Local Enterprise Facility (LEF). The Bank will pursue an active investment policy in sectors such as agribusiness, manufacturing and services, ITC and tourism, all of which have the potential to modernise and increase value creation in the Albanian economy, which is still too reliant on imports and labour-intensive textile subcontracting.

- **Strengthening the financial sector and deepening intermediation.** The Bank will support the banking system in a difficult market environment with credit lines and other facilities such as the Medium Size Co-Financing Facility (MCFF). The Bank, through a close consultation with the Bank of Albania, will respond in a timely way to emerging needs of the local financial sector.

The Bank will cooperate closely with the European Union and with other IFIs in all of its operations as well as through policy dialogue, in order to achieve maximum transition impact and to enable Albania to integrate further into EU and global structures.

1. THE BANK'S PORTFOLIO

1.1. Overview over Bank activities to date

As of end-2011, the Bank had signed a total of 56 projects in Albania with a cumulative EBRD investment value of €667 million since the start of its operations in 1992. On average, every 1 euro of EBRD investment has attracted 2.5 euros of investment by other partners, implying a total project value of €2.33 billion (see Table 1). The current portfolio stock is allocated 37 per cent to infrastructure, 33 per cent to energy, 22 per cent to industry, commerce and agribusiness and 7 per cent to financial institutions. This distribution broadly represents the investment needs and opportunities in the Albanian economy over the past two decades.

During 2009-2011, the Bank increased its financing activities in Albania, in part responding to a decrease in alternative sources of funding amidst the European sovereign debt crisis and its impact on neighbouring countries such as Greece and Italy. During 2011 the Bank achieved new records with an annual business volume of €6 million and gross disbursements of €3 million. The private sector share of the EBRD portfolio in Albania has gradually increased during the course of the previous country strategy period, from 47 per cent in 2008 to 56 in 2011. Another positive trend in recent years is the decrease in the percentage of undrawn amounts: from 44 per cent in 2008 to 30 per cent in 2011 (see Table 2).

Table 1: Portfolio Overview in Albania as of 31 December 2011

| SECTOR | NET CUMULATIVE BUSINESS VOLUME | | | | CURRENT PORTFOLIO STOCK | | | |
|-------------------------------|--------------------------------|-------------|--------------------|-----------------|-------------------------|----------------|------------------|-----------------------|
| | Number of projects | EBRD Signed | Total Project Cost | EBRD % of Total | Portfolio | % of Portfolio | Operating Assets | % of Operating Assets |
| <i>Amount in EUR million</i> | | | | | | | | |
| Energy | 12 | 211 | 805 | 26% | 150.3 | 33% | 93.3 | 29% |
| Natural Resources | 2 | 39 | 110 | 35% | 36.8 | 8% | 33.8 | 11% |
| Power and Energy | 10 | 172 | 695 | 25% | 113.5 | 25% | 59.5 | 19% |
| Financial Institutions | 16 | 75 | 128 | 59% | 31.4 | 7% | 29.9 | 9% |
| Bank Equity | 4 | 38 | 45 | 84% | 3.6 | 1% | 3.6 | 1% |
| Bank Lending | 5 | 23 | 43 | 53% | 20 | 4% | 20 | 6% |
| Small Business Finance | 5 | 8 | 30 | 27% | 4.3 | 1% | 4.3 | 1% |
| Services | 2 | 6 | 10 | 60% | 3.5 | 1% | 2 | 1% |
| ICA | 20 | 188 | 767 | 25% | 101.7 | 22% | 98.1 | 31% |
| Agribusiness | 4 | 14 | 32 | 44% | 0.8 | 0% | 0.8 | 0% |
| Equity Funds | 5 | 8 | 17 | 47% | 5.5 | 1% | 2.4 | 1% |
| Manufacturing & Services | 5 | 64 | 350 | 18% | 53.1 | 12% | 53.1 | 17% |
| Property & Tourism | 3 | 39 | 82 | 48% | 17.5 | 4% | 17 | 5% |
| Information & | 3 | 63 | 286 | 22% | 24.8 | 5% | 24.8 | 8% |
| Infrastructure | 8 | 193 | 629 | 31% | 169.7 | 37% | 95.9 | 30% |
| MEI | 1 | 15 | 15 | 100% | 11.5 | 3% | 9.3 | 3% |
| Transport | 7 | 178 | 614 | 29% | 158.2 | 35% | 86.6 | 27% |
| TOTAL | 56 | 667 | 2329 | 29% | 453.1 | 100% | 317.2 | 100% |

Table 2: Portfolio Development in Albania, 2008 – 2011

| Amount in EUR million | 2008 | 2009 | 2010 | 2011 | Development over 2007-10 (3 years since last Strategy) |
|------------------------------------|------|------|------|------|---|
| | | | | | <i>(end 2008 vs end 2011)</i> |
| Net Cumulative Business Volume | 475 | 518 | 575 | 667 | 192 |
| Current Portfolio Stock | 339 | 370 | 393 | 453 | 114 |
| Number of Operations | 41 | 46 | 52 | 56 | 15 |
| Operating Assets | 189 | 226 | 253 | 317 | 128 |
| % Undrawn | 44% | 39% | 36% | 30% | - 14 p.p. |
| Annual Business Volume | 88 | 59 | 75 | 96 | 8 |
| Number of Operations | 9 | 7 | 9 | 9 | 0 |
| Gross Disbursements | 82 | 61 | 57 | 93 | 11 |
| Annual Cancellations | 9 | 5 | 0 | 9 | 0 |
| Active Pipeline Stock | 180 | 273 | 286 | 243 | 63 |
| Private Sector Share (% Portfolio) | 47% | 54% | 54% | 56% | - 9 p.p. |
| Non Sovereign (% Portfolio) | 53% | 62% | 62% | 62% | + 9 p.p. |

1.2. Implementation of the previous country strategy

The previous Strategy for Albania was approved on 17 November 2009 and outlined the following main priorities:

- In the **Energy** sector: Support much-needed priority safety investments in dams with other IFIs and donors. Consider working with private investors to develop new hydro power plant concessions through the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDF), and in the natural resources sector. Support appropriate regulatory and institutional reforms through policy dialogue.
- In the **Transport** sector: Continue to support the upgrading of networks in Albania with emphasis on regional linkages and local roads network. Support sector reforms also through technical assistance and promote private sector involvement in the development of transport infrastructure through PPPs or other forms of concession financing. Seek to widen dialogue and explore opportunities to develop economically viable projects in the railway sector
- In the **Municipal and Environmental Infrastructure** sector: Consider investments in municipal services, such as water and public transport, combined with regulatory improvements to allow for bankable structures on a sub-sovereign basis. Explore opportunities to work with larger municipalities for priority projects with particular attention to waste and water systems.
- In the **Enterprise** sector: Promote the private sector through financing existing companies, greenfield developments and/or acquisition projects. Reach SMEs either directly, through LEF and WeBSEDF or with local banks through products such as the MCF and Western Balkans Sustainable Financing Facility (WeBSEFF). Expand activities in agribusiness (including processing, logistics and retail distribution), textiles/processing, property and construction materials. Design new products to provide financing of energy efficiency/sustainable energy and also to support companies which are developing in the IT sector.
- In the **Financial** sector: offer MCF facilities and other risk-sharing products aimed to ensure continued lending to the real economy and strengthen the

banks' risk profile and their lending policies and procedures. Support the banking system in case of need with equity and quasi-equity instruments and to maintain the level of lending and ease the impact of the crisis seek to design adequate lending products mobilising donor funds to support SME and MSME development. Work with the Bank of Albania to provide policy advice on deposit insurance and financial sector supervision.

- **Policy dialogue:** Seek to further strengthen Albanian institutions and to enhance the environment for the private sector to flourish. Focus on (i) identifying the existing impediments to private sector and gain direct feedback on Government policy and actions; (ii) ensuring environmental and energy efficiency reforms are adopted at the Government and company levels; (iii) ensuring requirements for transparency and accountability are included in projects; (iv) expanding the use of private concessions in infrastructure; and (v) examining the scope for further specific assistance for the telecoms authorities.

Since the Strategy was approved, the Bank has committed €230 million for 25 new projects. Although market conditions have been difficult, the Bank has continued to play an important role in Albania and has expanded operations across a number of areas, working closely with other IFIs as needed. Overall, the Bank successfully addressed most of its objectives during the past strategy period. Business volume increased, project implementation and disbursement were improved, and the Bank engaged in an enhanced policy dialogue and coordination with other IFIs and donors. There was strong collaboration with the IFC in the private sector and the EIB in the public sector. The cooperation with the EU, through the WBIF framework and the availability of IPA funds, has increased the affordability of public investments, helping the Government to overcome some of the constraints imposed by the limited fiscal space. Further technical cooperation programmes were developed in areas such as transport, energy, municipal infrastructure and legal and regulatory improvements to support sector reforms and private sector development.

The Bank responded to the key transition challenges by implementing the following activities in the priority areas:

In the **Energy** sector, the Bank worked with the IFC to support the turnaround of the distribution company (OSSH), following its privatisation, by co-financing the investment programme of CEZ Shperndarje. In the hydropower sector the EBRD was the first IFI to finance the construction of small HPPs through the WeBSEDF and has set new standards for local commercial banks. The Bank has also worked to improve the regulatory framework by providing TC to the Ministry of Economy, Trade and Energy to develop a proper feed-in tariff methodology for renewable energy projects.

In the **Transport** sector, the Bank has assisted the Government in rebuilding and upgrading the underdeveloped Albanian infrastructure. The Bank contributed to the reconstruction of the transport network by financing the rehabilitation of the Local and Regional Roads Project and the construction of Fier and Vlore Bypasses. These projects are examples of successful donor coordination among the Bank, EC and EIB through the Western Balkans Investment Framework (WBIF). The Bank is implementing a major TC project to assist the development of the railway sector by upgrading the railways link between the capital Tirana and the city of Durres. At the

same time the Bank has been implementing the Levan-Vlore and Levan-Tepelene road projects and the construction of a passenger terminal at the Port of Durres. These projects are also linked to sector reforms and institutional strengthening, such as the preparation of a Tolling Strategy for the Albanian Roads and the preparation of a Sustainable Transport Plan.

In the **Municipal** sector, the Bank has been working very closely with the administration of the City of Tirana, supporting investment initiatives such as the new multi-modal transport terminal, which is expected to be the first large PPP project ever implemented at the municipal level. In the same period the last component of a Municipal Road Project has been completed as well as preparatory work for an integrated transport control system in Tirana. Activities elsewhere in this sector have been hampered by lack of capacity at the local level and an incomplete decentralization process.

In the **Enterprise** sector, the Bank supported a local company, Balfin Group, for the construction of the largest shopping mall in the country, facilitating the entry of prominent international players such as the French retailer Carrefour. In the strategy period important foreign investments were completed with a significant impact on job creation, export promotion and business innovation, such as a new modern hospital, Hygeia Hospital, offering unique medical services in the region, and a new cement factory, Antea Cement. The Canadian company, Bankers Petroleum has constantly increased production and exports also thanks to a new financing package provided by the Bank in early 2012. The Bank has also been successful in reaching out to local corporates with its dedicated facilities, the LEF and the WeBSEDF. The WeBSEDF has made the Bank a strategic player in the hydropower sector which is considered a key driver of Albanian future economic growth. LEF and WeBSEDF clients are implementing good business standards in their respective sectors in Albania, thus setting examples for other investors to follow. In addition, the Bank has been cooperating with other local banks, inviting them to participate in co-financing private sector projects.

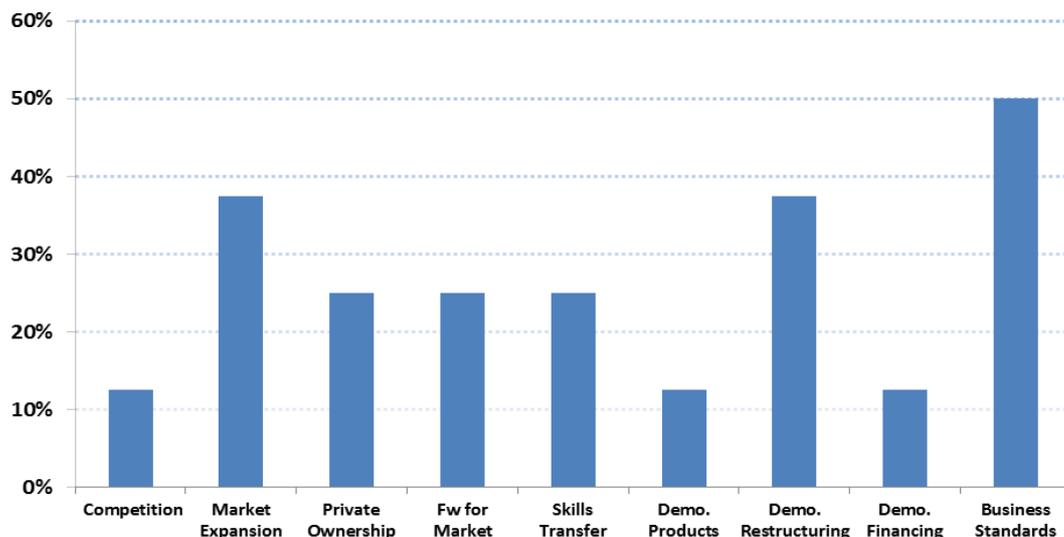
In the **Financial** sector the Bank has continued to be a reliable partner for local banks and financial institutions. The banking system has maintained adequate capitalisation and liquidity levels thanks to an increasing deposit base and new regulations introduced by the Bank of Albania; hence, the need for external funding has been limited. The Bank has, however, increased its role in the sector through a credit line to Tirana Bank, a subsidiary of the Greek Piraeus Bank and through the MCFE signed with Societe Generale Albania. The Bank has also supported the credit flow to local SMEs through a credit line with a local micro-finance institution, Fondi Besa, and the first operation with a local leasing company, Landeslease. An Advisory Support project to the Albanian Financial Supervisory Authority has been successfully completed, with new regulations implemented and legislation passed by the Parliament.

1.3. Transition impact of the Bank's portfolio

Since 2009, when the previous strategy was adopted, eight transition-rated operations were signed by the Bank in Albania.¹ All eight projects in Albania were ex ante rated as having “Good” or “Excellent” transition impact potential, therefore exceeding the institution-wide target of 80 per cent of projects to be assessed “Good” or better. One project that involves the development and environmental remediation of an oil field in Albania was rated with Excellent transition potential. The operation targets increased private sector participation in a sector that has been dominated by the state-owned player, as well as a significant upgrade in environmental standards and skills and technology transfer.

The transition objectives of projects signed during the strategy period reflect the diversified nature of the Bank’s activities in Albania in 2009-2012. Apart from the above described project in the country’s oil and gas sector, the Bank extended two SME credit lines to Albanian financial institutions, signed two road rehabilitation projects, invested in two corporate projects and participated in the electricity distribution efficiency improvement programme. As a result, key transition objectives for the new projects varied across different dimensions, with a special focus on setting higher standards for corporate governance and business conduct, demonstration effects related to successful restructuring, as well as market expansion (see Figure 1).

Figure 1. Targeted transition objectives in Albania (share of projects), 2009-2012



The projects in the country’s portfolio are performing well in terms of achieving their envisaged transition impact. Out of 22 operations projects in the Bank’s active portfolio all but one are, as of end-May 2012, on track to achieving their transition potential.² Out of these 21 projects, five active operations have a rank³ in the range

¹ There were 3 additional operations (under LEF and WeBSEDF frameworks) which were not individually assessed for their transition; these are assessed and monitored at facility level.

² All active operations more than 6 months since signing and are monitored for their transition impact at least once.

³ Rank is a combination of the relevant rating for transition impact potential and risks to transition impact. Expected transition of operations is usually monitored once a year and is ranked numerically

from 1 to 3 – in other words, they have mostly achieved the desired transition impact. Sixteen operations are currently ranked 4 or 5, which indicates that they are on the way to achieving their transition objectives. The only operation that has failed to achieve its transition potential is in the agribusiness sector. Due to difficult conditions as a result of financial crisis, the client has been unable to meet the expected objectives, including environmental improvements and a training programme, which has resulted in a downgrade. While the average rank of the Albania's active portfolio, at 4.23, is below that of all Bank operations (4.09), the overall performance of the country's portfolio can be described as on track.

2. OPERATIONAL ENVIRONMENT

2.1 Political Context

The centre-right Democratic Party of Prime Minister Sali Berisha has led a coalition government since 2005 and won a second consecutive mandate in general elections in 2009. Representatives of the governing political party currently also hold the positions of President (elected by the parliament in June 2012) and the Mayor of the capital Tirana (elected in local elections in May 2011). There has been a high degree of continuity in policies, including the government's top priorities – market reforms, completion of privatisation, and further integration into Euro-Atlantic institutions. It should be noted that there is a reasonably wide consensus among Albanian political parties, including the centre-left opposition, regarding these priorities.

The main opposition political party did not recognise the outcome of the 2009 elections, which it lost narrowly to the ruling party. This led to periodic boycotts of the national parliament by the opposition contributed to an increase in social tension and slowed down certain policy reforms. The fraught relations between the central government and local authorities in the capital Tirana, which intensified in the aftermath of the 2009 general elections, were eased after local elections in May 2011

There has been considerable improvement in the political dialogue and the overall political atmosphere in Albania since the end of 2011, following a political agreement between the government and the opposition. The opposition has returned to the parliament and has cooperated in the adoption of laws requiring a qualified majority. A cross-party parliamentary committee started work on electoral reform, which culminated in July 2012 with the adoption by Parliament of amendments to the Electoral Code that had been recommended by the OSCE and the Council of Europe. This should create a sound basis for the next general elections, due in 2013, provided all stakeholders exercise the necessary political will to implement the law in an impartial and fair manner.

Albania plays a constructive role in regional cooperation, and the authorities actively support various cross-border and regional projects.

See Annex 1 for a more detailed political assessment.

from 1 to 8, with 1 to 3 indicating the mostly realised impact, 3 to 6 – generally on track to achieve transition objectives, and 7 to 8 – minimum transition impact or excessive risks.

2.2 Macroeconomic context

The Albanian economy stands out in the region in the past few years as having weathered the global crisis significantly better than its neighbours. While most of south-eastern Europe entered a deep recession in 2009 and has struggled to recover, Albania's GDP continued to grow each year, albeit at reduced rates relative to the pre-crisis period. Real GDP rose by 3.6 per cent in 2009 and 3.8 per cent in 2010, highlighting the relative insulation of the economy to shocks elsewhere thanks in part to the flow of remittances and relatively stable domestic demand. More recent macroeconomic figures, however, point to a deceleration in economic activity, in particular in light of the worsening situation in some key EU markets, such as Greece and Italy. The economy's growth rate slowed down to 3.1 per cent in 2011 and is expected to decline further to a (currently) projected 1.2 per cent in 2012.

Various factors help to explain the slowdown. Export growth has fallen significantly since the middle of 2011 as a result of weaker demand from abroad. Domestic demand is also sluggish, reflecting declining confidence and a growing nervousness among consumers and investors about the short-term economic outlook. Credit growth to the economy is only marginally positive in annual terms and the level of non-performing loans remains high at about 19 per cent of total loans. The level of remittances, a vital source of income for many Albanians, has held up reasonably well but may be expected to decline further because of the economic problems in Greece and Italy, the two main source countries for Albanian remittances.

The government and the central bank have had notable success in recent years in terms of maintaining macroeconomic stability. The inflation rate accelerated in early 2011 but slowed down in the second half of the year and, in January 2012, it fell below the central bank's target range of 2-4 per cent. With concerns mounting over the weakening economic growth, the Bank of Albania decided to introduce another cut to the policy rate, bringing it down to a ten-year low of 4.5 per cent in January 2012. More recently, inflation has moved back within the target band.

On the fiscal side, a number of reforms have been introduced in recent years to improve revenue collection and implement more targeted spending policies. As a result, the overall general government deficit has dropped significantly (as a percentage of GDP) relative to levels seen in the middle of the previous decade. The deficit in 2011 was 3.5 per cent of GDP, and the government is targeting a deficit of 3 per cent of GDP in 2012 – an ambitious target that will be difficult to achieve in light of the weaker growth projections. Despite the improved performance, public debt is still high relative to regional comparators. As of mid-2012, it is close to 60 per cent of GDP. As such, the scope for increased public spending is limited.

On the external side, Albania's share of exports relative to GDP is low in comparison to neighbouring countries, although the share has risen over the strategy period as Albanian exporters gradually gain greater access to markets abroad. Key exports continue to be textiles and minerals. The current account deficit is still large, at around 13 per cent of GDP in 2011. Despite the persistence of current account deficits over the years, foreign reserves remain at a relatively comfortable level (covering about 4.5 months of imports in 2011) and total external debt is less than 40 per cent of GDP, the lowest in the SEE region. Inflows of foreign direct investment (FDI) have actually risen in recent years, averaging about US\$ 1 billion per annum in the period

2009-11, bucking the regional trend. However, these figures are heavily influenced by a few key privatisations; greenfield FDI in Albania is limited to date.

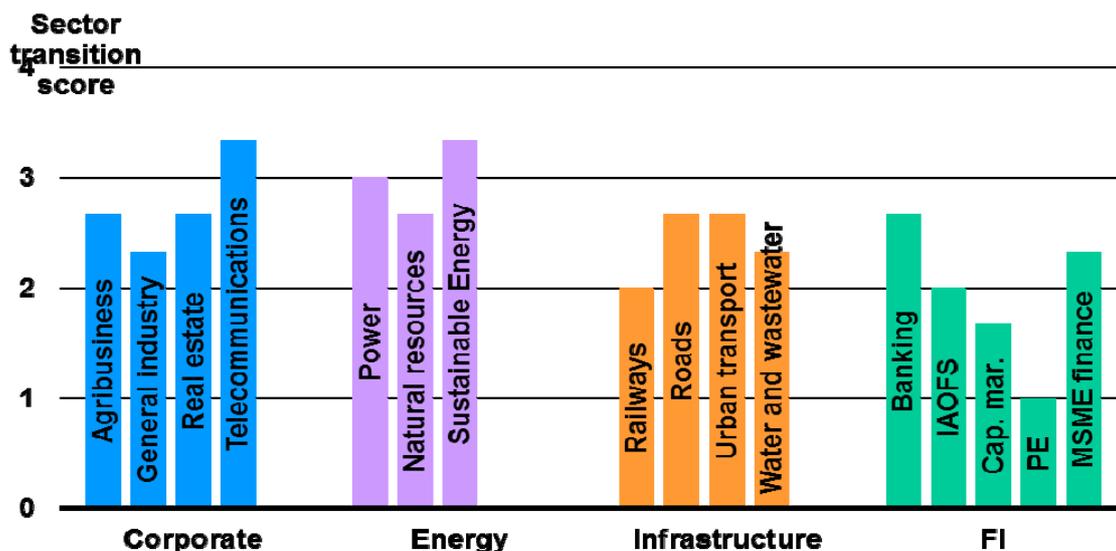
Looking ahead, short-term projections for the economy are highly uncertain, given the current (mid-2012) regional and global turmoil. Albania is quite vulnerable to negative contagion effects, given its close trading and investment ties to Greece and Italy, although the authorities have made commendable efforts to prepare for different contingencies and protect as far as possible the economy and financial system from spillovers. Over the medium term, Albania has major catch-up potential; GDP per capita, adjusted for purchasing power standards, is just 31 per cent of the EU-27 average, according to Eurostat estimates. Achieving this potential, however, will require a continued commitment to, and implementation of, the reform priorities identified below.

See Annex 7 for a table with Selected Economic Indicators.

2.3 Structural reform context

Albania has made steady progress over the past two decades with structural reform, overcoming serious institutional weaknesses and one of the most difficult starting points for transition. In terms of the EBRD's country-level transition indicators, Albania has achieved the maximum score (4+) for price liberalisation and trade and foreign exchange system, reflecting the liberalised and open nature of the economy. It also scores highly on small- and large-scale privatisation (4 and 4- respectively). However, the scores for governance and enterprise reform and competition policy are much lower – 2+ in both cases – illustrating the scale of the reform challenges ahead, as progress in these areas is traditionally much harder to achieve than in other, first-stage, reforms.

At the sectoral level, important progress has occurred recently in several areas, notably in the roads sector, including the establishment of a road agency in July 2011, and in the water and wastewater sector. Supervisory and regulatory measures have also been improved in the financial sector as a response to increased pressures on banks and other financial institutions. Nevertheless, the detailed analysis carried out each year by the EBRD's Office of the Chief Economist of the remaining transition challenges across 16 sectors of the economy demonstrates that Albania still has a long way to go in its transition. The sector transition scores, on a scale of 1 to 4+, are shown in Figure 2. The scores are based on an assessment of the remaining transition "gaps", in terms both of the structure of the market in question and of the strength of market-supporting institutions. In virtually all cases, the sectoral gaps in Albania are assessed as either "medium" or "large", with the highest gaps typically in infrastructure sectors, such as urban transport and railways, and in non-bank financial institutions, such as capital markets and private equity.



See Annex 2 for a more detailed description of sectoral transition gaps in Albania.

2.4 Business environment

Albania's business environment is generally perceived to have improved steadily over the years, and a strong entrepreneurial spirit is evident in the economy. More than 14 per cent of those surveyed in the EBRD-World Bank Life in Transition Survey said that they had at some point successfully set up a business, a higher percentage than in any other transition country except Mongolia. However, weak law enforcement and high perceived levels of corruption remain important impediments to business development. Although the reported frequency of corruption in the courts and customs service has declined in recent years, firms still report above-average levels of corruption in the tax administration, according to the latest EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS), carried out in 2008/09. The BEEPS results point to business managers' concerns regarding land titling and ownership. In addition, the energy sector remains problematic because of the high level of non-payment and theft.

Other cross-country indicators highlight the extent of the challenges ahead. Despite recent improvement in its Transparency International Corruption Perceptions Index (CPI) score, Albania still ranks 95th out of 183 countries. Other indicators, such as the World Economic Forum's Competitiveness index, on which Albania ranks 78th in the world, and the World Bank's Ease of Doing Business report, where Albania is in 82nd place, also illustrate the remaining challenges in the business environment. Further improvements to the business environment would help to attract greater amounts of both domestic and foreign investment.

2.5 Social context

Over the past decade, per capita income and living standards in Albania have improved substantially. On a per capita basis, real income rose by 53.7 per cent between 2001 and 2011. However, income distribution remains highly uneven, and with a 2011 PPP adjusted per capita income of US\$ 7741, Albania remains among the

poorest countries in Europe. According to the World Bank, poverty in Albania has a significant geographic dimension. In rural areas, poverty rates are up to 50 per cent higher than in urban areas and 66 per cent higher than in the capital, Tirana. Poverty is particularly pronounced in the rural areas of the Mountain region in the north and north-east of the country, where almost 50 per cent of the population is classified as poor and more than 20 per cent of the population is classified as extremely poor.

Unemployment in Albania has declined from 16.4 per cent to 13.3 per cent over the past ten years. The past decade was also marked by a decline in the gender gap in employment rates as well as a reduction in youth unemployment. At the same time, unemployment support has declined and is very low in absolute terms. According to the Albanian statistical office (INSTAT), only 5.9 per cent of the unemployed Albanians received unemployment benefits in 2011 as compared to 10.2 per cent a decade earlier. By comparison, the corresponding figure for Western Europe for 2011 is around 35 per cent.

Education enrolment rates in Albania remain among the lowest in Europe across all educational levels. According to data from UNESCO, primary school enrolment is only 93 per cent, and at 30 per cent, the tertiary education gross enrolment ratio is particularly low (64 per cent for other European countries in the sample). Albania also scores the lowest among SEE regional peers on the 2009 Programme for International Students Assessment (PISA) conducted by the OECD. Overall, Albania's human capital needs significant upgrading over the medium to long term, in order to enhance the economy's ability to grow and innovate.

Although the global financial crisis did not affect the Albanian economy as strongly as its SEE neighbours, evidence from the EBRD-World Bank Life in Transition Survey (LiTS) shows that the perceived impact by the Albanian people was nevertheless quite high. Around 60 per cent of households reported that the crisis affected them either a great deal or a fair amount, compared with a transition region-wide average of 42 per cent. A large proportion of households reported having to cut back on essential expenditures like staple food and health care to cope with the crisis.

2.6 Legal context

Albania's legal environment continues to remain complex and challenging despite significant reforms over the last decade aimed at supporting investment. The general legal framework has improved substantially and the steps taken appear to have allowed progress in establishing a legal system that conforms to international standards. For instance, the 2006 Albanian law on Concessions is one of the best in the region.

Albania's judicial sector is relatively weak, under-funded, and registers high in corruption surveys which jeopardizes Albania's aspirations for EU membership. Albanian courts do not enjoy high levels of public confidence, especially in the business community. Certain other legal areas – such as the enforcement regime where mortgages are concerned - are still in urgent need of reform.

See Annex 3 for a more detailed assessment of the legal environment.

2.7 Energy efficiency and climate change context

Albania's primary energy intensity was almost four times higher in 2010 than the average energy intensity of the EU (EU15) and still higher than most countries in south-eastern Europe.

Since 1990, demand for oil products has increased rapidly as a result of the country's growth and the fast development of individual energy needs. This is particularly the case in the transport sector with the increased use of individual cars. Between 2000 and 2006, the total final consumption of oil products increased annually by 3.6 per cent on average. Household energy growth is particularly strong in electricity, with increasing use of electric space heating. Winter peak demand is now some 70 per cent higher than the summer peak.

As Albania has limited domestic energy resources, the security of electricity supply remains a challenge. The supply is subject to hydrological conditions, due to the country's almost exclusive dependence on hydro power plants for domestic generation. Renewable energy in general represents a key area for sustainable development for Albania. Also, public buildings are often inefficient, which raises the potential for energy cost savings investments. While these investments often have positive net present values, a lack of both technical expertise and funding prevents public building owners from exploiting these saving potentials.

Albania has played an active role in the establishment of the Energy Community Treaty for south-eastern Europe. The country was one of the first in the region to sign the Treaty in October 2005. Being a Contracting Party to the Energy Community, Albania is not obliged to implement the RES Directive 2009/28 in its national legislation at this time, but would be expected to do so in the future.

The government also approved a National Energy Efficiency Action Plan for the period 2011-2018 (NEEAP) but the legal framework and inter-institutional distribution of responsibilities for its implementation have yet to be established. The NEEAP decrees that national indicative target must be allocated to the sectors of final energy demand, so that the effectiveness of proposed measures can be monitored at a more disaggregated level.

As part of Albania's programme to achieve the aims of the National Energy Strategy, the National Energy Efficiency Law sets out plans to improve energy efficiency. Priorities for action are: significantly reducing transmission and system losses; enhanced enforcement of the energy provisions of the Building Code; greater use of solar hot water; improved insulation, use of decentralised heating and hot water systems; increased efficiency of boilers and use of new boilers; use of incandescent lighting; and promotion of public transport and use of rail for freight.

Albania's 2nd National Communication to the United Nations Framework Convention on Climate Change (UNFCCC) identifies a number of climate change adaptation priorities that are relevant to the Bank's operations. Shifts in precipitation and temperatures are projected to intensify pressure on water resources. Improvements in water supply infrastructure, and in water use efficiency in agriculture and industry, will be priorities. Hydropower generation is forecast to be affected by climate-driven

shifts in hydrology and reductions in surface runoff, which will need to be taken into account in investments. The energy sector may also be affected by shifts in seasonal peak demand caused by temperature shifts. Impacts on sea-level rise and coastal erosion will need to be taken into account in investments in coastal infrastructure such as ports.

3. STRATEGIC ORIENTATIONS

3.1 Transition challenges

Albania has made steady progress with structural reform over the past two decades, despite having to overcome serious institutional weaknesses and one of the most difficult starting points for transition. However, the country faces significant challenges across the board. Key transition challenges that can be addressed with the support of EBRD financing and assistance include:

- **Moving towards a more balanced energy sector.** Albania has the potential to become a regional player in the renewable energy market, but achieving this goal will require improved efficiency and viability of distribution and generation, a substantial increase in private sector participation in power generation, and an improved regulatory framework.
- **Upgrading infrastructure including through an increased participation of the private sector.** The implementation of PPPs projects and other concession financing will be critical for addressing this transition challenge. The development of railways and port infrastructure will also be a key factor in advancing Albania's regional integration and sustainable transport.
- **Developing a more vibrant corporate and agribusiness sector.** In a difficult international economic environment the Albanian private sector will need financial and technical support to promote greater vertical integration, innovation, competitiveness and improved corporate governance. Further challenges include the reduction of the administrative burden facing businesses, the completion of privatisation and greater enforcement of the rule of law.
- **Deepening financial intermediation.** Financial intermediation is still low by regional standards and its development was slowed down by the negative impact of the crisis. Challenges ahead include enhancing the flow of credit to the real economy in the face of more stringent capital requirements and boosting the development of non-bank financial services.

3.2 Bank priorities for the strategy period

The Bank's priorities for the next three years will focus on sustainable development of the private sector, building on the strong entrepreneurial spirit in the economy. The Bank will also invest in high-priority public sector projects in infrastructure where such investments can address important transition gaps. In light of the transition challenges identified above, the Bank's activities in Albania will focus on the following areas:

- **Promoting Sustainable Energy Policies and Environmentally Sound Investments.** The Bank will cooperate with the Albanian authorities and the independent regulators to enhance the regulatory and administrative framework

facilitating private sector investments, particularly in the renewable energy sector. The Bank, through its dedicated facilities WeBSEFF/WeBSEDF, will finance energy efficiency and renewable energy projects and, in cooperation with other IFIs and commercial banks, will support the upgrading and financial viability of energy generation and distribution. Interconnection lines and gas pipeline will be also of key importance to improve competitiveness and regional integration. Under the Sustainable Energy Initiative, the Bank will continue to use energy audits in this sector and identify investment potential across the sectors. The Bank will also explore opportunities for carbon market development linked to intermediated financing in the Western Balkans, including in Albania.

- **Enhancing commercialisation, competition and private sector involvement in infrastructure, alongside targeted public projects.** The Bank will assist the Albanian authorities both at the national and local level to increase private sector involvement in transport and municipal services. Financial assistance will be complemented by technical advice, capitalising on the Bank's experience to successfully structure and implement PPP and concession financing, to improve maintenance and ensure long term sustainability of public infrastructure. The Bank will also work closely with the Government in advancing the transition in the seaport and railways sectors.
- **Supporting the development of a more competitive private sector.** The Bank will continue to be a strong partner for foreign investors and for local corporates, both directly and through the LEF. The Bank will pursue an active investment policy in sectors such as agribusiness, manufacturing and services, ITC and tourism, all of which have the potential to modernise and increase value creation in the Albanian economy, which is still overly reliant on imports and labour-intensive textile subcontracting. The Bank will also enhance activities to support micro, small and medium sized enterprises (MSMEs) in key sectors through Business Advisory Services (BAS) and the Enterprise Growth Programme (EGP).
- **Strengthening the financial sector and deepening intermediation.** The Bank will support the banking system in a difficult market environment with credit lines and other facilities such as the MCF. The Bank, through a close consultation with the Bank of Albania, will respond in a timely fashion to the emerging needs of the local financial sector.

3.3 Sectoral challenges and the Bank's operational response

3.3.1 Energy

Sectoral challenges

- Although the Energy Regulatory Authority is in place, its institutional capacity needs further strengthening and its independence is limited.
- Generation, distribution, and transmission networks need significant improvements, and losses and non-payment levels are very high by regional comparison.
- Private sector participation in generation is very limited to date, covering only a small percentage of the hydro market. The legal and institutional framework to support small renewable projects needs to be further strengthened.

- The gas market remains underdeveloped, and the lack of economic wholesale gas supply and gasification is a significant impediment to firms and households in the country.
- Mining and extractive companies in the natural resources sector need significant restructuring and modernisation, as well as improvements in environmental, health and safety standards.

Bank's operational response

To support generation, distribution and transmission improvements, the Bank will continue its assistance to the Albanian Power Corporation (KESH), to help the company improve its financial viability and stability, by providing long-term loans for the safety, maintenance and upgrading of its generation utilities as well as for a possible restructuring of its operations. The Bank will also focus on the improvement of distribution efficiency, loss reduction and payment collection through its existing investment programs with the Transmission Corporation (TSO) and the privatized distribution company (CEZ Shperndarje). The Bank will maintain a strategic view on the sector to facilitate the integration of the Albanian energy market into the regional one, in line with the objectives of the Energy Community Treaty (ECT) for creating a competitive integrated regional energy market. The Bank will contribute to this especially by supporting investments in interconnection lines with neighbouring countries.

To support private sector involvement in power generation, the Bank will continue to implement the WeBSEFF/WeBSEDF frameworks for the financing of renewable energy and energy efficiency projects by extending support to private concessionaires and companies implementing energy savings. The Bank will also closely follow the privatization process of state-owned power generation assets and will cooperate with other IFIs and commercial banks, capitalizing on its experience and knowledge of the sector. The Bank will continue to encourage new investments in the hydropower sector through the organization of high-profile promotional events. The Bank will also prepare a regional Western Balkan programme to improve the regulatory framework governing ESCO energy efficiency projects. In the case of Albania, this programme will focus on creating an enabling legal framework for ESCO projects during the strategy period.

To promote wholesale gas supply and gasification, the Bank will consider the opportunity to share its experience of financing major regional pipelines if the Trans Adriatic Pipeline (TAP) project and the Ionian-Adriatic Pipeline (IAP) project are chosen as priority and viable routes to be implemented. This is also part of the ECT's strategy to target projects of regional significance.

To restructure, modernize and improve the standards of mining & extractive companies, the Bank will consider private investments that adopt high standards of governance and business conduct (including the Extractive Industry Transparency Initiative – EITI), the transfer of skills and best practices for an environmentally sustainable production. The Bank will assess the upcoming Albpetrol privatization with a particular focus on the environmental and social remediation, supporting investors capable of providing appropriate solutions to the severe environmental damage of the previous decades.

Policy Dialogue

The Bank will continue its policy dialogue to consolidate the independence and institutional capacity of the Energy Regulator and of the National Agency of Natural Resources, which is responsible for hydrocarbon licensing and monitoring. **To strengthen the Energy Regulatory Authority (ERE)**, the Bank will continue to deploy technical assistance to increase ERE's skills and institutional capacity, promoting progress toward a fully independent energy regulator. The Bank will work together with other IFIs and stakeholders to ensure a closer consultation process through more regular meetings of the Energy Working Group. The Bank will engage with the ERE to promote a full and fair application of cost-reflective tariffs, an effective functional and financial separation of the public wholesale supplier from the public generation utilities, and a consolidation of the energy law in full accordance with the EU's *Acquis Communautaire*.

In the Natural Resources sector the Bank will lobby for an improved investment climate, which will not only facilitate ongoing investments but also attract new ones in a strategic sector for the country's economy. The Bank will be an active participant in sector working groups, including the one for the resolution of the adverse environmental legacy in the oil fields of Patoz Marinza, and will continue to assist the Albanian Government in enhancing the regulatory and tariff framework in the renewable energy sector.

3.3.2 Infrastructure

Sectoral challenges

- While significant transition progress has been made in the road sector in recent years, competition and private sector participation in areas such as road maintenance remain limited. Remaining institutional and framework challenges in the transport sector include the preparation of a sustainable transport study and tolling strategy, the introduction of performance-based maintenance contracts, the establishment of the Albanian Road Agency and the introduction of a service level agreement, and setting of corporate governance within ARA.
- The seaport and railway sectors can play an important role to achieve sustainable transportation in the country (including containing, if not reducing, CO2 emissions and localised pollution). The landlord model could be introduced for the port of Durres, outsourcing terminal management and operations to the private sector through tenders. In the railway sector, further corporate restructuring and financial sustainability improvements would be required.
- In the water sector, the fragmentation of the institutional framework together with low tariffs and collection rates make it difficult for investors to formulate viable investment projects outside the capital, Tirana. This is further exacerbated by the large number of small water/wastewater companies in existence today. The limited independence of the water regulator is a further deterrent to potential investors. Private sector participation in the urban transport sector is on the rise, but the market is fragmented and contractual arrangements with the regulator are weak.

Bank's operational response

To increase private sector participation in transport, the Bank will promote PPPs and other forms of concession financing, and will provide direct support to private initiatives. Particular attention will be given to PPPs in road maintenance (such as the Milot-Morrina Highway). PPP opportunities are also expected to arise in the port sector, particularly in the port of Durres which is planning to launch tenders for port terminal operations and management. Direct co-operation with private companies investing in improving logistic, shipping and storage facilities will also be encouraged as a way of supporting export-oriented companies and lowering the cost of imported goods. The Bank will also support further possible developments at the Tirana Airport concession, building on the success of its past experience.

To advance sustainable transport, the Bank will intensify its focus on increasing the feasibility of railway sector investments and further commercialisation and energy efficiency capability in port management. The Bank will support these sectors through policy dialogue initiatives and pilot projects such as the Tirana-Durres railway line, the detailed design of which is being funded through the WBIF. A particular focus will be devoted to strategic transport connections with neighbouring countries and in rural areas, supporting the Government's efforts (in cooperation with other IFIs and the EU) to complete the rehabilitation and upgrade of the Albanian transport network. The Bank will continue to work with the authorities to improve project management and execution capacity of key infrastructure projects.

To increase the commercialisation of municipal services and utilities, the Bank will seek opportunities to support investments and the reorganisation, including possible regionalisation, of water/wastewater utilities and, together with other donors, will endeavour to devise appropriate financing frameworks that promote cost-recovery projects. While the tariff level and collection rates remain low and environmental standards and regulatory enforcement continue to be weak, the Bank will support the strengthening of the regulatory functions and environmental standards in this area. In the urban transport sector, the Bank will promote the construction and the upgrade of integrated transport terminals on a PPP basis and parking facilities, actively promoting and supporting the participation of the private sector, also through financing of feasibility studies and improving the quality of contractual arrangements. The Bank will also assist local authorities, especially the Tirana Municipality, in selected infrastructure projects that promote a more integrated urban transport policy and alleviate heavy traffic in the capital, aiming also to maximize private sector involvement. In this vein, Tirana has begun studies for the introduction of a tram system on a PPP basis.

Policy Dialogue

To address remaining institutional and framework challenges in the transport sector, policy dialogue and technical cooperation instruments are expected to remain key tools for enhancing institutional reforms and capacity building. The Bank will develop a Sustainable Transport Study (STP), which will be a key document assisting the Government in meeting energy savings targets for the transport sector in Albania. The STP's overarching objectives are to set targets for sustainable development of the

national transport network and to implement them in the form of an Action Plan. For urban transport, the primary objective is to provide the authorities with best practice policies, which can then be implemented at the municipal level. The Bank will also assist in preparing a Tolling Strategy to support the Government's efforts to find other means of generating revenue and improving maintenance. Specific assistance will be provided to help the Albanian Development Fund (ADF) in supporting the communes in the maintenance of local roads, including identifying opportunities for the engagement of private contractors.

3.3.3 Industry, Commerce, and Agribusiness

Sectoral challenges

- Privatisation is well advanced, but some significant assets remain to be sold, including the state-owned oil producer, Albpetrol.
- Financial instruments to support the growth potential or restructuring of viable local and international companies operating in Albania are not adequately in place.
- The development of competition and market forces in agribusiness is held back by ambiguity over property rights and high land fragmentation.
- Various aspects of doing business are still problematic. Weak ownership, transfer and property rights, complicated and lengthy dealings for construction permits and paying taxes are particularly serious issues.
- SMEs are particularly constrained by bureaucratic obstacles, lack of compliance with European standards and norms and inadequate managerial knowledge. Furthermore, the SME support infrastructure faces large transition challenges. The quality of available advisory services is perceived as relatively low, and local consultants lack experience and international market insights and standards. A professional association has recently been established but the institutional framework requires further support.
- Cross-country surveys point to the lack of market-oriented skills and managerial standards. Albania needs to consolidate appropriate standards of corporate governance and business conduct, limiting the informal practices that are still common among small and medium-sized local companies.

Bank's operational response

To advance private sector involvement and initiatives, the Bank will support the privatisation of remaining state-owned enterprises, ensuring a fair and competitive process. The Bank will continue to assist the private sector through financing existing businesses, green-field developments and acquisition projects. The Bank will further expand its efforts to reach directly SMEs through the LEF or alongside local banks through products such as the MCFE.

To support the growth of private companies and provide financing for restructuring of viable businesses, the Bank will offer capital increases through the LEF, as well as longer-term debt and other risk-sharing instruments to companies that have sound business plans but limited access to the local banking sector. The Albanian manufacturing sector will be a priority area, supporting companies with an export-oriented production or with large efficiency improvement potential, in areas

such as recycling and pharmaceutical retail. The Bank will also explore the ICT sector where new technologies for data transmission are offering new opportunities to telecom operators. The deployment of ICT infrastructure, including fibre optic cables, is still in an initial stage. In the property sector, feasible projects are expected to arise that expand real estate infrastructure, particularly those that improve retail efficiency (logistics as a primary focus), retail energy efficiency (e.g. refurbishment and redevelopment of existing hotels, etc.) and enterprise efficiency (offices). In the tourism sector, areas of potential support include coastal and mountainous holiday resorts. Lastly, the EBRD's Small Business Support Team, in collaboration with LEF, will implement an accounting improvement programme (AIP) in Albania to prepare businesses for EBRD investment.

To support the development of competition and market forces in agribusiness, the Bank will utilize LEF or indirect facilities through Bank-supported financial intermediaries, given the relatively small size of most agriculture companies. Meanwhile, increased attention will be paid to medium-size food-processing companies for longer-term lending. The Bank is also interested in supporting local corporates, under the recently devised Agribusiness Sustainable Investment Facility, focusing on investments related to energy efficiency, including biomass and renewable energy resources, improved environmental standards and the development of sustainable farming techniques and processing efficiencies.

To enhance the competitiveness of the SME sector, the Small Business Support Team will combine advice and mentoring at the enterprise level with the development of a sustainable infrastructure of MSME support at the market level. Planned operations will strengthen MSME performance and sophistication in areas such as managerial skills, branding and marketing of products, compliance with international standards as well as skills in human resources and environmental management, which in the medium-term will aid Albania to move towards a more competitive, export-oriented and knowledge-based economy. Key sectors of SBS support include the agribusiness and food processing sector, tourism and hospitality, wood and metal processing, ICT and textile/shoe production. SBS will also explore potential interventions in the renewables and energy sector, and will actively promote rural development, female entrepreneurship and cross-border linkages.

Policy Dialogue

To help improve competitiveness and the business environment, the Bank's policy dialogue in the corporate sector will be aimed at promoting further improvements of the business climate and exploring opportunities to contribute to the enhancement of property rights, tax administration and the judicial system. The Bank will also continue to advocate increased efficiency in VAT reimbursements and public works payment schedules. The Bank may also consider, in cooperation with other donors, the organisation of workshops to increase awareness of corporate governance of local companies. The Bank through SBS will continue to contribute to the development of a viable and business-enabling environment by facilitating public/private dialogue. In particular, LEF-TC funds will be used to support the growth of local private firms strengthening their governance standards and managerial capacities, encouraging the adoption of European quality standards, and the improvement of supply-chain, operational, and marketing efficiencies. Albania's accession path to the European

Union would have significant implications on the legal and regulatory framework, positively influencing the business environment. The Bank will closely work with the European Commission to jointly identify and prioritise policy dialogue initiatives which can be undertaken to maximize the benefits of Albania's accession process.

3.3.4 Financial Institutions

Sectoral challenges

- Overall financial intermediation is low in comparison with some other south-eastern European countries, risk management problems in the banking sector are significant (as evidenced by the high level of non-performing loans), and the dependence of some foreign banks on parent funding is a significant vulnerability in the current climate.
- Transition challenges remain large in most parts of the non-bank financial sector – insurance and other financial services, capital markets, and private equity – as overall development of these sectors is well below regional standards.

Bank's operational response

To increase financial intermediation and limit the dependence of banks on parent funding, the Bank will continue to support its existing partner banks and develop relationships with new banks. The Bank will intensify its efforts to offer streamlined MCFF facilities, SME/energy efficiency credit lines (such as WeBSEFF), LEF parallel lending and other risk-sharing products that aim to ensure continued lending to the real economy while at the same time strengthening the banks' risk profiles and their lending policies and procedures. In particular, the Bank may be called upon to consider equity, quasi-equity and/or debt investments to banks which, until now, have been able to rely on local deposits or parent funding to support their lending operations. As one of the major challenges will be to avoid any significant deleveraging, the Bank will seek to design adequate lending products, where possible coupled with donor-funded subordinated resources, to support MSMEs. If appropriate and feasible, the Bank will explore approaches to assist banks that face significant NPLs and are trying to restructure their loan portfolios. The SBS team will seek to facilitate access to finance to its beneficiaries through better linkages with EBRD banking teams, credit lines and partner financial institutions.

To promote the non-banking financial sector, the Bank will support leasing, microfinance and insurance companies through customized financing and technical assistance for institutional capacity building.

Policy Dialogue

The Bank will continue to engage in policy dialogue and technical cooperation (including through the existing TC on modernizing supervisory reporting) with the Bank of Albania to ensure that it further strengthens its market supervision capacities. The Bank will also continue to engage in a constant dialogue with the Bank of Albania to monitor the needs of the banking sector and be able to quickly respond to critical adverse events. The Bank will consider offering assistance in improving the governance of local banks and in supporting the efforts of the Bank of Albania to

improve financial literacy among the society at large, through publications and training for students and professionals.

3.4 Environmental and Social Implications of Bank Proposed Activities

EBRD projects are subject to the 2008 Environmental and Social Policy and Performance Requirements. For direct investments, these require projects to be structured to meet EU and national environmental requirements. Where appropriate, EBRD will work with clients, so that any complementary action to projects that do not meet EU environmental criteria will bring them toward fully meeting EU standards in the future.

The Bank will work with clients to assess each project's environmental risks and opportunities, and for high risk sectors, an extensive implementation/monitoring plan will normally be agreed in the legal documentation with the Bank, as part of the project commitments.

For projects in the sustainable energy sector, including hydropower, careful attention will need to be paid to biodiversity on hydropower projects as well as to stakeholder engagement. Improved energy distribution and collections may result in tariff affordability being a key issue for more vulnerable households. Measures will be undertaken to ensure affordability of the basic minimum service for the poorest families.

The Bank will ensure high risk sectors, such as the restructuring and modernisation of mining, extractive companies and distribution projects, such as pipelines will undergo rigorous due diligence and monitoring throughout project implementation. Projects that may have transboundary impacts will need to follow requirements for UNECE Espoo Convention.

The Bank will work with its clients to maintain a high level of stakeholder engagement, including community engagement, both during the due diligence phase as well as during operations, in order to ensure that their concerns and priorities are understood.

For infrastructure projects, normal due diligence will be implemented. As these projects sometimes involve land acquisition, the Bank will work with the client to register land titles so as to facilitate the process of expropriation and compensation, where appropriate.

In the property and tourism sector, the Bank will undertake due diligence, including reviewing lessons learned from projects and other IFIs on coastal zone management, habitat loss and stakeholder engagement.

Gender

In accordance with its current Gender Action Plan, and with its forthcoming Gender Strategy, the Bank will aim to mainstream gender-related projects and technical assistance across sectors, as appropriate. For example, the Bank will work with its clients to identify ways to support women entrepreneurs and increase financial literacy. Clients will be encouraged to provide opportunities for women and to promote equal opportunities in the work place and will be provided with support where it is needed. Clients will be encouraged to develop appropriate corporate social responsibility programmes whose components may include skills training and identifying opportunities for employment for both men and women.

4. ACCESS TO CAPITAL: PRIVATE AND PUBLIC SOURCES OF FINANCE

4.1 Private sources of capital

At the sovereign level, Albania has traditionally relied on funding from donors and IFIs (see section 4.2), while access to private sources of capital has been limited. Nevertheless, a landmark event occurred in November 2010, when the country launched its first Eurobond – a five-year €300 million bond with a coupon of 7.5 per cent. Since then, the authorities have been reluctant to venture again into international capital markets because of the current volatile situation in the global economy. Two of the main international credit rating agencies, Standard & Poor and Moody's, rank Albania's sovereign debt as non-investment grade: B+ from S&P and B1 from Moody's as of June 2012 (Fitch ratings does not yet rate Albania).

The Albanian banking sector is largely foreign-owned. Out of the 16 banks that operate in Albania, only two are majority-owned by Albanian entities. Foreign-owned banks account for about 90 per cent of all banking assets in Albania.

Credit to the private sector in Albania has been steadily increasing over the past decade. The financial crisis reduced the vigorous pace of credit growth of the previous four years (credit grew by over 600 per cent between 2004 and 2008), but Albania did not experience the deleveraging and credit crunch that occurred in some of its SEE neighbours. Over 2010 and 2011, credit to the private sector grew at a slower pace, on average by 10 per cent y-o-y, due to both weaker demand for loans (higher uncertainty and less investment spending among businesses plus unfavourable developments in the real estate sector among households) as well as tightening lending conditions among banks (largely due to macroeconomic uncertainty and the high level of non-performing loans).⁴

Household loans represent a smaller share of total loans as compared to the pre-crisis period – they were affected by changes in demand and lending practices more strongly than business loans. This along with increased perceptions of risk in the economy has been reflected in a shifting term structure of loans. Short term loans represent a larger share of total loans than they did prior to the crisis.

Access to finance for MSMEs remains particularly constrained in Albania. MSMEs account for 99.9 per cent of the total number of companies and 82 per cent of official employment. Yet they account for only about a quarter of bank lending.

4.2 MDB finance and collaboration with other IFIs and multilateral donors

The Bank has maintained a close cooperation with other IFIs and multilateral donors, particularly through parallel financing with the World Bank and IFC in the energy sector and large private undertakings and co-financing with the EU Commission, EIB and other donors in transport infrastructure projects. Established frameworks such as the WBIF and Sector Working Groups, and Developing and Integration Partners Meetings have served as instruments for coordinating efforts.

⁴ Bank of Albania Lending Surveys (quarterly surveys for 2009, 2010, 2011)

Through the WBIF, the EU, EBRD, EIB, CEB, KfW and IBRD have created an effective mechanism to co-ordinate sectoral policies and project priorities among donors and countries in the region. WBIF is increasingly used by all parties to focus resources on critical projects for regional integration in both the public and private sectors, while the EU accession process has led to increased use of the WBIF as the vehicle of choice to channel regional IPA resources. So far, about Euro 5 billion have been allocated by the WBIF for projects in the region, co-financed by two or more of the participating IFIs and more than Euro 250 million in grant co-financing has been sourced.

Looking ahead, the WBIF will play a critical role as a policy dialogue platform for regional strategies (e.g. the Balkan gas ring road) and for projects with an impact on regional integration (e.g. the completion of the electricity interconnection). In addition, the WBIF will play a role to support new initiatives such as the Enterprise Development and Innovation Facility (EDIF) and the new EBRD-led energy efficiency initiative aimed at promoting, inter alia., ESCO financing.

The World Bank Group is in the process of releasing an updated Country Partnership Strategy Progress Report for Albania. The World Bank expects to focus on the following objectives:

- support the economic recovery and help counter any effects of the crisis. To this end the WB is discussing a US\$ 200-300 million budget support assistance promoting key structural reforms;
- enhance social safety nets; iii) support water management – especially by increasing the focus on investments in water supply for agriculture and tourism;
- support the energy sector – especially by advancing with sector reforms and assisting KESH and CEZ Shperndarje to improve their viability.

The WB's focus on social safety nets and budgetary support is instrumental for improving the funding of the state budget, and hence lead to improved liquidity to the private sector (through payment of overdue contracts and VAT reimbursements). It would also help the state to maintain infrastructure investments and push forward with necessary structural reforms, particularly in the energy sector. As such, the WB strategy would be complementary to the Bank's operational objectives by nurturing economic growth and social development, facilitating the Bank assistance to the private, energy and infrastructure sectors. Meanwhile, the Bank will coordinate closely, in existing and new parallel financing, with the WB in KESH for the dam safety project, and with the IFC in large private projects – i.e. the existing ones in CEZ Shperndarje's modernisation of its low/medium voltage distribution network to reduce transmission and non-collection losses, Banker Petroleum's development and environmental remediation of the Patos Marinza oil field, and cement production at Antea and Fushe-Kruje Cement Factories.

The EU and EIB remain actively engaged to advance the upgrade of the country's infrastructure. In the framework of Albania's Stabilization and Association Agreement, the EU offers comprehensive assistance to the country through the Instrument for Pre-Accession Assistance (IPA) funds. The current IPA framework that focuses on five pillars – strengthening institutional capacity, cross-border

cooperation, economic and social development, rural development and regional development – will end in 2013. The next IPA framework will begin in 2014 and is expected to be based around sector strategies. The Bank will remain committed to common projects co-financed with the EU Commission and EIB, including projects originated through the Western Balkans Investment Framework. The recent road projects, such as the Fier and Vlora Bypass, Regional and Rural Roads as well as the port project in the Port of Durres for the construction of a new ferry terminal and rehabilitation of quays 7 and 8, are expected to progress towards completion. Future cooperation in the transport sector is anticipated to focus more on the railway and port projects. The Tirana-Durres railroad will be the first pilot project during the last 25 years in the railway sector, for which the detailed design is being prepared with the assistance of EU Commission. Future projects will aim to increase the regional integration, especially through higher shipping capacity, by modernizing railways to FYR Macedonia and Montenegro and increasing commercial activities in other ports, such as Vlore, Porto Romano, Shengjin, etc. In addition, the water treatment and sewerage sector is one where the Bank, together with the EU, EIB, WB and other bilateral donors, will aim to shape appropriate financing framework that promote cost-recovery and sustainability.

Bilateral Donors are active and important partners in Albania. Since they provide grant funds or soft loan financing, these donors are well positioned to assist sectors with lower cost-recoverability. The Bank and such bilateral donors will continue to work together to devise financing structures that promote cost-recovery in the municipal sectors, especially the water and waste treatment utilities. At the same time, energy interconnection lines and renewable power projects are other areas where the Bank and Bilateral Donors can develop synergies. The Dam Safety project that is under implementation is an example of coordinated assistance to avoid a potential dam failure.

ANNEX 1 – POLITICAL ASSESSMENT

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

In the period since the adoption of the previous Strategy in 2009 progress in further democratic transition has been uneven. The main opposition political party did not recognise the outcome of the 2009 general elections. The opposition boycott of Parliament and other democratic institutions slowed down certain policy reforms requiring consensus. It had a negative impact on European Commission's "Opinion" on Albania's application for membership in EU, which was issued in 2010. The Commission did not recommend granting Albania formal status as an EU candidate country, and it concluded that further efforts would be needed to reach the criteria related to the stability of institutions guaranteeing democracy and other Copenhagen criteria.

The authorities have made a sustained effort to implement the recommendations of the "Opinion", including in 12 priority areas identified by the EC. There has been considerable improvement in the political dialogue following the November 2011 political agreement between the government and the opposition. The opposition returned to the Parliament and has cooperated in the adoption of laws requiring a qualified majority; the government and the opposition managed to agree on the new Ombudsman; a working group continued efforts to revise the Parliament's Rules of Procedure; a cross-party parliamentary committee started work on electoral reform, which culminated in July 2012 with adoption by the Parliament of mutually agreed amendments to the Electoral Code.

In October 2012 the EC issued a conditional recommendation to grant Albania EU candidate status subject to completion of certain measures in the areas of judicial and public administration reform and revision of the parliamentary rules of procedure. On 11 December 2012 the Council of the EU stressed the need to further intensify reform efforts and invited the EC to report to it as soon as necessary progress has been achieved by Albania with a view to deciding whether to grant Albania EU candidate status.

Representative and Accountable Government

Free, fair and competitive elections

Elections in Albania are generally conducted in a manner deemed by the OSCE and the Council of Europe to be largely free, fair, and competitive. The legal framework, which benefited from several waves of electoral reforms, enables a sound basis for democratic elections. The last four elections in Albania (parliamentary in 2005 and 2009; local in 2007 and 2011) were peaceful, which represented a significant achievement compared to past elections that were often accompanied by violence and intimidation. However, procedural shortcomings continue to mar the elections, which, according to OSCE, do not yet meet the highest international standards and best practices for democratic elections.

The last general elections, on 28 June 2009, were particularly closely monitored due to the formal bid for EU membership, which the Albanian authorities had submitted shortly before. According to the International Election Observation Mission, which brought together observers from the OSCE Office for Democratic Institutions and Human Rights (ODIHR), OSCE Parliamentary Assembly, Parliamentary Assembly of the Council of Europe (PACE), and NATO Parliamentary Assembly, the elections marked tangible progress with respect to many procedural issues, including the overall legal framework, voter registration, voting, counting and the adjudication of election disputes. Nevertheless, a number of shortcomings were noted, including politicisation of the work of the Central Election Commission (CEC) by representatives of the two main political parties, bias in some media outlets, and attempts by the political parties to use legal loopholes in order to circumvent the provisions designed to ensure fair representation of women. The vote count was protracted and marked by a high level of mistrust among political parties, while the CEC frequently chose not to intervene when problems arose at the local level.

In the final report on the 2009 elections issued by ODIHR, detailed recommendations were offered for consideration by the authorities, political parties and civil society. Additional recommendations were offered by ODIHR in its report on the local government elections in May 2011. These recommendations formed the basis for the work of a cross-party body for electoral reform, which proposed amendments to the Electoral Code adopted by the Albanian Parliament in July 2012. Importantly, all these amendments were mutually agreed by the representatives of the government and the opposition. This included the most sensitive issues: the composition of the Central Election Commission, the appeals process, and the use of electronic technologies.

The amended Electoral Code represents a sound basis for the successful conduct of the next general elections, due in 2013. It should be noted, however, that one of the ideas underpinning the assessments contained in the Joint Opinion on the Electoral Law and the Electoral Practice in Albania, adopted by ODIHR and the European Commission for Democracy Through Law (Venice Commission) on 19 December 2011, is that improvement in the conduct of democratic elections in Albania cannot be resolved through changes in electoral legislation alone; political will to implement the law in an impartial and fair manner is the key.

The international community closely followed the election of the new President of Albania by the parliament in June 2012. The President was elected only with the votes of the governing majority, falling short of expectations for a consensual choice. However, there were efforts towards reaching consensus and the procedure itself was in line with the constitutional requirements.

Representative government that is accountable to the legislature and electorate

The constitutional and legislative framework for a pluralistic parliamentary democracy, including procedures of legislative oversight and empowerment of the legislature in prescribed domains of decision-making, is in place in Albania and largely in line with international and European standards, as assessed by the Council of Europe and EU.

Albania formally applied for EU membership in 2009, and continuing EU approximation remains an important anchor for democratic reforms and for strengthening of institutions in order to meet commitments under the Stabilisation and Association Agreement with EU and coordinate work towards EU integration.

The national parliament experienced, in the course of 2009-2011, periodic boycotts by a considerable number of MPs stemming from the decision of the leadership of the main opposition political party not to recognise the final results of the general elections in 2009. It was consequently not always able to adopt bills requiring a qualified majority. Following local elections in May 2011, the opposition again initially refused to accept the results of the election of the mayor of capital Tirana.

The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards. However, the above-mentioned parliamentary boycotts by the opposition in the aftermath of the 2009 general elections objectively limited the effectiveness of parliamentary control. The situation has improved since the normalisation of the work of the parliament, however. In the first six months of 2012, the Prime Minister and Government Ministers participated in six interpellations requested by the parliamentary opposition; Ministers participated in 22 hearings at the parliamentary committees. Exercising its right to initiate and amend legislation, the parliamentary committees initiated, in the first six months of 2012, 487 amendments to existing laws.

Freedom to form political parties and existence of organised opposition

The freedom to form political parties is both guaranteed by the Constitution and implemented in practical terms, highlighted by existence of significant opposition able to campaign freely and oppose government initiatives. The main opposition political party currently holds more than 45 per cent of seats in the national parliament, its representatives head a number of parliamentary committees, and they are also in majority in a number of municipalities. 36 political parties participated in the last general elections in Albania. In the municipal elections in May 2011, 53 political parties had their candidates registered for competing for seats in the local self-government.

Civil Society, Media and Participation

Legal framework for civil society organisations

There is a favourable legal framework for civil society organisations (CSOs), which has improved significantly in recent years, including the laws related to the functioning of non-profit organisations adopted in the course of 2011. The process for the registration and operation of CSOs is relatively straightforward and generally in line with international standards. However, there are unresolved issues related to the definition of non-profit activities and taxation of economic activities.

More than 1,600 CSOs are currently registered with the tax authorities in Albania. However, there are only a handful of well-established and well-funded CSOs, mostly in the largest cities. Some CSOs are highly professional in their respective areas of

expertise, particularly those specialised in EU integration related issues, environment, media, and gender. At the same time, the role of CSOs is affected by the polarisation, real or perceived, of CSOs and their leaderships, which mirrors high level of polarisation in the country in general, where people have been for years divided into two large camps of supporters of the two main political parties. Many CSOs face problems with funding. They are predominantly funded by international donors, and many CSOs depend on only one (often the same) donor, while the last years witnessed withdrawal of many foreign donors due to their reorientation towards other regions.

Free and pluralistic media that operates without censorship

Pluralism in the media, which operate freely and without censorship, has increased overall in recent years. The legal framework is largely in place and in line with international standards. However some questions regarding the media's independence from political and business pressure persist, and there is a lack of transparency in media ownership. There are more than 250 broadcast outlets and 26 dailies operating in Albania, which is one of the highest numbers per capita in the region (although the circulation, even if taken per capita, lags behind). Electronic media dominate the market. The main media outlet is the public Albanian Radio-Television with its two national channels, particularly influential in rural areas. There are also two private national channels, and a large number of regional and local private broadcasters.

Recent years witnessed explosive growth in Internet access. According to ITU, the percentage of population with Internet access increased from 0.1 in 2000 to over 43 per cent in 2010, and more than doubled in the last two years. Given the high number of media competing in a limited advertising market and the lack of transparency in their funding, media observers raise concerns about excessive interference by business interests. Although there are a few journalists associations and trade unions, there is still no self-regulatory body for the media.

A number of amendments have recently been made to the civil and criminal codes, which led to the removal of prison penalty for defamation, although full decriminalisation of defamation and libel have not yet been achieved.

Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place, but there is a lack of clearly defined rules and procedures, in particular regarding public consultations. While CSOs are often sought to provide their expertise by parliamentary committees (according to the parliamentary statistics, in 2012 the committees invited 47 various CSOs for consultations) this is usually done on ad hoc basis. The documents submitted for public consultations are often presented to the public at very short notice.

Rule of Law and Access to Justice

Supremacy of the law

Issues related to the supremacy of the law, particularly introduction of measures to limit or lift the immunity of high-level officials and judges continue to be hotly debated in Albania.

Efforts have been made to align the work of the High Court of Justice with European standards by means of amending the evaluation system for judges and improving the reasoning behind appointments. The newly established evaluation system now needs to be verified in practice. An MoU was signed in 2011 between the State Commission for Legal Aid and the Commission for protection against Discrimination, and other measures undertaken designed to improve access to justice, but delays in judicial proceedings call into question efficiency of the access to justice.

A major problem remains restitution of property confiscated during the communist regime, resolution of land titling and ownership. In 2012 the authorities adopted a Property Rights Strategy, covering restitution, compensation, and legalisation, which now needs to be implemented.

Government and citizens equally subject to the law

Corruption remains a serious problem, including in the judiciary, where the objective of limiting or abolishing the immunity of judges represents an additional problem. The authorities have since undertaken various measures in order to fight corruption, organised crime, and trafficking. According to the latest reports by the Council of Europe's Group of States against Corruption (GRECO), most recommendations regarding incrimination and political party financing have been implemented, and the institutional framework to combat corruption has been further developed. A new anti-corruption Action Plan was adopted in 2011. According to the European Commission, the quality of action plans, including indicators to monitor progress, has improved, but a solid track record still remains to be established in prosecutions and convictions of high-level corruption cases. The Stabilisation and Association Council noted on 15 May 2012 the efforts made by the authorities in fighting organised crime.

According to the 2011 Transparency International Corruption Perception Indexes (CPI), Albania had a score of 3.1, which placed it 95th out of 183 countries. This is 17th overall among the transition countries, and the lowest ranking among the Western Balkans countries.

Independence of the judiciary

Comprehensive reform of the judiciary is making progress but much remains to be done to ensure its full independence, transparency, accountability and efficiency. According to the European Commission, Albania's alignment with European standards and the *acquis* in the field of judiciary is at an early stage. A Judicial Reform Strategy, which was consulted with a broad group of stakeholders, was adopted in 2011, and forms a good basis for further efforts in this direction.

Civil and Political Rights

Freedom of speech, information, religion and conscience, movement, association and assembly

The Albanian Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status. The Constitution guarantees the basic freedoms and rights of citizens recognized in international law, while international treaties are directly enforceable by domestic courts and their status is superior to the domestic law (Article 122). The Constitution also requires the State to supplement private initiative and responsibility in relation to certain “social objectives”, such as the provision of care to persons with disabilities, the aged and orphaned and similar.

Albania is a signatory to all major international human rights instruments. The high level of ratifications of the conventions of the United Nations, Council of Europe, and regional human rights instruments represents a significant achievement. Albania has also put in place the institutional framework for the protection of human rights, which includes the Ombudsman, a range of State and inter-ministerial bodies and National Councils, and technical secretariats within ministries.. The main challenges Albania faces are related to the provision of the necessary human and financial resources for implementation and monitoring of these instruments.

The constitutional guarantees of freedom of thought, conscience and religion are generally respected, and Albania continues to provide an example of religious harmony in the region. According to the Constitution of Albania, there is no official State religion and the rights of all religious communities (the main are Muslim, majority Sunni and Bektashi, and Christian, majority Orthodox and Catholic, as well as Protestants) are equally guaranteed.

The latest assessment of the track record of Albania in the area of human rights in the framework of the UN’s Universal Periodic Review was conducted in 2009-2010. More than 50 per cent of the recommendations made in the course of this review have either been already implemented or are in the process of implementation by Albanian authorities.

Political inclusiveness

The legislative framework for the protection of ethnic minorities is broadly in place, including the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expression, and they are guaranteed full rights under the Constitution. Ethnic minorities actively participate in political life, mainly through their own political parties. Albania has a less diverse ethnic composition than most of its regional neighbours. Ethnic Greeks, who are the largest ethnic minority, are, according to estimates, only a few per cent of the population. The last census, conducted in 2011, included for the first time optional questions regarding ethnic origin and religious affiliation. The Roma minority, as in many other neighbouring countries, is the most vulnerable and continues to face difficulties in access to education, housing and employment. Albania has joined the Decade of Roma

Inclusion (2005-2013), thus making a political commitment to promoting inclusion of Roma.

The key legislative elements for gender equality are in place in Albania. Important laws adopted in the last years include the Laws on Gender Equality in Society, On Measures Against Violence, On Health and Safety at Work, and On Protection from Discrimination. The National Strategy on Gender Equality and the Fight against Domestic Violence were, in June 2011, extended for the period 2011-2015. However, secondary laws and implementation remain uneven.

Women have a few high-profile representatives at the national level, including the Speaker of the Parliament, Chief Prosecutor, and Members of the Government. Nevertheless, the role of women in political life, especially in decision-making positions, remains limited. In the previous composition of the parliament only 7 per cent of MPs were women, which was very low by regional standards. Despite the provisions designed to improve women's representation, enshrined in the electoral code and other legislation, women often face difficulties in being selected as candidates and reaching leading positions in political parties and in public administration. The new gender quotas introduced in 2008, which stipulate that there should be at least 30 per cent women in elected positions at both national and local levels led to an increase of women's representation in the parliament to 16 per cent in the current parliament. However, weaknesses in the formulation of the legal provisions sometimes undermine the objective of quotas. The order of placement of women candidates on the ballot lists continues to influence their representation, and certain loopholes need to be closed that defy the purpose of the Law on Gender Equality. In the May 2011 local elections there were only 14 women among the 872 mayoral candidates. Six women were elected as Mayors.

ANNEX 2 – ASSESSMENT OF TRANSITION CHALLENGES

The table and the supporting text below provide an overall assessment of Transition Challenges by sector, based on the Transition Report 2011. There are two separate scores for each sector, rating market structures and market-supporting institutions. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards the standards of a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform.

| Sectors | Market Structure | Market-Supporting Institutions |
|----------------------------------|------------------|--------------------------------|
| Corporate sectors | | |
| Agribusiness | Medium | Medium |
| General industry | Medium | Medium |
| Real estate | Large | Medium |
| Telecommunications | Medium | Medium |
| Energy | | |
| Natural resources | Medium | Medium |
| Power | Medium | Medium |
| Sustainable energy | Small | Medium |
| Infrastructure | | |
| Urban Transport | Medium | Large |
| Water and Wastewater | Large | Large |
| Roads | Medium | Medium |
| Railways | Large | Large |
| Financial Institutions | | |
| Banking | Medium | Medium |
| MSME | Medium | Medium |
| Insurance and financial services | Large | Medium |
| Private Equity | Large | Large |
| Capital Markets | Large | Large |

Agribusiness

Market structure: *Medium*

Market institutions: *Medium*

Although prices have been liberalised and trade controls are gradually being reduced (under the umbrella of the EU SAA agreement signed in 2006), the sector still suffers from the very small size of average land holdings, a lack of infrastructure and skills, inefficient agribusiness producers and producer organisations, low quality standards and limited investment. The comprehensive re-distribution of state agricultural land has been completed. However, there are still ambiguous property rights and weak ownership dispute resolving instruments. To become more competitive, farmers will likely have to consolidate land plots. Most agri-processors have been privatised. There has been limited foreign investment in the sector. Foreigners may not own

agricultural land, but can obtain leases of up to 99 years. Agribusiness companies are hampered by lack of raw materials, outdated equipment and low hygiene and quality standards. In general agribusiness processing, logistics and retail distribution activities remain underdeveloped. Although access to credit is increasingly available through micro-credit type schemes, it remains limited since there is very little interest in investments into agricultural activities.

General industry

Market structure: *Medium*

Market institutions: *Medium*

The creation of a uniform 10 per cent tax rate on corporate and personal income in 2007/08 and the obligation that most payments (including salary payments) must pass through banks contributed to improvements, but the informal sector remains a serious obstacle affecting business. At the same time, Albania made it easier and less costly for companies to pay taxes by amending several laws, reducing social security contributions and introducing electronic filing and payment. In June 2009, a one-stop-shop for licences and permits was opened. Since submitting its application for EU membership in 2009, Albania has also been making steady progress with the approximation of its laws to the EU *acquis*, including trade-related provisions, customs and taxation. Standards of corporate governance and business conduct have shown some improvement, particularly concerning the adoption of ISO standards, which is reflected in the recent rating change. However, political uncertainty, the small size of the country and its limited integration into the rest of the region has hampered foreign investments (despite the creation of a highly liberalised climate for foreign investors, including a facilitation agency, AIDA). At the same time, the procedures and time required for starting a business are still much more cumbersome than in other countries in the region and ownership transfer and weak property rights remain a serious issue, especially for domestically controlled property.

Real estate

Market structure: *Large*

Market institutions: *Medium*

Albania's property market is characterised by a significant lack of supply of modern commercial property in all sub-segments. The residential mortgage market is underdeveloped and there is a lack of long-term construction debt finance. There is little state interference (subsidies etc.) in the sector. The government has made important progress with regard to property registration and access to land is not seen as a major problem by the private sector. There is some evidence of progress in enforcing existing legislation and regulations, particularly in the capital, but gaps remain with regard to the efficiency of the practical implementation of the legislative framework and dealing with construction permits. Enforcement of mortgages has been a challenge. There is a lack of new products and financing methods in the sector despite significant construction activity by SMEs in main coastal regions. Gaps in terms of the development of modern secondary legislation supporting the sustainability of real estate (energy efficiency, impact on environment) are still large. Public awareness of the sustainability issues is also low.

Telecommunications

Market structure: *Medium*

Market institutions: *Medium*

Although the legal framework for telecommunications is aligned with that of the EU, implementation has been relatively weak. The regulator, the Albanian Authority of Electronic and Postal Communications (AKEP), is independent but governance issues have hindered its decision making. The fixed-line incumbent Albtelecom was privatised in 2007 after a number of attempts. Although the market is liberalised, competition is not yet very strong, with Albtelecom dominating over the fixed-line and internet markets as well as broadband ADSL internet access services. The market is still highly underserved in the fixed line and broadband internet segment as evidenced by a large pent-up demand and low fixed line penetration. The mobile telephony market is more developed and competitive, improving even further with the entry of the fourth mobile network operator, Plus, in late 2010, and mobile penetration levels are growing rapidly. Mobile number portability was introduced in 2011. The Internet and IT market is underdeveloped and characterised by high prices, lack of strong competition and accessibility and limited broadband access. The lack of connectivity of the country itself is hampering the development of data services. Albtelecom fully controls the traffic via Italy by owning the only sub-sea cable between Albania and Italy. The process of digitalisation of national broadcasting networks is nascent in Albania, presently driven by the Government which is preparing the DSO strategy.

Energy and Infrastructure

Natural Resources

Market structure: *Medium*

Market institutions: *Medium*

The natural resources industry in Albania is small and concentrates on chromium, bitumen, copper and nickel. Oil has been extracted in Albania since 1918, but the domestically produced diesel is of low quality and meets only a fraction of domestic demand. Oil by-products are mainly imported from Greece and in lower quantities from Italy, Russia and other countries. Albpetrol, the state-owned oil and gas company, has been restructured and corporatised, with separate lines of activity operating as separate companies under a holding structure. A number of foreign oil companies operate in Albania both in exploration and in production. Bankers Petroleum, a Canadian-based oil and gas explorer and producer, reached an agreement in March 2011 with Albpetrol to become the sole operator of the Patos-Marinza oil field. The sale of an 85 per cent stake in Albania's oil refinery, ARMO, was concluded in August 2008. Progress has been made in creating market supporting institutions and legislation, in particular in the field of the internal energy market. A law on the gas sector was adopted in June 2008 and subsequent legislation assigned to the Energy Regulatory Authority (ERE) regulatory powers to the gas sector, although there is no gas distribution network in Albania yet. The country is a signatory of the Energy Community Treaty, together with other SEE countries. However, the revised National Energy Strategy has not yet been adopted and environmental protection remains a serious concern. Despite having recently acquired the status of EITI candidate country, fiscal transparency and accountability remains low and revenue

collection has been traditionally weak. Hydrocarbon licensing decisions and monitoring of contractual obligations are taken by the National Agency of Natural Resources, which is a subdivision of the ministry of energy, hence not fully independent.

Sustainable Energy

Market structure: *Medium*

Market institutions: *Medium*

In 2005, a new Energy Efficiency Law was passed and an Energy Efficiency Fund established. The Albania-EU Energy Efficiency Centre (EEC) supported by EC is the only specialised institution in the field. A National Energy Efficiency Action Plan has been adopted in 2010. RE targets haven't been set yet. Electricity tariffs have increased but do not include environmental costs. Therefore price signals provide limited incentives to use energy efficiently and to invest in renewable energy sources (RES) projects. Theft of electricity and non-payment of power bills offer a viable alternative to investments in energy savings. Feed in tariffs are in place. Over 90 per cent of electricity production comes from large hydro. Regulatory incentives for the development of new renewable energy projects are not in place. Albania ratified the United Nations Framework Convention on Climate Change (UNFCCC) and Kyoto protocol where it holds the status of the Non-Annex 1 Party. No greenhouse gas (GHG) emission targets or policies were adopted. Albania's contribution to global greenhouse gas emissions is relatively low due to the large share of hydropower and the collapse of energy intensive industries. The key remaining challenges include to increase and better enforce energy tariffs, reduce commercial losses in the power grid (from 38 per cent in 2008), advance the climate change agenda and establish a legal and institutional framework to support small renewable projects.

Power

Market structure: *Medium*

Market institutions: *Medium*

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

increases and roll forward accumulated debt, which frustrated the development of supply competition.

Water and Wastewater

Market structure: Large

Market institutions: Large

Formally the control of municipal infrastructure has been transferred to the municipalities. However, a contradicting legal framework for land rights results in substantial central government interference into local infrastructure operations. The majority of municipal utilities have been fully corporatised. Financial performance is generally weak and there seem to be little concern for generating commercial revenues as low tariffs, inadequate metering, and poor collection of tariff revenues is observed in a majority of municipalities around the country. This has led to municipal infrastructure operations based on grant driven investment and often subject to systematic underinvestment. An independent national regulator for the water sector has been established and some initiatives have taken place to strengthen the payment discipline in Tirana. Still there is absence of a well defined tariff formula and adequate contractual framework between municipal utilities and local authorities, the tariff setting and operational planning is often politicised and not transparent.

Urban Transport

Market structure: *Medium*

Market institutions: *Large*

The urban transport system operates at a very low level of organisation where small private bus operators are organised into loose associations. Tirana's public transport market is characterised by fragmentation of market participants, poor regulation, and poor quality of service. Financial performance is mixed. Urban transport operators have gained limited access to the commercial funds as a source of investments, albeit with short-term tenors; however, due to the simple and weak contractual arrangements with the regulator (operators are granted a simple license), financial resources are currently insufficient to provide for financing of modern bus fleets. Due to the rapid growth in car ownership, traffic congestion is a growing problem; the need for investment in key missing link road segments and traffic management is evident in Tirana and other secondary cities.

Roads

Market structure: *Medium*

Market institutions: *Medium*

Road restructuring efforts have been made in recent years, after a restructuring plan for the General Roads Directorate (GRD) was approved in 2008. The divestment and commercialisation of construction companies are in progress and GRD has contracted out more than 50 per cent of periodic maintenance contracts to the private sector. However, competition and private sector participation remain limited. The financing of the road sector remains broadly unreformed. There is a need for comprehensive institutional and financial restructuring. The transition challenges remain in the following areas: (i) introduction of tendering procedures and full contracting to the private sector for routine maintenance of national roads; (ii) the introduction of

performance-based maintenance contracts; (iii) the introduction of a service level agreement between the government and ARA (successor of GRD) with defined responsibilities and obligations; (iv) development of PPP strategy and project development (optional).

Railways

Market structure: *Large*

Market institutions: *Large*

In railways, operating and policy setting functions are not separated and core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. Following significant labour restructuring, the number of staff declined from 8,800 in 1989 to 1,900 in 2008. Ancillary rail activities have been divested and are now operated by private entities (on a lease basis). Freight tariffs were liberalised in early 1990s while passenger tariffs are regulated by the ministry of transport. There is still need for significant institutional reforms. There are significant transition challenges remaining in almost all areas, but the priority should be given to the following areas: (i) initiate institutional separation; (ii) increase financial transparency and independency from the government; (iii) establishment of the financial sustainability in passenger and infrastructure businesses (including tariff reform and introduction of PSO mechanism); and (iv) introduction of competition in railway businesses.

Financial Institutions

Banking

Market structure: *Medium*

Market institutions: *Medium*

In 2009 the Bank of Albania drafted several new regulations while amending others, with a view to comply with the Basel Committee's core principles for effective banking supervision and the European Council's directives. For example, the regulation "On consumer and mortgage lending to households" was adopted to protect and orient Albanian customers lacking sufficient knowledge in new products. The regulation "On licensing and operation of banks and branches of foreign banks in the Republic of Albania" is a complete review of regulation "On granting a licence to conduct banking business in the Republic of Albania", which harmonises the requirements of the Law on Banks, and the rules and criteria of the supervisory authority. In addition, capital requirement shall be denominated only in the national currency. The regulation "On liquidity risk management" stipulates the minimum requirements and standards for effective liquidity risk management by banks and branches of foreign banks, in order to prevent systemic risks that may arise from liquidity risk. An update to the Deposit Insurance regulations was aimed to bring the local framework into alignment with the European Union Deposit Guarantee Directives, as well as to strengthen the role of the Albanian Deposit Insurance Agency. As part of its crisis response, in March 2009, ADIA increased the deposit insurance ceiling from ALL 700,000 to ALL 2,500,000 (around EUR 20,000) aiming at stabilising the deposit base. According to ADIA, over 90% of depositors are fully covered.

Micro, Small and Medium-sized enterprises

Market structure: *Medium*

Market institutions: *Medium*

MSMEs play a very important role in the economy. They accounted for about 99.9 per cent of the number of companies, and the majority were micro enterprises (that account for 96 per cent of the total) as of end-2007. Micro, small and medium businesses generated nearly 63 per cent of value added of non-financial enterprises and account for 82 per cent of official employment. There are some banks and microfinance institutions offering credit to the MSMEs sector. Yet, financial intermediation to the private sector remains relatively low at about 27 per cent of GDP in 2009, of which 41 per cent goes to MSMEs. Alternative official sources of external finance for MSMEs are limited. The central collateral registry is in place and the system for registration of movable assets is operating completely. This allows enterprises to use movable assets as collateral in their efforts to access bank finance. The credit registry is also operational since January 2008 and available to financial institutions and to the public. Some improvements have also been made on the time of getting credit and the depth of credit information. However, contract enforcement remains a lengthy and expensive process. Since September 2008, a Programme for SMEs' support has been in place, including a soft credit line. A guarantee fund to support SME to obtain loans when they lack of collateral started operations in 2010.

Insurance and other financial services

Market structure: *Large*

Market institutions: *Medium*

Non-bank financial institutions and savings and loans associations account for a small share of the Albanian financial system. While the latest insurance law has strengthened the legal and regulatory environment, effective implementation remains a challenge. Further improvements are also needed in the areas of accounting, disclosure and auditing standards. There are no restrictions on foreign entry into the non-bank financial institutions sector. Privatisation of the state-owned insurance company, INSIG, still remains to be done. The voluntary private pension market remains small. The private voluntary pension market in 2009 grew 37 per cent from 2008 to 2009, but at ALL 72,968,573 remained only .01 per cent of GDP. The framework for the leasing sector has been established and the regulator is active in monitoring the market, although leasing legislation remains at early development stages. Leasing penetration is low at only 1 per cent of GDP. Mortgage data are scarce, but BoA reports lending to households for real estate at 99.7 bln ALL (8.1 per cent of GDP), of which 72 per cent is in foreign exchange (predominantly EUR).

Private equity

Market structure: *Large*

Market institutions: *Large*

Less than five regional fund managers have been identified for which Albania is included in the target region but there are no country dedicated fund managers present in the market yet. Despite the inclusion of Albania within the target regions of regional managers, there is no significant private equity activity in the country. The majority of net committed capital is in buyouts and a small portion is found in the

growth funds segment. Mezzanine, small capital, venture capital and distressed and restructuring investment strategies are not present. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector. The underdevelopment of local institutional investors and relatively low conformity with the OECD Principles of Corporate Governance also contribute to the large gap on the market institutions side.

Capital markets⁵

Market structure: *Large*

Market institutions: *Large*

The security market is not developed in Albania, and the only market is the market of government debt instruments (T-bills and bonds). Shares are exchanged by registering ownership changes in the companies' registers. Privatised companies which have been registered with the Share Registration Centre register their shareholder transactions at the Centre. Government bond and money markets remain at early stages of development. Benchmarks remain to be developed further in Albania's money market whilst activity in the interbank market and currency forward markets remains very limited or absent. No corporate bonds have been issued in the last six years.

⁵ The Market institutions indicators used refer to a survey conducted in 2007. In addition, the survey focused on equity markets primarily. The limitations of the data will hence need to be taken into account in the following commentary.

ANNEX 3 – LEGAL TRANSITION

Commercial laws of Albania

Overall

Over the last decade, Albania has adopted a number of significant reforms aiming to support investment. The legislative frameworks for public-private partnerships, corporate governance, insolvency, and secured transactions are relatively advanced. Concerns remain however, in particular in connection with law enforcement through the courts, which do not enjoy a high level of public confidence. In addition, specific areas of legislation still lag behind, for example in the energy sector, including both renewable energy and energy efficiency.

Energy sector

Overall, progress in Albania has been very limited in the energy sector. In November 2011, the government passed an amendment to Albania's Power Sector Law, which became effective on 1 January 2012. Under this amendment any customer who is connected to a power network of voltage greater than or equal to 110kV, or whose annual electricity consumption is greater than 50 million kWh is eligible to choose their own electricity supplier. Non-eligible customers must be supplied by the public supplier (ERE), at the price set by ERE. However, since ERE keeps the price of electricity below market price, there is little incentive for eligible customers to switch suppliers.

In terms of the legal framework for renewable energy source (RES) no progress has been made. At present, integration of new RES producers is hampered by excessive administrative burdens and lack of adequate regulation regarding connection to the grid. A National Renewable Energy Action Plan providing a target for the share of RES in final energy consumption by 2020 has not yet been published. The draft Law on Renewable Energy Sources has not yet been adopted.

Infrastructure

Even though a general policy framework for improving the legal environment and promoting public-private partnerships (PPP) may not be easily identified in Albania, the way the government recently approached concession legal framework reform illustrates its interest in promoting and using PPP in its infrastructure and services. The 2006 Albanian "On Concessions" (the "Law"), as amended reflect many of the best international standards.

It is one of the few concession laws in the region that includes in its definition the transfer of risk to the concessionaire and the remuneration considerations. It also requires a "value-for-money" analysis. Entities and sectors eligible for PPP are clearly identified. Such sectors include transport, electricity, water, waste water, solid waste, education, health care and prison sectors as well as any other sector specified in government resolution.

The Law contains provisions assuring a fair and transparent selection process: pre-selection of bidders, procedure for requesting proposals – with a distinction drawn between technical and financial proposals – possibility of two-stage procedure, publication of concession award, limited exceptions to concession award without competitive procedure, existence of review procedures, parameters for the negotiation process, etc.. The provisions regulating the project agreement give clear guidance on the main issues to be covered yet remain sufficiently flexible, thus allowing the parties to freely negotiate its terms.

The Law, however, is rather silent on security and support issues. This may well stem from the fact that the country is particularly concerned with the degree of public debt and potential consequences on the public budget of PPP projects. In addition the reference to “management contract” in Article 2 is somewhat unclear.

The Albanian Law is one of the best drafted laws in the region. However, the lack of practical experience in the implementation of the Law may be an obstacle for investors at this stage.

The law was further amended in 2009 and 2010, and a new review body for hearing complaints was introduced, namely the Public Procurement Commission. The new amendments detail the procedure of administrative review in front of the Public Procurement Commission by setting clear provisions, timeframes and procedures to be followed during the review process.

A further set of important amendments to the Concessions Law has been submitted to the Government allowing for "step-in" rights. If approved this will facilitate a reduction in collateral financing in order to secure their loans, thus should significantly improve the bankability of PPPs and help mobilise private investments in infrastructure.

Court system

Albanian courts do not enjoy high levels of public confidence, especially in the business community. Uncertainty about the ability of creditors to enforce their legal rights contributes to a more cautious approach to lending. Debtors are perceived not to fear legal action by creditors, affecting the rate of non-performing loans. Several factors underpin concerns about judicial performance in the area of commercial law. First, judicial expertise in commercial law areas is considered to be limited. Until recently, judges received little training in business-related topics. The Albanian School of Magistrates has been endeavouring to address this issue, and currently runs a number of commercial law modules for both candidate and sitting judges. The School of Magistrates is an independent body established and funded by the Albanian government, and has been operating since 1999. It is considered to be a successful institution, and currently works with a number of international organisations, including the EBRD, which is assisting the development of commercial law content in the training programme.

Secondly, corruption remains a concern in the country which also affects the judiciary. The government has made efforts to respond to the problem. A new anti-

corruption action plan for the period 2011-2013 was adopted in June 2011, however implementation of the action plan is still on going and the results are yet to be seen.

Thirdly, judicial proceedings are typically protracted, and there is a substantial backlog of cases which are more than three years old. Civil cases involving property disputes, which are large in number, are particularly affected by delays. In 2011, a new law was adopted on mediation in conflict resolution. This is expected to contribute to a reduction in the backlog of cases and enhance the speed of justice in the Albanian courts.

Finally, improvement of the judicial system is one of the key requirements established by the EU for accession, a fact which continues to drive local interest in judicial reform. The importance of judicial reform in accession negotiations was underscored in the most recent EU Progress Reports.

Private sector supporting laws

The development of SME credit lines requires a good legal regime for **secured transactions**. In the context, security over movable assets is governed by the Law on Securing Charges and the established regime reflects most of the modern secured transactions principles. In general, the law is clear, comprehensive, and provides the right flexibility to accommodate relatively sophisticated transactions. A drawback lies with the priority of secured creditors as priority may be lost to some employee, social security and state claims.

Taking security over immovable assets (mortgage) is governed by the Civil Code (Art 560-607). The weakest point of the secured transaction system is in the enforcement, especially of mortgages; therefore more efforts are needed to improve the current system. The legal provisions of Law on Securing Charges aim at providing a fast and efficient system by providing secured creditors with the automatic right to start enforcement upon debtor's default (execution clause) using execution officers (bailiffs) and choice between private or public mode of realisation. However, bailiffs proved not to be as reliable and efficient as needed. Courts are also reported to be slow and not very experienced in handling enforcement cases. The enforcement of mortgages is especially problematic and banks have been denouncing the fact that they are unable to recover the secured debt at a satisfactory return level when enforcing the mortgage. The problem stems from the enforcement provisions of the Civil Procedure Code and relate to the limited number of available auctions, undefined time periods for the bailiff to notify the debtor with effect of process being dragged on and no commonly set standards for real estate property valuation.

When considering **corporate governance of banks**, the recent EBRD assessment highlighted that the banking law requires banks to be organised under a two-tier system, with the steering council in charge of oversight of management. Executives are allowed to sit in the steering council, which creates a potential for conflicts of interest. To mitigate this risk, the law requires that 1/3 of the members of the council are "not connected through private interests with the bank, shareholders that control the bank or its executive directors", but it fails to clearly define their role. In practice, this requirement does not seem to be well understood or implemented, as some banks have no "independent" directors. Further, these "non-connected" directors are not

required to sit in board committees, where the potential for conflicts of interests is higher. Instead, outsiders can sit in the audit committee and committee's members are not subject to duty of loyalty and care as other directors. Non-financial disclosure by banks is poor and banks' compensation practices do not seem to be aligned with prudent risk management.

In the context of assisting local banks address their portfolio of non-performing loans, the quality of the **insolvency law** framework will be highly relevant. Albania has made a number of recent improvements to its Bankruptcy Law, which provides for one single portal of entry into insolvency procedures for debtors in financial difficulty and for the liquidation, sale or reorganisation of a debtor's business. In practice, reorganisations are uncommon.

Building on the establishment of the BSA in 2011 and changes to the training of the insolvency office holder profession, Albania should examine further ways in which reorganisation may be encouraged, whether in law or practice, to enable the survival of viable businesses in financial difficulty. Albania may also potentially consider introducing an expedited process for sale of the business in bankruptcy.

ANNEX 4 – SMALL BUSINESS SUPPORT

The Small Business Support Team (SBS) supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises (MSMEs) and contributing to the development of a sustainable infrastructure of MSME support and local business advisory services. This is achieved through two complementary instruments, the Enterprise Growth Programme (EGP) and Business Advisory Services (BAS).

Previous SBS experience in Albania

EGP has been active in Albania since 1996 with €2.3 million of donor funding mobilised from the EU, Luxembourg, Japan, the United Kingdom and other bilateral donors. To date, 46 projects have been initiated, with interventions concentrated in food manufacturing, building materials and the fabricated metal product sectors. Around 30 projects have been evaluated, of which 42 per cent have been rated highly successful; beneficiaries have reported an increase in turnover by more than 60 per cent and have increased their number of employees by almost 30 per cent. In addition, 8 assisted companies have benefited from overseas business matching trips facilitated by EGP since 2010.

Since inception in 2006, **BAS** Albania has received a total of €3.5 million in donor funding, which has been supplemented by €1.4 million in enterprise client contributions. As of mid 2012, the programme has undertaken a total of almost 300 projects, engaging over 120 consultants. Projects related to market analysis and introduction of quality management and certifications have been the most common types. The industry spread has been wide, with food and beverages / agribusiness, travel/tourism and construction & engineering being the most common sectors. To date, 194 projects have been evaluated, of which 74 per cent were rated successful or highly successful. In addition, BAS has also undertaken 20 market development activities (MDAs) to help develop an adequate MSME support infrastructure.

In terms of cross-cutting issues, SBS Albania has in particular focused on facilitating rural development, with more than 40 per cent of EGP beneficiaries and 50 per cent of BAS projects being located in rural areas. In addition, SBS strongly promotes gender equality and helps facilitate female and youth entrepreneurship through training and direct assistance.

MSME and Consulting sector in Albania

The MSME sector

MSMEs play a very important role in the Albanian economy. They account for about 99.9 per cent of the total number of companies, and the majority are micro enterprises (96 per cent) according to Eurostat figures⁶. MSMEs generated nearly 57 per cent of value added of non-financial enterprises compared to 58.5 per cent in the 27 EU

⁶ SBA Factsheet Eurostat 2010-2011

economies, and they account for 77 per cent of the official employment (67 per cent for EU 27). Whilst medium-sized enterprises (> 20 employees) represent 71 per cent of total investments and dominate the industry and construction sectors, micro enterprises represented 91 per cent of the total enterprises and are dominant in the services sector.

The consultancy market

The Albanian consultancy sector faces large transition challenges and lacks demand, diversification and market development. The industry has steadily grown in recent years and initial consolidation efforts materialised in 2011 when the first professional consultancy association formally launched operations. However, significant improvements are still required with respect to providing information, quality assurance, pricing and availability of an appropriate range of services. Most consultants are located in the main city; therefore even further restricting access to good quality advisory services for entrepreneurs in more rural areas. The spectrum of advisory services offered is adequate but requires more diversification, and most consultants seem to be concentrated in the area of market analysis and development planning.

Infrastructure of SME support

The institutional support infrastructure is fragmented and the Albanian authorities have so far failed to adopt an SME law to regulate development. SME policy is overseen by the Ministry of Economy, Trade and Energy (METE), which has been responsible for proposing and implementing legislation and initiatives to support SMEs. The government increasingly recognises the importance of SME development and, in 2010, established the Albanian Investment Development Agency (AIDA), which supports the sector through direct enterprises assistance and serves as a mediator for public/private dialogue. Notwithstanding these efforts, AIDA's resources remain limited. In 2007, the country adopted a long-term strategic framework for the development of the SME sector for 2007-2013. A new Business and Investment Development Strategy for the period 2013-2020 is currently in preparation. In the private sector, various business associations cover the whole territory and act as lobbyists for their members. There are also 12 chambers of commerce, which partially cater the SME sector, but overall private sector representation of the SME sector remains inadequate.

Continuation of SBS in Albania

SBS will continue to support Albanian SMEs through direct enterprise assistance in order to contribute to the development of a competitive and sustainable private sector. In close coordination with other donors and the national authorities, SBS will focus on activities in priority sectors such as agribusiness and food processing, tourism and hospitality, wood and metal processing, ICT and textile/shoe production. SBS will also seek potential interventions in the renewables and energy sector. Cross-cutting issues such as rural development, gender equality, youth entrepreneurship and environmental improvement will continue to be addressed in SBS activities.

At market level, SBS will further aim at promoting best international practises in priority sectors through dissemination of successful showcases and trainings, creating a platform for dialogue amongst SMEs and public/private business development organisations and at supporting the development of a sustainable MSME support infrastructure. Lastly, SBS will facilitate client access to finance through the EBRD and its partner financial institutions, as well as through external sources in Albania.

Subject to funding, **EGP** plans to further support the transfer of management skills. EGP will work with enterprises which have a potential for import substitution and to become major suppliers for the domestic market, thereby tackling shortcomings in the food supply chain. In addition, it will focus on export-oriented companies helping them to internationalise their products, enhance their exposure to international best practise and create operational linkages with other companies in the region. Furthermore, EGP's assistance will focus on types of advice such as product development, business planning, financial management and sales and marketing. All projects will be carefully selected in close collaboration with the EBRD Resident Office.

BAS Albania plans to further enable MSMEs to access consulting services by facilitating projects with local consultants. A flexible grant scheme will be applied through annual updates of the Grant Guideline Matrix to prioritise intervention and avoid duplication of efforts with international donors and governmental organisations. Typically, higher grants will be allocated for smaller enterprises, for enterprises located outside of Tirana, for more complex consultancy services and for projects involving consultancy services where market demand is less mature, including environmental management, reducing costs, HR and advanced quality standards and product certification.

BAS assistance at the enterprise level will be complemented with market development activities in order to maximise the programme's transition impact in Albania. These will include:

- (i) *visibility and dissemination* to promote the use of business advisory services, especially in rural areas, and to stimulate demand for more sophisticated consultancy services;
- (ii) *MSME and consultancy training*; and
- (iii) *Support to and development of existing local institutions*, in particular the Albanian Consulting Network.

In addition, BAS Albania will implement the recently introduced LEF financial management and reporting programme (AIP) with the objective of raising enterprise financial management practices and standards in support of potential EBRD investments.

ANNEX 5 – TECHNICAL COOPERATION

TC COMMITMENTS BY DONOR THROUGH EBRD, 2009-2011

| Donor | TC Commitments (€) |
|-------------------------------|--------------------|
| Central European Initiative | 45,000 |
| EBRD Shareholder Special Fund | 1,587,268 |
| EU | 1,136,347 |
| Italy | 270,680 |
| Luxembourg | 1,044,707 |
| Netherlands | 244,172 |
| Norway | 650,000 |
| Slovak Republic | 405,225 |
| Western Balkans Fund | 274,950 |
| Grand Total | 5,658,349 |

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2009-2011

| Sector/Team | | TC Commitments (€) |
|------------------------|------------------------|--------------------|
| SME Development* | SBS (formerly TAM/BAS) | 2,607,994 |
| Environment | Environment | 49,800 |
| Financial Institutions | Financial Institutions | 242,000 |
| LTT | LTT | 527,225 |
| Infrastructure | MEI | 858,830 |
| | Power and Energy | 650,000 |
| | Transport | 677,500 |
| Other | Other | 45,000 |
| Grand Total | | 5,658,349 |

Note: Commitment values based on year end or period end data for each year.

* This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils)

ANNEX 6 – SELECTED ECONOMIC INDICATORS

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|---|---------|---------|---------|---------|---------|-------------------|
| | | | | | | | <i>Projection</i> |
| Output and expenditure | <i>(Percentage change in real terms)</i> | | | | | | |
| GDP | 5.8 | 5.4 | 5.9 | 7.5 | 3.6 | 3.8 | 3.1 |
| Private consumption | 15 | 10 | 0.0 | -3.6 | -0.5 | 16 | n.a. |
| Public consumption | 4.1 | 7.0 | 9.2 | 3.9 | 12 | 2.3 | n.a. |
| Gross fixed capital formation | 13 | 3.8 | 15.7 | -7.4 | -112 | -3.1 | n.a. |
| Exports of goods and services | 13.7 | 18.9 | 16.3 | 1.4 | 9.7 | 4.3 | n.a. |
| Imports of goods and services | -0.7 | 10.5 | 7.5 | 0.1 | -4.5 | 3.6 | n.a. |
| Industrial gross output | 13.2 | 13.6 | 3.5 | 12.2 | 6.7 | n.a. | n.a. |
| Labour Market¹ | <i>(Percentage change)</i> | | | | | | |
| Gross average monthly earnings in economy (annual average) | 5.0 | 9.2 | 25.2 | 25.3 | 5.2 | n.a. | n.a. |
| Real LCU wage growth | 2.6 | 6.7 | 216 | 213 | 2.9 | n.a. | n.a. |
| | <i>(In per cent of labour force)</i> | | | | | | |
| Unemployment rate (end-year) | 14.2 | 13.9 | 13.2 | 12.7 | 909.6 | 928.1 | n.a. |
| Prices | <i>(Percentage change)</i> | | | | | | |
| Consumer prices (annual average) | 2.4 | 2.4 | 2.9 | 3.4 | 2.3 | 3.6 | 3.5 |
| Consumer prices (end-year) | 2.5 | 3.1 | 2.2 | 3.7 | 3.4 | 3.4 | 17 |
| Fiscal Indicators | <i>(In per cent of GDP)</i> | | | | | | |
| General government balance | -3.5 | -3.3 | -3.3 | -5.1 | -7.4 | -4.2 | n.a. |
| General government revenues | 25.1 | 26.0 | 26.0 | 26.7 | 25.8 | 25.3 | n.a. |
| General government expenditure | 23.6 | 23.3 | 23.2 | 24.6 | 24.2 | 23.4 | n.a. |
| General government debt | 57.4 | 56.1 | 53.4 | 54.7 | 58.3 | 58.9 | n.a. |
| Monetary and financial sectors | <i>(Percentage change)</i> | | | | | | |
| Broad money (M2, end-year) | 0.0 | 16.0 | 13.7 | 7.7 | 6.8 | 9.1 | n.a. |
| Credit to the private sector (end-year) | 73.4 | 57.3 | 48.2 | 32.1 | 10.3 | 8.1 | n.a. |
| | <i>(in per cent of total loans)</i> | | | | | | |
| Non-performing loans ratio | 3.1 | 3.4 | 6.6 | 10.5 | 14.0 | 18.8 | n.a. |
| Interest and exchange rates | <i>(In per cent per annum, end-year)</i> | | | | | | |
| Local currency deposit rate | 5.5 | 6.3 | 6.8 | 6.9 | 6.1 | n.a. | n.a. |
| Foreign currency deposit rate | 3.5 | 4.2 | 4.7 | 3.8 | 3.2 | n.a. | n.a. |
| Local currency lending rate | 12.2 | 13.9 | 112 | 12.2 | 117 | n.a. | n.a. |
| Foreign currency lending rate | 7.6 | 8.7 | 8.2 | 8.1 | 6.3 | n.a. | n.a. |
| Discount rate | 5.50 | 6.25 | 6.25 | 5.25 | 5.0 | n.a. | n.a. |
| | <i>(Leks per US dollar)</i> | | | | | | |
| Exchange rate (end-year) | 103.3 | 93.7 | 83.0 | 91.0 | 94.0 | n.a. | n.a. |
| Exchange rate (annual average) | 99.9 | 98.1 | 90.4 | 83.9 | 95.0 | 101.0 | n.a. |
| External sector | <i>(in per cent of GDP)</i> | | | | | | |
| Current account | -7.0 | -7.5 | -10.8 | -15.5 | -15.3 | -11.8 | n.a. |
| Trade balance | -24.6 | -23.6 | -26.7 | n.a. | n.a. | n.a. | n.a. |
| Merchandise exports | 8.0 | 8.8 | 10.1 | 10.4 | 8.7 | 15.3 | n.a. |
| Merchandise imports | 30.4 | 32.4 | 37.2 | 37.8 | 35.2 | 39.5 | n.a. |
| Foreign direct investment | 3.2 | 3.5 | 6.0 | 6.7 | 7.9 | 7.5 | n.a. |
| Gross reserves, excluding gold (end-year) | 17.6 | 20.1 | 19.9 | 17.4 | 20.8 | 20.1 | n.a. |
| External debt stock | 25.0 | 24.8 | 27.5 | 33.4 | 36.7 | 36.5 | n.a. |
| Public external debt | 15.4 | 15.1 | 14.3 | 14.1 | 21.4 | n.a. | n.a. |
| Private external debt | 8.6 | 11.8 | 15.9 | 19.5 | 22.1 | n.a. | n.a. |
| | <i>(In months of imports of goods and services)</i> | | | | | | |
| Gross reserves, excluding gold (end-year) | 3.8 | 3.7 | 3.5 | 4.2 | n.a. | n.a. | n.a. |
| Memorandum items | <i>(Denominations as indicated)</i> | | | | | | |
| Population (end-year, million) | 3.142 | 3.151 | 3.161 | 3.182 | 3.194 | 3.218 | n.a. |
| GDP (in billions of Leks) | 814.8 | 882.2 | 967.7 | 1,089.3 | 1,151.0 | 1,306.0 | n.a. |
| GDP per capita (in US dollars) | 2,596.6 | 2,854.0 | 3,385.0 | 4,080.5 | 3,793.7 | 3,992.5 | n.a. |
| Share of industry in GDP (in per cent) | 22.1 | 22.9 | 21.8 | 22.1 | 21.6 | n.a. | n.a. |
| Share of agriculture in GDP (in per cent) | 18.6 | 17.5 | 17.1 | 16.7 | 16.8 | n.a. | n.a. |
| FDI (In million of US dollars) | 258.4 | 314.6 | 647.4 | 874.3 | 1,098.0 | 967.0 | n.a. |
| External debt - reserves (in US\$ million) | 2,058.9 | 2,537.9 | 3,205.7 | 4,474.1 | 5,141.1 | n.a. | n.a. |
| External debt/exports of goods and services (in per cent) | 98.1 | 87.9 | 93.8 | 116.5 | 114.3 | 107.7 | n.a. |
| Broad money (M2, end-year in per cent of GDP) | 70.5 | 75.5 | 78.3 | 74.9 | 75.7 | 81.9 | n.a. |

ANNEX 7 – GENDER EQUALITY

Gender Inequality and Human Development

According to the UNDP 2011 Human Development Index (HDI), Albania is among the countries with a high human development index. It is ranked 70th out of 187 countries, which is around the regional average for Europe and Central Asia. The HDI is comprised of three dimensions: health, education and decent standard of living. The country ranks far better in terms of the UNDP Gender Inequality Index (GII), at 41st globally. The GII is a composite measure, which captures the loss of achievement within a country due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.

Labour force participation and gender pay gap

Women's labour market participation is significantly lower compared to men's in Albania. According to the World Bank, in 2010 the proportion of women in the labour force aged 15 years and older was 50 per cent as compared to 71 per cent for men. In 2009, the proportion of female part-time workers was 63 per cent as compared to only 37 per cent for male part-time workers. Women comprise 37.8 per cent of full-time employment as compared to men comprising 62.8 per cent of full time employment.

In 2009, women in Albania earned on average 11.5 per cent less than men, when median monthly earnings of men and women were taken into account. This compares to 25 per cent pay gaps in EBRD countries of operation and 20 per cent for EU countries⁷.

| Indicator | Female | Male | Year |
|----------------------------------|--------|-------|------|
| Labour force participation rates | 50% | 71% | 2010 |
| Part-time employment rates | 63% | 37% | 2009 |
| Full-time employment rates | 37.8% | 62.2% | 2009 |
| Gender Pay Gap | 11.5% | | 2009 |

Source: UNECE 2009, World Bank 2010

According to the World Bank's Women, Business and the Law database, women are entitled to the minimum of 365 calendar days as paid maternity leave; however, they are paid only 62 per cent of their salary during this period. Men are eligible for Paternity leave but only in the public sector. They are entitled to three days of paid leave.

According to the Institute of Statistics of Albania, in 2010 women's enrolment in tertiary education was slightly higher as compared to that of men (55.14 per cent for women compared to 44.86 per cent for men). However, there are gender differences in the fields of study. For example, according to UNECE, 85 per cent of students enrolled in the field of education were female as opposed to just 28 per cent of students being female in the fields of engineering. Gender segregation in education tends to be accordingly translated into occupational segregation in the labour market, as the table, below, shows:

⁷ Averages reported are based on GPG estimates for 24 EBRD countries and for 23 EU countries. United Nations Economic Commission for Europe (UNECE), Statistical Division, 2011 or the latest available.

| Albania: total employment by economic activity | Male | Female |
|--|------|--------|
| Mining and Quarrying | 99% | 1% |
| Construction | 96% | 4% |
| Financial intermediation | 87% | 13% |
| Electricity, gas and water supply | 80% | 20% |
| Public administration and defence | 73% | 27% |
| Wholesale and retail trade | 67% | 33% |
| Hotels and restaurants | 64% | 36% |
| Real estate | 62% | 38% |
| Manufacturing | 53% | 47% |
| Transport, storage and communications | 53% | 47% |
| Agriculture | 45% | 55% |
| Education | 32% | 68% |
| Health and social work | 31% | 69% |

Source: Institute of Statistics of Albania 2009

According to the 2012 Women's Economic Opportunity Index (WEO) of the Economist Intelligence Unit that ranks 128 countries on their ability to support economic advancement of women, Albania is ranked 54th globally and 15th among the countries of the EBRD's region. The country ranks 62nd place globally and 16th in the EBRD region with respect to the labour policy and practice indicator (sub-indicator of the WEO Index) that covers various questions including maternity and paternity leave provisions, regulations on equal pay for equal work, and the availability, affordability and quality of childcare services, just to name a few.

Entrepreneurship, access to finance

There exist some differences related to gender with respect to access to formal financial services in Albania. According to the World Bank's Global Financial Inclusion database, (surveying approximately 1, 000 people using randomly selected, nationally representative samples) in 2011 23 per cent of female adults and over 30 per cent of males held an account at a formal financial institution.

According to the EBRD/World Bank 2007 Business Environment and Enterprise Performance Survey (BEEPS), 10.8 per cent of 304 surveyed firms had women among owners (compared to 36.7 per cent average for Eastern Europe and Central Asia), and women constituted 37.5 per cent of permanent full-time workers.

Land rights

According to OECD, the country's Civil Code gives men and women equal rights to inheritance of property. In practice, in most cases, inheritance follows the male line, and men inherit family-owned land, mainly because women move to the husband's family home upon marrying. If a single woman inherits property from her father, although by law she is entitled to the same title, by custom she often passes it to her husband's family when she marries. It is rare for Albanian women to have access to land title (to be used for collateral, for example), as land belonging to a couple can only be registered in the name of the household head, who is usually the husband.