

# Albania



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Investment Profile

# 2001



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EBRD ANNUAL MEETING



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# Foreword

The political coalition which is the basis for the present government of Albania has continuously worked to replace political conflict with an ongoing dialogue among various stakeholders. Last October local elections showed that Albania, with a modern constitution adopted by national referendum in November 1998, is on the right track with the organisation of free and democratic elections.

A mid-term economic programme, backed by the IMF in 1998, is due to be completed at the end of 2001. It aims at speeding up privatisation, public sector reform, and full disposal of the assets of the bankrupt pyramid schemes, now virtually completed, as well as strengthening democracy and combating corruption.

The economy is on a stable recovery path, as demonstrated by a stable currency, low inflation, a strong GDP growth rate, and other macroeconomic data. Macroeconomic stability is widely accepted as one of the main achievements of the Albanian government. GDP has grown steadily by an average of around 8 per cent each year for the period 1998-2000, after a 7 per cent fall in 1997. Inflationary pressures have been sharply reduced to 1 per cent. Efforts to reduce the budget deficit are now starting to pay off, including better tax collection and more efficient and cost-effective public expenditures. The GDP growth rate is expected to continue at around 8 per cent in 2001, while the budget deficit will continue to be steadily reduced to under 5.5 per cent of GDP. For several years now, the government has been working on the IMF's Enhanced Structural Adjustment Facility (ESAF) programme, and almost all the objectives agreed have been met.

The government is implementing an open and fast privatisation strategy. Firstly, it is encouraging total SME privatisation, which offers low-risk opportunities for investment. Secondly, it is actively using privatisation as a means of attracting strategic foreign investors to key sectors of the economy, particularly mining, banking, telecommunications, energy, transport and infrastructure, which together account for some 70 per cent of state-owned assets. The list of fully state-owned companies due for privatisation includes the main telecoms operator, banks, an oil company, an electricity producer and distributor, a chrome mining company, a metals corporation and a seaport.

The country's capacity to sustain economic growth in the medium term is largely dependent on private sector development and on attracting foreign direct investments (FDI), which together with trade are the main vehicles for

globalisation. The government is making a firm effort to regain and enhance investors' confidence. Development of a legal and regulatory framework that guarantees openness, transparency, predictability, and non-discriminatory policies towards FDI is considered crucial, as well as a generally more accessible business environment. This is the main aim of the Investment Compact now being organised under the auspices of the Stability Pact for South-Eastern Europe.

In terms of the origin of private investments, Italy is the leading investor country, with about 500 companies investing more than € 100 million, mainly in the clothing and shoe industries, furniture production and fishing. Greece is the second, with about 200 companies involved in direct investments totalling about € 100 million. Investors are particularly attracted by the low cost of labour.

In addition, trade, a vital sector for Albania, has undergone major liberalisation since the start of the transition. Last September Albania was declared a full official member of the World Trade Organisation (WTO). Albania is working hard to set targets for the development of trade, financial and economic policies, in favour of domestic interests and at the same time within the framework of the obligations arising from WTO membership.

Within the framework of regional integration, Albania is actively involved in the Stability Pact initiative. Progress has been made under specific initiatives such as the Investment Compact and the programme for Trade Liberalisation and Facilitation.

Sustainable economic development and the creation of new employment opportunities will depend on the development of the private sector. The Albanian government's policy for private sector development is focused on the enhancement of the business environment and the development of cross-border trade and investment. In this respect, the 2001 Investment Profile prepared by the EBRD is an excellent document, giving a thorough overview of the Albanian reality and our market potential for investors.

**Ermelinda Meksi**

Minister of Economic Cooperation and Trade  
EBRD Governor for Albania

# Introduction



*Despite the setbacks of recent years, including the pyramid scheme collapse of 1997 and the influx of refugees from the war in neighbouring Kosovo in 1999, Albania's firm commitment to economic reform has been rewarded with encouraging macroeconomic results. The country appears to be entering a period of political stability, national security has improved, and international moves to support regional integration are helping to restore infrastructure and boost trade. Albania remains one of Europe's poorest countries and still faces major challenges to strengthen its institutions and achieve sustainable development.*

## Recent achievements and political prospects

For a small country with limited resources, Albania has achieved remarkable results in management of the economy, which is growing without imbalances. Inflation is low, reserves are increasing, the currency is stable, the IMF programme is on track with a new programme to be drafted, and privatisation is advancing. Conditions for investment have improved, with greater public security and ongoing renovation of transport infrastructure. The government has strong western support and will benefit from greater regional stability following the change of regime in Yugoslavia as well as from international action to encourage south-east European integration and cooperation.

Political stability has increased and the anarchy of the mid-1990s is well in the past. Local elections were held in early October and were largely successful for the ruling Socialist Party (SP), who now control the local administration in nearly two-thirds of the country's municipalities. Despite fears that it could have been a time of civil unrest, the election was on the whole peaceful, and demonstrated that democracy is developing. International monitors called it the fairest election since the fall of the communist regime in 1990, marking progress towards international standards. The main opposition party, ex-president Sali Berisha's Democratic Party (DP), boycotted the second round of voting and held protests, claiming irregularities in the first round. These rallies were not entirely free of violence but did not attract large crowds, implying that Berisha's influence is waning. Although police action was generally restrained, two protestors were killed by the police in Bajram Curri.

An entirely peaceful general election in the summer would confirm the country's new-found political maturity. However, there is still a risk that political uncertainty could paralyse decision making and jeopardise deep structural reform. The general election will be a key test of the new-found stability.

## Challenges ahead

In spite of the positive achievements, Albania still faces some major challenges in the transition to a market economy. The economy may be growing at a fast rate, but starting from a very low base. Unemployment is high and the economy is still dependent on remittances from the large number of Albanians working abroad, mainly in Greece and Italy. The country's institutions are weak and the IMF has identified strengthening of the administrative capacity throughout the public sector as a priority, alongside good governance and the full restoration of public order. Corruption is prevalent within the public administration, and while law and order has largely been restored to Albania, there is still widespread banditry and smuggling, with pockets of the country at the mercy of criminal gangs. The government is fully committed to addressing these problems and is stepping up the fight against corruption and crime. Only when solutions have been achieved will the country be able to attract higher levels of foreign investment.

Completion of the privatisation process will also be critical to economic growth and investor confidence. Large-scale privatisation is still at an early stage, and successful privatisation of some larger enterprises to strategic investors would enhance the credibility of the privatisation programme and demonstrate the potential for sound business. Privatisation of the dominant state-owned Savings Bank is a priority in order to strengthen the supply of credit to enterprises and to complete the sale of state banks. Another urgent area for privatisation is the public utilities sector.

Although the investment climate has improved, enterprises continue to face major obstacles, particularly unfair competition from the informal economy. Effective law enforcement would bring more enterprises into the formal sector. Although the government is planning increased public investment in infrastructure, and transport infrastructure has

recently benefited from international financing, the troubled energy sector poses a threat to continued growth, with energy shortages affecting manufacturing and causing public dissatisfaction. KESH, the state energy monopoly, is presently under the management of ENEL (Italy), and the successful completion of its aims to cut technical losses and theft will be critical. The government also needs to take action to ensure electricity tariff collection and thus secure financing for the sector. Infrastructure is generally in a poor state of repair, requiring large investments.

### **International relations and regional integration**

Albania has won high praise from the IMF and strong international support for its continued economic stability and commitment to reform. The Stability Pact for South-Eastern Europe is offering Albania a unique chance to build the foundations for strong and sustained growth and enhanced regional cooperation. So far it has funded a number of transport projects as “quick start” emergency projects. In October 2000 the third regional conference of the Stability Pact was held in Istanbul, where Albania’s representative reported that the road projects were being satisfactorily implemented, but that Albania needed substantial funding for restructuring of the electricity industry.

Along with the former Yugoslav republics, Albania was invited to attend the EU summit in Zagreb in November 2000, at which the EU expressed its commitment to help countries not yet in the accession process to become potential candidates for membership, and gained from them a commitment in return to be good neighbours, to respect international obligations, and to work towards greater economic cooperation and joint efforts in fighting corruption and crime. In exchange, the EU will grant approximately € 4.65 billion to a new aid programme for the region to run from 2000-06, with further funding forthcoming if required as a result of increased regional cooperation. In 2001, € 839 million will be on offer to the five states. In December an EU mission visited Tirana to discuss proposals for spending on the public infrastructure, judicial reform and institutional consolidation.

In autumn 2000 the EU agreed to alter the General System of Preferences for the western Balkan states, lifting tariffs for 95 per cent of goods, meaning almost entirely duty-free export to the EU. This was the second boost to new opportunities for

trade in 2000, following Albania’s accession to the World Trade Organisation in September, in line with which it has adjusted its tariffs. In early 2001 Albania was due to open talks for a Stabilisation and Association Agreement with the EU, a new kind of agreement intended for the western Balkan countries that will lead to free trade in industrial products. These moves may contribute to narrowing Albania’s uncomfortably wide trade deficit.

Albania is working constructively with its neighbours and with the EU and the US to promote the stability of the region. It welcomed the fall of the Milosevic regime in Yugoslavia and offered its support to the new Kostunica administration. However, Albania has implied that its approach is cautious, by saying that it prefers to wait and see if Yugoslavia has really embraced “democratic reform”. Albania supports independence for Kosovo, which Mr Kostunica opposes, as dangerous for regional stability. However, the reopening of economic and political links with Yugoslavia should facilitate transport for Albanian trade with central Europe.

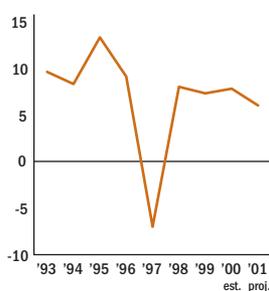




# Economic summary

*The recovery of growth remains strong, though the country still faces challenges in its transition to a market economy. Given continued stability, regaining of control over the entire country, a reduction in corruption in the public administration, improvements to infrastructure and action to push ongoing privatisations ahead, the country will succeed in building on its good growth record. Albanian continues to enjoy strong support from the international community, and the IMF has confirmed its positive appraisal of the country's efforts to achieve economic stability.*

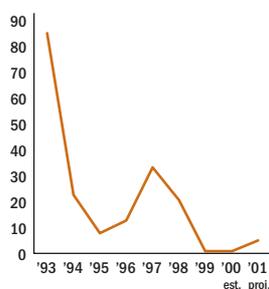
## GDP % change



## GDP growth

Real GDP growth continues to be strong, recording an estimated 7.8 per cent in 2000, as recovery from the 1997 pyramid crisis and the Kosovo war of 1999 continues. Growth reflects improvement in all sectors of the economy, especially construction, trade and services. Agricultural output also increased to a 10-year high. However, the recovery is also influenced by smuggling and other illegal activities, remittances from Albanians living abroad, and the continuation of official foreign aid. The government has stuck closely to targets set under the IMF's current Poverty Reduction and Growth Facility (PRGF, see below). The 2001 state budget passed in December 2000 envisages growth of about 7.3 per cent in 2001. Given the low starting base of the economy, annual growth rates of 7-8 per cent are possible over the medium term, matching the growth rates of 1993-96. Ongoing modernisation of agriculture, where a land market is being gradually developed, will contribute. GDP per capita was an estimated US\$ 1,112 in 2000, and the country remains one of the poorest in Europe. Unemployment is expected to stay high, at about 18 per cent of the labour force, while roughly the same proportion of the workforce will continue to find employment abroad, mostly in Greece and Italy.

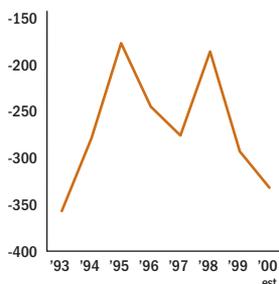
## Consumer prices Annual average, % change



## Inflation

Consumer prices remained stable in 2000, with deflation year on year every month between August 1999 and May 2000. End-year inflation in 2000 was about 4.2 per cent on an annualised basis, while average annual consumer price inflation came in at near zero. This was the result of tight fiscal and monetary policies, and low levels of employment and imported inflation, as prices remained low in the EU, Albania's main trading partner. Inflation did rise in September, and the end-year rate is attributable to a rapid rise in energy prices since April, rising by 24.7 per cent year on year in November. Petrol prices have since stabilised. The budget for 2001 expects inflation to be in the range of 2-4 per cent.

## Current account US\$ millions



Source: EBRD, January 2001

## Current account and trade balance

Exports increased in 2000, and the trade deficit narrowed by nearly 20 per cent to some US\$ 692 million, which is still high. As structural changes are required to improve the trade deficit, it will only be reduced slowly. Albania is obliged to import many essential goods because of the weaknesses of its own production base. Changes will eventually come about with the restoration of industries such as cement, where recent foreign investment has the potential to restore domestic production to pre-transition levels. As a consequence of remittances from Albanians working abroad, the current account shortfall was US\$ 332 million, which was partly offset by foreign investment and IMF assistance. Continued strong performance in 2001 is expected to further reduce the trade deficit. WTO accession will mean a reduction in the maximum tariff on imports, while the EU's asymmetrical trade liberalisation measures mean that almost all Albanian exports to the EU are now duty free,

both of which will boost trade. (See *Investment climate: Markets and trade* below.)

Foreign reserves are equivalent to a comfortable four months of imports. The new state budget envisages keeping them at about the level of 4.5 months of imports.

### Foreign Direct Investment and privatisation

With greater regional stability following the fall of the Milosevic regime in Yugoslavia, Albania expects foreign investment to increase rapidly and far exceed the US\$ 92 million attracted in 2000. However, it will also depend on internal factors such as a return to full control over all parts of the country and a demonstrable reduction in corruption within the public administration. Ongoing infrastructure improvements, especially road construction will help. Privatisation revenues in 2000 were strong, rising from Lek 1 billion (US\$ 6.6 million) in 1999 to Lek 13.8 billion (about US\$ 100 million) in the first half of 2000 and an expected US\$ 120 million by the end of the year. Much of this is attributable to the sale in July 2000 of GSM operator Albanian Mobile Communications to a Norwegian-Greek consortium for US\$ 86 million, and of the Fushe-Kruja cement plant in September for US\$ 12.5 million to a UK-Lebanese consortium. Key sales are planned to go ahead in the banking sector and public utilities. If successful in 2001, these privatisations will boost investor confidence (see *Investment climate: Privatisation* below). The licence for a second mobile operator was awarded in February 2001 to a consortium of Panafon (Greece) and Vodafone (UK), who offered US\$ 38 million in an open and transparent international tender.

### Government balance

The budget deficit in 2000 came in at an estimated 9.5 per cent of GDP. Government revenues relative to GDP are among the lowest in all the transition countries. Efforts are being directed at strengthening revenue collection agencies with the help of international financial institutions, and positive results are already in evidence (see *Investment climate: Taxation and social expenditure* below). The state budget for 2001 envisages a general budgetary deficit of 9.2 per cent of GDP, with income of Lek 134,987 billion and expenditure of Lek 189,022 billion. The deficit is to be financed by Lek 27,313 (or 4.6 per cent of GDP) from internal sources and Lek 26,722 billion (or 4.5 per cent of GDP) from foreign financing. The budget aims to realise sectoral priorities in infrastructure, education, health and social assistance, and covers economic, financial and social policies aimed at creating a proper climate for stable economic development. It also envisages increasing tax and customs revenues by about 13 per cent. At the same time, tax cuts have been introduced.

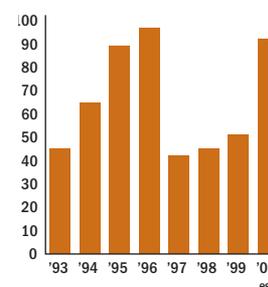
### External debt

External debt was estimated at some US\$ 972 million in 1999, but is gradually being reduced. Continued efforts are aimed at lowering it further, including an agreement signed in November to reschedule US\$ 1.9 million of debt owed to Italy. In December US\$ 9.3 million of interest on US\$ 17.6 million owed to Turkey was repaid. External debt servicing in 2001 is expected to reach 3.7 per cent of GDP, down from 5.3 per cent in 2000.

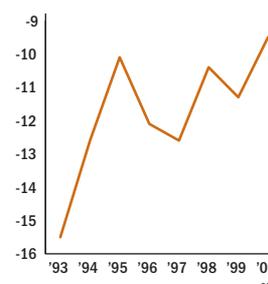
### Exchange rate

By mid-December the exchange rate of the Lek had depreciated against the US dollar since the start of the year by about 7 per cent, reaching some Lek 146 to US\$ 1 (facilitating the increase in exports of goods and services). However, low inflation and good external reserves prevented it from a larger fall in value. At the end of the year the Lek strengthened against the dollar to about

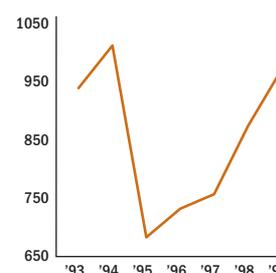
**Total FDI**  
US\$ millions, cash receipts, net



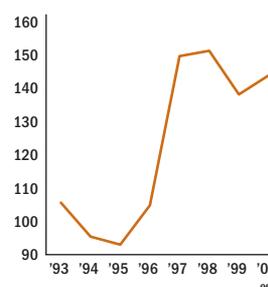
**General government balance**  
% of GDP



**External debt stock**  
US\$ millions



**Exchange rate**  
Annual average, leks per US\$



Source: EBRD, January 2001

Lek 143 to US\$ 1, as migrant workers came home for the holidays and drove up demand for the local currency, and as the euro appreciated against the dollar.

### **Relations with the EU**

The EU is by far the country's main trading partner. In September the EU's General System of Preferences was altered for Albania and other western Balkan states for industrial and agricultural exports, allowing many to enter the EU duty free. A forthcoming Stabilisation and Association Agreement will integrate Albania closer into European structures and will give the country new trade opportunities (as will its recent accession to the WTO). (See *Investment climate: Markets and trade* below.) Another boost for Albania will come from the EU-sponsored Stability Pact for South-Eastern Europe (see Introduction above). The EU's main assistance in Albania focuses on strengthening the public administration through training for civil servants in the management of public expenditures, drafting new laws in line with EU standards, reforming the judicial system, training police, judges and magistrates, and renovating public buildings.

### **IMF and World Bank agreements**

A three-year PRGF was approved in May 1998 (originally as an Enhanced Structural Adjustment Facility), in a total amount of about US\$ 60 million. The first annual tranche (US\$ 6 million) was released in January 2001, by which time about US\$ 47 million had been drawn down. The facility is due to end in June 2001. In October 2000 an IMF mission travelled to Tirana to help with budget preparations, notably fiscal changes (see *Investment climate: Taxation and social expenditure* below). The IMF highly commended the government's performance and its success in achieving the economic aims of the PRGF. In November the IMF mission was joined by representatives of the World Bank, the EU, the UN and the OSCE of a conference with Albanian ministers and NGO representatives to develop a strategy for a new three-year PRGF to cover the period from June 2001 to June 2004. It is likely to be in place before the general election in June.

In December the World Bank released the second and final tranche of a Structural Adjustment Credit (SAC) worth US\$ 45 million in total, which was originally approved in June 1999. The SAC aims to support the restoration of sustained growth and improved living standards through structural reforms that enhance government functioning and strengthen the environment for more efficient private sector development. The World Bank commented that Albania had undertaken important measures to comply with the conditions of the second tranche release.

## Selected economic indicators

	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP (% change)	9.6	8.3	13.3	9.1	-7.0	8.0	7.3	7.8	6.0
Consumer prices (annual average % change)	85.0	22.6	7.8	12.7	33.2	20.6	0.4	0.4	5.0
Current account (in US\$ millions)	-357	-279	-177	-245	-276	-186	-293	-332	na
General government balance (% of GDP)	-15.5	-12.6	-10.1	-12.1	-12.6	-10.4	-11.3	-9.5	na
Trade balance (in US\$ millions)	-490	-460	-475	-692	-518	-621	-846	-692	na
Total FDI (in US\$ millions, cash receipts, net)	45	65	89	97	42	45	51	92	na
External debt stock (US\$ millions)	936	1,012	683	732	757	874	972	na	na
Unemployment (annual average, % of labour force)*	28.9	19.6	16.9	12.4	14.9	17.8	18.0	na	na
Exchange rate, annual average, leks per US\$	105.6	95.4	93.0	104.8	149.6	151.2	138.1	143.8	na
Gross reserves, excluding gold (end-year, US\$ millions)	147	204	240	275	306	384	481	na	na

\* Figures do not account for emigrant workers abroad, who accounted for an estimated 18 per cent of the total labour force in 1995.  
Source: EBRD, January 2001



# Investment climate

Albania's investment climate is finally emerging from the most difficult years of instability. Foreign investor interest has increased, thanks to progress with privatisation in the banking sector and public utilities. With a stable exchange rate, low inflation and reasonable interest rates reflecting the state's growing institutional capacity, conditions for both foreign and domestic investment are improving. The opening of Yugoslavia promises greater regional integration, another positive factor for Albania. However, despite some recent reforms that will benefit the business climate, a sustained period of stability, the full restoration of public security and a reduction of corruption in the public sector are needed before Albania becomes an attractive destination for foreign investment.

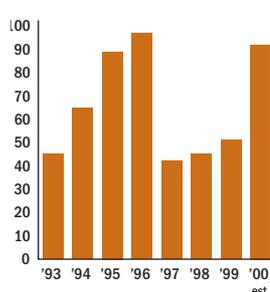
## Foreign direct investment

Net foreign direct investment in 2000 was US\$ 92 million, a considerable improvement from 1999, when only US\$ 51 million was recorded. However, investment is still low and in need of much better conditions to make the country an attractive FDI destination. The authorities expect it to reach US\$ 110 million in 2001.

Cumulative net FDI since 1993 is estimated at only US\$ 526 million, reflecting the impact of the crises that have hit Albania since the fall of communism, namely the pyramid scheme collapse and subsequent unrest of 1996 and the conflict in neighbouring Kosovo in 1999. However, the political stability of the past year and the improvements in law and order imply that prospects may improve, as Albania becomes better integrated into European structures within the general international drive to guarantee stability in south-eastern Europe.

Recent successes in attracting FDI have included the sales of the National Commercial Bank in June 2000 and of Albanian Mobile Communications in July 2000, bringing in restructuring

**Total FDI**  
US\$ millions, cash receipts, net



Source: EBRD, January 2001

capital. Privatisation is expected to continue to be the main source of FDI in 2001 (see *Privatisation* below).

## Investment policy and incentives

The enterprise sector remains dominated by very small businesses (about 98 per cent of enterprises have 10 employees or fewer), many of which operate in the informal economy and have little or no access to formal sources of finance. The investment climate has improved over the past two years, notwithstanding difficulties in 1999 associated with the Kosovo crisis, but all enterprises continue to face the problems of poor infrastructure, delays with property registration, and a judicial system that is often slow or corrupt. However, new laws are expected to spur improvements in enterprise performance. A law on secured transactions was approved in January 2000 and a new bankruptcy law is expected to be approved early this year.

The general environment for investors is improving in two notable respects, namely that personal safety throughout the country is better ensured by improvements in law and order, and the heavy investment in road building allows easier circulation of freight. According to a World Bank research study of some 170 foreign businesses operating in Albania, most are determined to stay in the country and very few suspended their activities in view of the recent local elections. Previous elections have inspired greater apprehension, but investors now appear to be more confident of Albania's business environment. In June an association of foreign investors was founded, with the object of discussing policy in their field with the authorities and helping to attract others to invest in the country; membership is expected to be about 150.

Sectors that are attractive for investors include oil and mineral extraction and the privatisation of the telecommunications and energy utilities. Other sectors in need of long-term investment are agribusiness, tourism, transport, and water and waste-water utilities.

## FDI by sector, end-May 2000

Sector	Joint ventures	Wholly foreign-owned	Total
Trade	1,002	592	1,594
Industry	292	123	415
Services	77	67	144
Construction	71	53	124
Transport	64	48	112
Agriculture	26	7	33
<b>Total</b>	<b>1,532</b>	<b>890</b>	<b>2,422</b>

Source: Instat

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### Private sector development

In February 2001 the government approved a Medium-Term Strategy for the Development of SMEs, including a plan of action and a timetable for implementation. This strategy is part of the government's overall plan for the country's social and economic development, aiming, among other goals, to create employment and achieve fair distribution of income as well as a more evenly balanced development of all regions and sectors across the country.

The government aims to use SME development as a catalyst for rapid increases in local production and employment. However, rapid and sustainable SME promotion and development will require considerable resources, and so the government will work closely with private sector institutions and the donor community in order to obtain the maximum resources and efficiency from increased co-ordination.

Creating a positive business development climate to allow for sustainable SME growth is the main objective of the strategy. Its more specific objectives include: encouraging the expansion of existing businesses and the creation of new ones (start-ups), including the transformation of traders into investors in production, while simultaneously supporting production for export and promoting SME joint ventures.

To reach these objectives a number of concrete measures are to be taken, and will be implemented in two stages: immediate actions, and medium-term actions. These actions include:

- establishment of a Small Business Development Agency (SBDA), an SME Loan Guarantee Fund, and Industrial Estates / Business Incubators;
  - elimination of legal barriers to SME development, and the introduction of a comprehensive SME law;
  - improving the existing SME credit system; and
  - further development of fiscal incentives for SMEs.
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### Legislation in brief

There are no restrictions on foreign ownership, which is welcomed in all economic sectors, and foreigners receive national treatment. There are no tax holidays or incentives for foreign investors. Companies may be fully foreign owned, and no government approval is required in most investment proposals. Profits can be repatriated under current legislation, though some of the bureaucratic hurdles entailed can make it a complex procedure. Legal entities, as defined by the Law on Commercial Companies of January 1993, include partnerships, limited partnerships, limited liability companies (minimum capital Lek 100,000) and joint stock companies (minimum capital

Lek 2 million or Lek 10 million if publicly held). Foreigners may lease property for up to 99 years and may own property if they make an investment worth at least three times the value of the land.

Legislation provides guarantees against expropriation and nationalisation in accordance with international standards. Foreign investors have the right of access to international arbitration. There are Mutual Foreign Investment Protection Agreements with around 20 countries. However, there are inconsistencies within the legal framework, and the resolution of disputes has proved to be lengthy and difficult. The judiciary does not appear to be independent, and suffers from corruption and a lack of professionalism. The new constitution better defines the independence of the judiciary, which is expected to help reduce corruption and raise standards.

Counterfeit goods are widely produced and circulated in Albania. A bill introduced in April 2000 brings the 1992 copyright law closer to international standards. The bill was amended to enable courts to impose prison sentences and fines for breaches of copyright and production of counterfeit goods, but the maximum penalties are mild.

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### Free Trade Zones

Following some debate over their relative merits and disadvantages, in July 2000 a new law on free trade/industrial zones was finally approved in July 2000, which may also help in attracting much-needed foreign investment, particularly in the export-processing sector. Doubts had centred on the possibility that the zones would not be policed properly and would lead to tax evasion and to a loss of revenues to the government. The IMF advised that tax incentives should be limited to indirect taxes and that adequate provisions are made to deal with tax evasion. In January 2001 the Law on Free Zones was amended to abolish the profit tax holiday. It is envisaged that the first such zones will be allocated in the major regional centres of the country – the Durres Industrial Park, the Triport Zone in Vlore, the Elbasan Metallurgical Plant and the Bajze Zone in Shkoder.

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### Challenges to the investment climate

Despite the recent improvements to the investment climate, enterprises continue to face major obstacles. Four areas of the investment climate are in particular need of improvement. First, tackling the problem of corruption is a major priority, as corruption is pervasive throughout the public sector and is a

major obstacle to private sector development. Second, the ongoing restoration of security must be achieved throughout the country so that investors can feel that they and their property are safe. Third, all privatisations must be carried out in an open and transparent manner. Fourth, the government must act to bring more of the grey economy into the formal sector. This would boost tax revenues and also reduce the unfair competition that untaxed, unregistered businesses cause for legitimate businesses. Effective law enforcement would bring more enterprises into the formal sector.

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#### Political risk insurance

In 2000 the Multilateral Investment Guarantee Agency (MIGA, a member of the World Bank group), provided political risk insurance for the first time for foreign investments in Albania, Bosnia and Herzegovina, and Macedonia. In its first project in Albania, MIGA issued a guarantee for US\$ 1.6 million to Ge.Por.Tur. (Italy) for its equity investment in Giorgi Alfo Sh.p.k. Ge.Por.Tur will design, construct, and operate a tourist marina on the southern Albanian coast. The guarantee insures against the risk of expropriation. The International Development Association (also a World Bank group member) has provided US\$ 10 million under its Private Sector Recovery project to support a political risks guarantee facility, which is being administered by the Albanian Guarantee Agency (AGA). The facility gives guarantees to private sector entities involved in production, and protects them against a range of political risks including civil disturbance.

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#### Albanian Economic Development Agency (AEDA)

AEDA was established in August 1998 to promote investment and exports. It offers investors a range of information on existing laws and regulations, including laws relevant to company formation. It also provides details of the country's industrial and other sectors which are open to investment. It can help put companies in contact with potential Albanian partners.

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#### Privatisation

Privatisation revenues in 2000 were strong, rising from Lek 1 billion (US\$ 6.6 million) in 1999 to Lek 13.8 billion (about

US\$ 100 million) in the first half of 2000 and were expected to be US\$120 million by the end of the year. Much of this is attributable to the sale in July 2000 of GSM operator Albanian Mobile Communications to Telenor/Cosmote (Norway/Greece) for US\$ 86 million (see *Major sectors of industry – Telecommunications* below), and of the Fushe-Kruja cement plant in September for US\$ 12.5 million to a UK-Lebanese consortium. The cement factory was one of five medium-sized companies put up for sale in April 2000 and is the second major cement plant to be privatised. (See *Major sectors of industry – Construction materials* below.) The other firms, a brewery (Birra Malto), a winery (Kantina), a dairy factory (Ajka) and a pharmaceutical factory (Profarma), were all sold to local firms by the end of 2000. (See *Major sectors of industry – Agriculture and food processing* and *Manufacturing* below.) USAID, which assisted the privatisation process for the five firms, commented that the tender process was open, transparent and competitive.

After successfully concluding the privatisation or liquidation of most state-owned SMEs, the government is concentrating on larger enterprises and utilities. In October 1999, parliament passed a law that defines tendering as the privatisation method for packages of shares of the commercial companies that operate in non-strategic sectors. Major privatisations achieved to date include the sale in June 2000 of a majority share in the National Commercial Bank, following comprehensive restructuring, to Turkey's Kent Bank (see *Financial sector* below).

The successful conclusion of major sales planned for 2001 would enhance the credibility of the government's programme and demonstrate the potential for sound business. These include the sales of Albtelecom, the fixed-line telephone provider, Servcom, the petrol distributor, a number of hydroelectric generating stations, and two large hotels in Tirana and Durres. The Savings Bank is also to be sold within 2001, though it may be held up by its poor profitability. KESH, the electricity utility, is also to be privatised, but this is very likely to be delayed by its poor performance. (See *Major sectors of the economy* and *Financial sector* below.)

#### Markets and trade

Full membership to the World Trade Organisation (WTO) for Albania was ratified in July 2000, with formal accession taking place in September 2000. Albania has made progress in lowering tariff barriers to imports in line with WTO requirements. In December 1999, it reduced the maximum tariff rate on goods from 20 per cent to 18 per cent, with the unweighted average tariff rate declining to 13 per cent from 14 per cent.

A further reduction of the maximum tariff to 15 per cent is effective as of January 2001. From January 2001 imports of machinery, equipment and raw materials that were taxed at 5 per cent fell to 2 per cent, while for waste-processing technology the rate fell to zero.

Albania has made progress towards opening negotiations on an **EU Stabilisation and Association Agreement (SAA)**, that will lead to free trade in industrial products. In the short-run, agreed trade liberalisation will be asymmetrically in favour of Albania. Since October 1999, the EU has granted unilateral trade preferences to Albania, including exemptions from duties and abolition of quantitative restrictions for industrial goods, special concessions for selected agricultural and fishery products, and provision of specific tariff ceilings for textiles. About 90 per cent of all exports from Albania to the EU are now duty-free, which will rise to 95 per cent in 2001-02. However, customs duty continues to be an important element of the Albanian government's revenues and about 90 per cent of imports are from the EU. Trade liberalisation, therefore, is expected to be gradual, as the government develops other revenue sources. The reopening of economic links with Yugoslavia will increase regional trade and will also facilitate transport for Albanian trade with central Europe.

The leading export sector is textiles and footwear (contributing 61 per cent of all exports), as cheap local labour is used to finish off clothing and footwear for west European companies. Construction materials are growing fast as an export category (by 46 per cent year on year), providing 9.1 per cent of exports in 2000. Agricultural exports accounted for 14.4 per cent of the total in 2000 but grew by only 2 per cent year on year. Food, beverages and tobacco are the largest import item, amounting to 22 per cent of the total. Machinery imports increased in 2000, implying that Albanian industry is continuing to be re-equipped.

Trade with EU countries, mainly Italy and Greece, makes up the bulk of Albanian exports and imports. Exports to Italy increased rapidly in 2000, reflecting the re-establishment of links with Italian companies that use Albanian labour to finish off textiles and footwear. The share of imports from Turkey and Bulgaria is growing.

### Taxation and social expenditure

Alongside the changes of tariffs introduced in line with WTO requirements (see above), on 1 January 2001 the corporate tax rate was cut from 30 per cent to 25 per cent and the maximum personal income tax rate fell from 30 per cent to 25 per cent. These measures were praised by the IMF for providing stimulation of business activity, reducing incentives for tax evasion and encouraging investment. New legislation on VAT has also been approved, which should speed up VAT refunds, as well as amendments to the general law on the tax system and tax-collecting procedures, and legislation providing tax stimuli for small businesses (along with new regulations on a form of simplified accounting).

Government revenues relative to GDP in Albania have been among the lowest of all transition countries. Efforts are therefore being directed at strengthening revenue collection agencies. Training courses for tax inspectors are being conducted with the assistance of the IMF and the World Bank. (The World Bank provided US\$ 8.1 million in November as part of a project to improve facilities at border crossings and reduce corruption in the customs service.) An EU Customs Assistance Mission is also helping in a number of areas, including the valuation of trade and the application of customs duties. In January 2000, the General Customs Directorate introduced bonus payments for successful measures against fraud and contraband. These measures appear to be yielding results.

#### Trade by commodities, QIII 2000, Lek millions

Commodity	Exports	% change year-on-year	Imports	%change year-on-year
Textiles and footwear	5,647	31	5,228	28
Machinery and equipment	214	-9	7,541	9
Foodstuffs, beverages and tobacco	1,290	2	8,251	21
Mineral products	207	42	5,316	104
Chemicals	93	155	3,560	37
Building materials	811	265	4,728	46

Source: Instat

#### Main trading partners, QIII 2000

Exports	Lek millions	% change year-on-year	Imports	Lek millions	% change year-on-year
Italy	6,040.5	71	Italy	13,530.5	25
Greece	1,496.7	-23	Greece	10,711.5	25
Germany	710.1	43	Turkey	2,185.8	32
FYR Macedonia	124.3	-33	Germany	1,675.8	12
France	101.8	63	Bulgaria	1,175.1	35

Source: Instat

In 2000 the total tax collection was estimated to have been boosted by about 30 per cent relative to 1999. Revenues from the collection of VAT and customs duties were estimated to have risen by 14 per cent in 2000 year on year. Revenues from VAT (currently at 20 per cent) were improved by the introduction of VAT invoices, which helped to counteract tax evasion. The government is now considering differential VAT rates, with lower rates for foodstuffs, writing materials and publications.

Over 2000, the number of small businesses paying taxes rose to 30,000 by the end of the year, a 30 per cent increase from the end of 1999. The total number of taxpayers rose in 2000 by 20 per cent. The 2001 budget brings the tax share of GDP up from 16 per cent in 2000 to 22 per cent, closer to the norm for successful transition economies.

### **Social assistance**

Despite recent impressive growth rates, Albania is still the poorest country in south-eastern Europe (and after Moldova, the poorest in the continent). According to a national survey in late 1999 by the Albanian Institute of Statistics, over one-third of Albanian families live with only one income source, averaging around US\$ 64 per month. The government is working closely with the IMF and World Bank to develop a comprehensive plan for poverty reduction. Key priorities are likely to include ensuring access to primary healthcare, reversing the recent

falls in secondary education enrolment, improving the targeting of social assistance and developing the rural land market.

Due to the low number of farmers paying insurance contributions (about 8.5 per cent by end 1999), during the period from October 1998 to June 2000 the government instituted a new amendment to the pension scheme of 1993. This amendment assists farmers by waiving the delay fee of contribution payments and thereby giving farmers better prospects to receive pensions, even for the period 1992-2000 when they were not paying insurance contributions. Farmers can obtain pension coverage for these years retroactively by paying a small amount (about 5 per cent of the regular pension as stated in the original scheme of 1993) without paying delay fees for each year.

# Major sectors of the economy

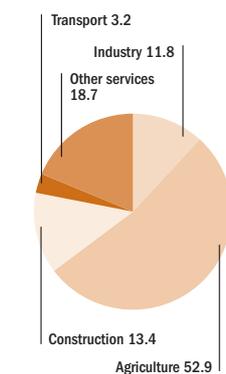


*Agriculture still accounts for over half of GDP, while services only account for about 22 per cent. Important manufacturing sectors include textiles and footwear, cement (recently boosted by a major foreign investment), steel and food products. Infrastructure is in urgent need of investment, with action under way in the transport and telecoms sectors. The most critical area for improvement is the energy sector. Tourism is expected to grow in the future, and is a focus for state investment.*

## Cement

Albania produces 200,000 tonnes of cement each year, but imports a further 500,000-600,000 tonnes. Following a tender, the Fushe Kruje cement plant was privatised in July by sale to UK-Lebanese consortium RMC-ECF for US\$ 12.5 million. The factory produces some 12,500 tonnes of cement per month and is undergoing an investment programme, to be completed in June 2001. It is expected that increased output by the Fushe Kruje plant will meet 45 per cent of domestic needs, reducing the import of cement for the booming construction industry. Construction materials in general account for some 9.1 per cent of Albanian exports, much of it supplying activities in neighbouring Kosovo.

**GDP by sector**  
1999, per cent



Source: Bank of Albania Annual Report 1999

**Seament Albania** is 100 per cent owned by Seament Holding, the holding company of the Seament Group (Lebanon), which is very active in the cement industry and in particular in cement trading which it conducts through several companies world wide. Seament Albania started its operations in 1996 as an importer and trader of cement, using as a base a terminal leased at the Port of Durres, Albania. In March 1997, following an auction organised by the Albanian National Agency for Privatisation, Seament Albania acquired a 70 per cent stake in the Elbasan Cement Factory, and a 70 per cent stake in United Quarries, the company which operates a limestone quarry situated near the factory. The Albanian government still has a minority stake in Elbasan Cement Factory and United Quarries.

Seament Group is now sponsoring an investment project for which the EBRD is considering providing US\$ 15 million to US\$ 18 million loan financing for the rehabilitation, expansion and modernisation of the Elbasan factory. The project includes installation of a new 500,000 tonne capacity dry process kiln. The IFC is co-financing the project for a similar amount.

## Manufacturing

The manufacturing sector has attracted a large number of small joint ventures in food processing, textiles, shoe making and wood processing, mainly with Greek and Italian companies. The textile industry offers plenty of opportunities for foreign investors and accounts for some 38 per cent of exports, with shoes accounting for a further 21 per cent. Forestry is a traditionally important industry, with local wood processing industries throughout the country supplied by relatively cheap local inputs of raw materials. The sector offers opportunities in saw milling, plywood and reconstituted panel making, parquet, joinery and furniture making.

Chemicals and pharmaceuticals are also produced in Albania. Profarma, Albania's leading pharmaceuticals producer, was privatised in November 2000, when an 88 per cent stake was bought by domestic firm Aldosh. Based in Tirana, it employs 184 people and makes 130 products for distribution by state wholesaler Fufarma. Profarma has been in profit since 1992 and maintains high quality control standards and a well-trained personnel. Albania has two other pharmaceutical firms, Prodentalfarma, which is an Italian-Albanian joint venture, and Euromedica.

## Agriculture and food processing

Agriculture still accounts for over half of GDP. Now that land registration is proceeding well, disputes over land ownership are no longer such a great obstruction to production as in the recent past. Market liberalisation and privatisation of most agricultural services have also helped recovery. However, farm sizes are very small, while equipment, inputs, irrigation and the capital to provide them are scarce. During 2000, agricultural exports were strong, mainly to Italy and Greece.

Numerous international initiatives are under way to promote agricultural development. World Bank assistance includes a US\$ 45 million project to restore irrigation facilities and hydrological monitoring systems, and a forestry support programme. It is also running an agricultural services project to increase productivity by supporting activities in seed

production, marketing, land consolidation and fisheries. A separate fishery development project aims to develop a sustainable fisheries industry. Both projects are IDA funded. The World Bank has also provided a US\$ 12 million small credit line for farmers.

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### Land market

The programme of registration of private property in the agricultural sector, begun in 1998, is slowly progressing towards the establishment of a fledgling land market, which will pave the way for consolidation of small parcels of land into viable holdings. It is also giving farming families secure tenure. The first step was the passing of a new land law in 1998, following a requirement of the IMF's then current ESAF programme. By September 2000, the project, whose US\$ 27 million cost is being covered mainly by the US and the EU, was completed in about 49 per cent of all cadastral zones in the country (1,501 out of a total of 3,046). The project is being financed by the World Bank with the support of USAID, which helped devise land titling laws and regulations. The process of land registration has been delayed due to difficulties in registration of remote areas. Completion will probably be in 2002. The programme has already led to an increase in property sales (mainly of houses and land). At the end of 2000 a government decision was passed requiring all legal documentation for property to be handed over to real estate registration offices, in order to improve the system. Previously, documents were spread around various institutions including privatisation offices.

Foreigners are now able to own land in Albania, but only if they make an investment worth three times the value of the land on the site. However, they may lease land in state-owned areas.

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USAID is involved in promoting private agriculture through a number of projects, including support for agriculture trade associations to set up a network of input supply dealers to provide fertiliser, seeds and other vital inputs. This has worked well, with almost all fertiliser now distributed by some 150 private dealers, who are also leading the distribution of farm chemicals and seeds. USAID has also supported the dairy sector by transferring new technology, organising a network of dairy producers and providing training. Issues for agricultural markets include problems with enforcing standards and licensing. Another USAID project aims to help deal with the problem of cumbersome administrative procedures and the non-transparent legal framework that encourage corruption; licensing is promoted as a good alternative as it only involves a simple fee to a notary.

Among the many other projects completed or ongoing are initiatives run by the UN, IFAD, EU-Phare and other agencies, to supply farm equipment, run irrigation and land erosion projects, rehabilitate rural roads, provide better management of forestry resources, and support fish farms.

### Food processing

Processed foods, beverages and tobacco account for about 10 per cent of exports. Leading products include flour, bread, macaroni, starch, canned fruits and vegetables, fruit juice, canned fish, tomato sauce, olive oil, sunflower oil, beer, wine, brandy, tobacco, milk and dairy products, and processed meat. Tobacco is the main export item in this sector, with a 70 per cent share. Most tobacco is sold to Greece.

In October 1999 an affiliate of Pepsi Cola (US) started production at its new factory in Gjirokaster and is selling its products in Albania's main cities. The factory is one of the most modern of its kind in the Balkans, and plans to establish four more soft drink production lines. Coca-Cola (US) has also invested in a bottling plant in Tirana, run on franchise by Italy's Busi Group.

A 94 per cent stake in Birra Malto, the country's leading brewery, was put on sale in 2000 through an international tender. Based in Tirana, the brewery produces pasteurised lager under the brand name Birra Tirana and has an approximately 30 per cent market share. The main international bidders included Birra Peroni (Italy) and Heineken (Netherlands). Although the tender was initially won by Birra Peroni, they withdrew in the negotiation phase and the tender was therefore assigned to a consortium of 11 local investors who made the second best offer, of US\$ 3 million. Ajka, Albania's leading dairy, was privatised in 2000 with the sale of a 90 per cent stake. Ajka has benefited from German government technical assistance funding which helped it to construct the biggest milk processing plant in Albania, which now produces a wide range of milk, yoghurt and cheese products. It is well equipped, profitable, and has strong growth prospects. It was bought by local firm Aldosh.

Seventy six per cent of the Kantina winery and distillery (also known as "Gjergj Kastrioti") located in Durres was sold by tender to local firm Rilindja for Lek 110.5 million (approx. US\$ 762,000), with a pledge to invest Lek 550 million (approx. US\$ 3.8 million). Kantina produces several wines including "Skenderbeg" brandy, which is well known throughout central and eastern Europe, and is profitable. Although it sells mainly to the domestic market through a

network of 15 retail and wholesale outlets, Kantina exports to the US and is to resume marketing in central and eastern Europe. It is also actively exploring export possibilities in the EU. The plant only works at 30 per cent of capacity, so there is plenty of scope for expansion.

### **Natural resources, mining and metallurgy**

Albania has large mineral resources, including chrome, nickel, copper, oil and coal, all of which are extracted. There are also large deposits of bauxite and phosphorite yet to be exploited. Lesser deposits include dolomite, gypsum, salt stone, clays, volcanic glass, bitumen and marble.

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#### **Examples of existing concessions**

Hayri Ogelman Madencilik (Turkey) has a long-term concession to develop the Kalimash chrome mine and concentrating plant and mines at Vllahane and Perollajt in north-eastern Albania. It is investing about US\$ 40 million in technology upgrades and the construction of a new ferro-chromium plant at Elbasan.

Darfo (Italy) has a 30-year concession to operate the ferrochrome plant at Elbasan and chrome mines at Pojska and Perrenjas. Darfo will invest US\$ 14.5 million in the plant and US\$ 0.5 million in the mines. Darfo is seeking to expand its Albanian activities with a second concession agreement to exploit the Bulqiza chrome mine and processing plant and the neighbouring Burrel chromium enrichment plant.

Turkish copper smelting company Ber-Oner is to invest US\$ 24.5 million in the Albanian copper industry, and has been granted a 30-year concession to operate the country's copper mines and processing plants on a build-operate-transfer basis. Apart from copper industry facilities in Mirdite, Puke and Lezhe, Ber-Oner's concession also covers chrome operations in the Has region. Ber-Oner would invest US\$ 16 million in copper and the rest in chrome.

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#### **Chrome and copper**

To attract investment in its copper and chrome mines, Albania offers long-term concessions to private companies on a Build-Operate-Transfer basis. A number of concession contracts were signed with foreign companies in 2000 (see above), mainly for chrome mine exploitation. However, the industry has suffered from lack of investment and, in an effort to restructure it, a number of unprofitable copper mines and processing plants

were closed in 2000. The workforce is also being reduced. Attracting foreign interest is difficult, as the industry is hampered by outdated equipment and is located mainly in the mountainous north of the country. This region is very hard and costly to access for those who want to check the reserves before investing. Intrepid investors in Albania's mining industry may have advantages in the future exploitation of Kosovo's mineral wealth. For some years the government has been planning to privatise Albchrom, the state-owned chrome industry monopoly, but it has failed to do so. The same fate has befallen Albbaker, the state copper industry monopoly. This was a lost opportunity in the 1990s, as now the mines have deteriorated too much to offer an attractive prospect.

#### **Oil and gas**

Albania has estimated recoverable oil reserves of about 550 million tonnes, offering large export capacity. The government encourages foreign investment in oil exploration, and both onshore and offshore exploration has aroused the interest of the international oil companies. Occidental Petroleum (US), Premier Oil (UK), OMV (Austria), Coparex (France) and Ina Naftaplin (Croatia) have been active in the country for some years. However, the results have not always proved fruitful, partly because enormous investment in infrastructure would be required to make extraction of the comparatively limited oil reserves worthwhile. Another problem is that the oil extracted has a high sulphur content, requiring special refinery treatment. In the 1970s crude oil production was as high as 2.25 million tonnes a year, but by the 1990s it had dropped to just under 850,000 tonnes. A study produced by state oil company Albpetrol concluded that investment of US\$ 6.7 million in the existing oil wells would yield almost 300,000 tonnes of extra oil over a five-year period.

Albania's oil sector recorded profits in 2000 for the first time since 1996, following the start of its restructuring. Local production accounts for 40 per cent of the oil products market. Albpetrol is due to be privatised, and in 1999 was divided into three commercial companies handling oil extraction (APC), services (Servcom) and refining and marketing (Armo). Privatisation was expected in 2000, but did not take place. However, its chances of success are increasing as profits rise and the sector becomes less indebted and more efficient. Armo is likely to be privatised in 2001, in cooperation with the World Bank and the Italian government.

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### Trans-Balkan oil pipeline

Infrastructure requirements include pipelines and an oil terminal. In September 2000 a memorandum of understanding was signed on construction of a trans-Balkan oil pipeline to run between Burgas on the Bulgarian Black Sea coast via Skopje in FYR Macedonia to the Albanian port of Vlore, a length of 913 kilometres. US-based AMBO (the Albanian, Macedonian and Bulgarian Oil Corporation) is seeking financing for the Burgas-Vlore pipeline, which is expected to have a total construction cost of US\$ 1.13 billion, of which US\$ 60 million will be raised from the bank credits and the rest from company shares. Various IFIs have been approached, including the EBRD, the IFC, OPIC and EXIM. The work is due to start in 2001 and is expected to take four years. Once operational, the pipeline will have a capacity of 750,000 barrels per day and will ship Russian, Azerbaijani, Kazakh and Turkmen oil from the Black Sea to western European and North American markets. An alternative route from Burgas to Alexandroupolis on the Greek coast has also been discussed. Separately, Russia has held negotiations with Albania on construction of a pipeline from Russia to its coastal ports.

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For lack of active processing facilities, crude oil is exported and petroleum products are imported. Oil extraction centres on Berat (south-central Albania) and Fier (south-west), with a large refinery at Ballsh with a capacity of 1 million tonnes, and a smaller one at Fier with half the capacity of Ballsh. In 2001 the Ballsh refinery is to start production of lead-free petrol, which until now has had to be imported. There are three other refineries with a total capacity of 1 million tonnes, but they are too primitive to provide more than primary processing. Petrol retailers include BP Amoco, and Global, in which Hellenic Petroleum (Greece) has a 75 per cent interest. Global has an 8 per cent share of the market and a chain of 11 service stations, which Hellenic plans to increase to 20 per cent by 2002. In December 2000 Cogef (Italy) announced plans to invest US\$ 20 million in the petrol retail market under a 30-year concession.

The country's **gas industry** centres on 11 fields with an annual capacity of 69 million cubic metres. However, output is much lower and imports are required to meet domestic needs. The government is anxious to develop its gas industry, and under EC-Phare's Multi-Country Energy Programme is being encouraged to do so. Albania is the only country in Europe which is not connected to an international gas pipeline. Options

are under discussion to remedy this, including links to Italy, Greece or Macedonia.

In 1998 **Grande Portage Resources** (Canada) signed a Joint Operating Agreement with Albpetrol for the development of the Delvina gas field. The agreement gives Grande Portage Resources the exclusive right to negotiate with Albpetrol for the joint operation and development of the gas field, located 70 kilometres from Fier in the mountains.

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### Elbasan steelworks

Over 2000, Turkish investor Kurum Steel continued to implement its plans for the Elbasan steelworks. Kurum Steel took out a 20-year lease in January 1999, and is committed to investing US\$ 15 million over that period, of which US\$ 6-10 million will be invested by the end of 2003. Kurum aimed to increase the plant's capacity to 200,000 tonnes of steel per year by the end of 2000 but was delayed by energy shortages. By the end of 1999, production was up from 20,000 tonnes a year to 10,000 tonnes a month, with plans to sell the products in Kosovo and Bosnia and Herzegovina as capacity rises in 2001.

Built in the 1970s using Chinese technology, the steelworks only supplies about 5 per cent of local demand. Production has dropped heavily since the communist era, when it had an annual capacity of 140,000 tonnes of steel.

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### Energy

Albania benefits from a supply of cheap hydro-power energy, with eight major hydro stations. Hydropower accounts for 95 per cent of all energy generation. Total installed capacity (hydro and thermal power stations) is 1,656 megawatts, producing about 3.6 billion kilowatt hours (KWh) per year, but the system works well below capacity. Moreover, the country's true hydro-power potential is estimated at over 16 billion KWh per year. Albania has no facility for gas power, only electricity, and has no storage for liquefied petroleum gas.

The government is now giving priority to ways of exploiting this potential, but meanwhile the sector is beset by problems. Power supplies are restricted and unpredictable, with increasing losses affecting over 60 per cent of the national grid. In August and again in late October electricity was only being supplied for five hours per day, following a drought which reduced water levels.

The rationing of electricity then led to water shortages as electric pumps used to distribute it could not be put into operation. In response to the emergency, the government established a fund of Lek 1.4 billion (about US\$ 9.7 million) for electricity imports. This allowed KESH, the state-owned Power Generation and Distribution Company, to pay off arrears to foreign energy companies and resume essential imports.

However, a long-term solution to the country's energy problems is urgently needed as Albania can ill afford electricity imports, which are mainly from Greece and lately from Slovenia. Despite the establishment of an energy task force in 1999 with Italian government assistance, KESH remains in serious financial difficulties. With no price controls, badly organised, corrupt distribution and public unwillingness to pay for a poor service, the energy sector has major problems that will take some years to resolve. About 50 per cent of the electricity generated in Albania is not paid for (tariff collection is only about 30 per cent), either because of technical defects or illegal consumption. To help counter these problems, an 18-month contract to manage KESH was awarded in May 2000 to the Italian company ENEL, with the objectives of cutting technical losses and theft. It is hoped that the intervention of ENEL will help, but a political decision is also needed to ensure tariff collection and thus secure financing for energy sector development.

The EBRD and the World Bank are also assisting in restructuring the sector by extending new loans to KESH in December 1999. However, the World Bank suspended its US\$ 29.5 million loan for several months until evidence of an improvement in the country's energy situation became apparent, following short-term measures such as the cutting of illegal energy connections, cutting off non-payers, encouraging the public to be energy efficient and reducing technical losses. The EBRD lent € 30 million for improvements to power transmission and distribution, with co-financing from the Japanese Bank for International Cooperation and the Austrian and Swiss governments. Total project cost is US\$ 62.7 million. The EBRD's loan replaced two existing energy sector investment projects that could not be implemented because of the adverse economic effects of the pyramid crisis and Kosovo war. The project is financing emergency reconstruction of the distribution system and is designed to reduce power theft. It will also increase the hydropower generating capacity.

KESH is also making efforts to install electricity meters for all customers and to computerise its billing system. The government is working to improve the electricity supply network, and recently five new distribution sub-stations opened, with another 13 to come on line in June. A Norwegian government loan of US\$ 6.7 million is helping to upgrade the Elbasan power station and increase production capacity. Negotiations began in December with the Chinese State Electricity Company on a US\$ 149 million contract to build a new hydropower station with an installed capacity of 80 megawatts at Bushat on the Drin river. The existing cascade on the Drin river is being rehabilitated with financing from the EBRD. Siemens (Germany) is to invest DEM 10 million to upgrade a power transmission station in the Korce region. Fitner (Germany) has been selected for a DEM 35 million German-funded project to rehabilitate two power stations on the Bistrice river and to build a high voltage line connecting them with Sarande's power grid. The project will also include rehabilitation of local transmission lines and installation of new meters in Sarande.

Network connections with neighbouring countries are also planned, and construction of a 400 kilovolt interconnection line with FYR Macedonia and Greece is now going ahead. Total project cost is estimated at US\$ 28.6 million, of which US\$ 20 million will be for work undertaken on Albanian territory. It will include construction of a transmission sub-station at Zemblak in the south east of the country. The project will help to eliminate power cuts and will reduce losses of energy in the existing power transmission line.

### Telecommunications

As the first infrastructure sector scheduled for privatisation, telecommunications has had encouragement from the major IFIs to ensure a transparent process that will stimulate further telecoms development and set an example for other sectors. The World Bank and the EBRD helped to provide a competitive framework through regulatory measures, and there is now a regulatory authority and appropriate legislation. A new telecoms law was adopted in mid-June 2000, designed to lay out key requirements for the development and minimum standards of the telecoms sector, including radio frequency allocation, payments for licences and the regulatory authority.

With fixed-line penetration at under 4 per cent and a six-year waiting list for new lines, there is enormous scope for the

mobile market. An 85 per cent stake of the state-owned mobile phone company, **Albanian Mobile Communications** (AMC), was sold in July 2000 to a consortium comprising Telenor of Norway and Cosmote of Greece for US\$ 86 million. This was Albania's single largest private investment to date. The consortium won the tender against strong competition from Greece's leading mobile operator, Panafon, in cooperation with Vodafone (UK). Fifteen per cent will remain for the company employees and for the owner of the land where its headquarters is located. Cosmote-Telenor plans to invest US\$ 120 million to expand the network and improve the quality of service. About 60 per cent of the investment will be made in the first three years. Since the privatisation, Nokia (Finland) has been contracted to supply equipment including switching centres and base stations.

AMC is the only mobile operator and was launched in 1996. Its network currently covers about 26 per cent of Albanian territory, inhabited by about half the population. Over 2000 its number of subscribers rose rapidly, from 15,000 to 30,000. OTE (Greece) is the parent company of Cosmote, the leading partner in the consortium that bought AMC, and is expanding rapidly in south eastern Europe, with investments in Romania and FR Yugoslavia.

Following the successful sale of AMC, the GSM market was opened up to competition. In September 2000 a tender was issued for a second GSM licence. In February a consortium of Vodafone (UK) and Panafon (Greece) was chosen as the winner, with an offer of US\$ 38.1 million, thus beating its closest competitor, Fintur Holdings (a consortium of Finland's Sonera and Turkey's Turkcell).

A 51 per cent share of the equity in the fixed-line operator, **Albtelecom**, is to be offered to a private investor, but the sale is unlikely to take place until the second half of 2001. Full liberalisation will follow this privatisation. Albtelecom's monopoly of fixed-line services is to end in January 2003. Meanwhile Albtelecom is conducting investment projects to improve the country's weak telecommunications system.

Before the transition began, only state organisations and few households had telephones, and the public had to rely on post office facilities. The penetration rate in Albania is still very low, but has been improved through a US\$ 49 million project (including an EBRD loan of US\$ 10 million and contributions

from the EU, Italy, Switzerland and Norway) designed to digitalise the network. By June 2000 fixed-line penetration had reached almost 4 per cent. A grant of US\$ 2 million from the Swiss government enabled Albtelecom to extend its national and international network. Other investments are planned to increase Albtelecom's value and double its capacity, and a reorganisation is under way with the help of Norwegian Telecom. Optic fibre links are to be established between Albania and Kosovo, FYR Macedonia and Montenegro.

Recent activities include completion of a new digital station at Durres, installed by Siemens (Germany) at a cost of € 2.8 million. The station will increase telephone capacity by 27,000. Siemens has been contracted to build digital stations in several other cities, adding 65,000 new telephone lines in all. In 2001 the company will construct a new international station in Durres at a cost of US\$ 4 million. Albtelecom has recently installed a Back Bone Internet network at a cost of US\$ 450,000 and is now able to operate as an Internet service provider (ISP). In June 2000 a licence was issued to Cybernet to operate as an ISP in Albania. Installation of an Integrated Services Digital Network (ISDN) was completed in 2000. Albtelecom is also increasing the use of phone cards.

### Transport

A number of important transport projects are due to go ahead in 2001-03, largely under the auspices of the Stability Pact, which is coordinating funding from a wide range of multilateral and bilateral sources. The government's own investment plan has set a 30 per cent increase in transport funding for 2001, totalling Lek 20 billion (about US\$ 71 million) for the year. The increased road capacity will be a boost for investment and for the economy in general by enabling easier passage of freight.

### Roads

Albania's 16,000-kilometre road network is in poor condition and is inadequate for the increasing traffic. Before transition, private car ownership was banned, but since it began more and more Albanians have become car owners, and the country has gained in importance as a transit route. The government has given priority to the main east-west and north-south routes, which are being upgraded within an EU-sponsored programme in cooperation with other international donors, more recently brought under the auspices of the Stability Pact, which is giving

priority to road rehabilitation under the “Quick Start” and Near-Term programmes. Total funding from the various donors under the Stability Pact for transport development amounts to US\$ 204 million for 12 projects, covering roads and also development of Durres port.

Within the Albanian network, various IFIs are providing credits of US\$ 200 million for the north-south route and the east-west road corridor. The east-west route is part of the Egnatia Road which runs on to Greece, and comprises the western end of the Pan-European Corridor No. VIII, which will link the Adriatic at Durres to the Black Sea at Istanbul. Once completed, this project will give Durres the opportunity to become a regional port serving the southern Balkans. In view of the post-conflict reconstruction programme, the east-west route across Albania has recently taken on new importance.

International donors involved in the rehabilitation of Albania's roads, apart from the EU, the EBRD, the EIB and the World Bank include the Kuwait Fund for Arab Economic Development, the Central European Initiative (CEI), the Italian, US, and Greek governments, as well as Albania itself. Responsibility for projects covering stretches of the major road routes has been divided between them. Under the Stability Pact, a number of the ongoing road projects have been given “Quick Start” status as priority infrastructure projects, including:

- the 32-kilometre stretch of the north-south route from Lushnje to Fier (funded by the Italian government for € 15 million),
- the 35-kilometre stretch from Fier to Vlore (funded by the EIB for € 21 million plus € 2 million from the Albanian government covering land acquisition),
- the 24-kilometre stretch of the east-west route from Tepelene to Gjirokaster (funded by the EIB for € 13 million, EU Phare for € 7.5 million and the Albanian government for € 5.5 million covering land acquisition),
- the 31-kilometre stretch from Elbasan to Librazhd (funded jointly by the EBRD, the Italian and Albanian governments and the CEI for € 16.1 million), and
- emergency repairs and pavement strengthening on a 221-kilometre stretch of the road from Durres to Kukes, giving access to Kosovo (funded by the World Bank for US\$ 13.65 million and the Albanian government for US\$ 0.81 million).

The World Bank is financing a feasibility study and emergency rehabilitation for the Durres-Kukes-Morine (the border point on the road to Kosovo) road following previous emergency repairs made by NATO on this segment during the Kosovo crisis. Another World Bank project involves financing for the emergency repair of the Shkoder-Morine road. Part of the Durres-Morine road overlaps with the north-south route and the rehabilitation of the overlapping segments will be financed by several donors, including the World Bank, Italy, the EU and the EIB.

The Albanian government is also seeking financing for the rehabilitation of the Milot-Rreshen-Kukes-Morine route.

The rest of the road projects come under the Stability Pact's Near-Term and Medium-Term programmes. Road projects have undergone some delay because of outstanding land ownership issues, but progress has been made to resolve them. A number of IFI road renovation projects have already been completed (such as the IDA's Rural Roads and National Roads Projects).

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The World Bank is funding a project for **Trade and Transport Facilitation in Southeast Europe**, which involves modernisation of customs administration, upgrading of information systems, improvements to border crossing infrastructure and equipment and technical assistance for trade facilitation. This regional programme involves Albania, Bosnia and Herzegovina, Bulgaria, Croatia, and FYR Macedonia. An investment of up to US\$ 140 million is planned for the period to 2003. The main sources of financing will be the World Bank (US\$ 38 million), its soft-loan arm the International Development Agency (US\$ 30 million), the US government (US\$ 9 million), and the EU (US\$ 50 million), with participating countries providing US\$ 18 million. This programme will represent the first regionally linked project in support of the Stability Pact.

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### **Railways**

The 447-kilometre main railway network is in a very poor state, speeds are restricted for safety reasons, and rehabilitation costs are estimated at US\$ 278 million. The government is placing priority on reconstruction and modernisation of the existing main north-south and east-west routes. Italy is contributing to the modernisation of Tirana-Durres route with commodity aid of US\$ 6million. Other lines to be renovated run from Durres to Pogradec, with a new extension to the

FYR Macedonian border. Plans to build a line from Rreshen to Kosovo are on hold for lack of the necessary US\$ 200 million. The Greek government has been considering financing a railway line from Pogradec to the port of Thessaloniki, which would provide an important outlet for central Albania's mines. In January 2000 the Japanese government donated US\$ 1.9 million towards Albanian railway rehabilitation.

### **Ports**

The two main ports are Durres, which has ro-ro ferry facilities, and Vlore, a naval and ferry port. Sarande has a passenger and light freight service to Italy and Greece. Following the Kosovo crisis, the port of Durres is expected to play a crucial role in the supply of goods and equipment to the southern Balkans region. Durres handles 80 per cent of Albania's maritime traffic and is to undergo major rehabilitation, starting with the construction of a container terminal at a cost of about US\$ 120 million. The US government is considering providing financing for the terminal.

The government has approved master plans for the development of the Port of Durres, a key project in the framework of the Stability Pact under the Near-Term programme. Financing is being provided by a US\$ 17 million loan from the World Bank to improve the efficiency and capacity of the port, firstly by establishing an autonomous port authority, privatising port operations, improving customs procedures, operations and safety; and secondly by rehabilitating its infrastructure to accommodate anticipated traffic demand and attract transit traffic. Under this project, the Durres Port Authority has been established as a joint stock company and has started operating under a Supervisory Board. The total cost is estimated at US\$ 23 million, of which the OPEC Fund for International Development will provide US\$ 5 million and the Albanian government the remaining US\$ 1 million. The World Bank loan is on International Development Agency terms. Another important donor for the redevelopment of Durres port is the Kuwait Fund.

Once the ongoing road projects are completed, Durres will become a major trade and transit centre. The Durres Industrial Park that EBRD has been promoting for some time is planned to be built just outside it. A land allocation study has been completed.

### **Airports**

Tirana's Rinas airport is undergoing modernisation and gradually regaining its European connections. A project worth US\$ 26.5 million to rebuild the runway, lights and boundary fence has been carried out by Siemens (Germany). Plans have been approved for a new passenger and cargo terminal, possibly to be operated under private concessions. Deloitte & Touche has been selected as the foreign advisor to prepare the international open tender for the construction of the new terminal at Rinas airport. The terminal is to be completed by 2015, when the number of passengers is expected to have reached 1.5 million. Foreign airlines operating scheduled services include Adria, Alitalia, Austrian Airlines, Malev, Olympic Air, Swissair and Turkish Airlines.

### **Tourism**

Albania's unspoilt Adriatic coastline has enormous tourism potential, but lack of infrastructure and financing has prevented the industry from taking off. Lack of public order and the Kosovo crisis have also deterred visitors. The government is giving high priority to tourism as a sector with great potential and hopes that it may benefit from the infrastructure development to be provided by the Stability Pact; the Kosovo crisis did have the positive effect of drawing foreign attention to Albania. Many projects suspended as a result of the pyramid scheme crisis in 1997 have now started up again. The government has major investment plans for the sector in the medium term.

Foreign investment in tourism over 1994-99 totalled about US\$ 70 million, but about US\$ 150 million more is required to cover the priority areas. Investment in tourism is encouraged through tax concessions. Projects worth a total of US\$ 930 million have been identified by the Committee for Tourism Development, and about 70 projects are currently under way for a value of US\$ 420 million. The most significant of these involve the construction of tourist resorts in the Durres and Kavaja coastal areas. Among the Committee's present activities are development projects for tourism based on the shores of Lakes Ohrid and Prespa.

At the end of September 2000 the Committee reported that the country had 900,000 visitors so far that year, and in November that tourism income in 2000 amounted to some US\$ 350

million. This is a notable increase over the preceding years, and some estimates place income from tourism at 12 per cent of GDP for 2000. Many of the visitors were Kosovar Albanians and Albanians living in FYR Macedonia. In December the Committee signed an agreement with the Montenegrin ministry of tourism for cooperation in regional tourism.

The most popular areas for tourists are the seacoast and Lake Ohrid. Apart from the glorious coastline, nearby Butrint is the home of some of Europe's most spectacular Roman architecture. The government plans to turn Butrint into a national park. The culture ministry has been working closely with the UK-based Butrint Foundation, which sponsors archaeological excavation of the site, to prepare a management plan for the park.

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#### **Hotel refurbishment and privatisation**

Three state-owned hotels, the *Adriatiku* and the *Apollonia* in Durres, and the *Enkelena* in Pogradec, were reconstructed before being privatised by auction in October 2000. They now have three-star status. Other unrefurbished hotels were also auctioned, and the sales were part of an effort to encourage tourism along the coast. Three other hotels, the *Tirana* and *Dajti* in Tirana, and the *Skampa* in Elbasan, are to be privatised in 2001. In November 2000 Kuwaiti company Mak Albania resumed its work to construct a five-star hotel in Tirana at a cost of US\$ 53 million, the country's largest investment to date. Work was suspended following the crisis of 1997.

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#### **Environment**

In November 1999 a major environmental project was announced, aimed at stopping pollution and making an effort to reverse some of the effects of decades of damage. Italy is providing funding of US\$ 300 million, and the funds will be managed by the World Bank, cooperating with five Albanian ministries. Top priorities for the Ministry of Agriculture include the destruction of pesticides and an end to excessive wood

cutting. The Ministry of Construction will be responsible for removing illegal buildings from the sea coast, improving the drinking water system and the sewage network. The Ministry of Transport will monitor and control pollution in urban areas and find a solution to the numerous car-wreck sites. Some of the funding will be used to restore parks and other green areas.

There are 50 water enterprises, of which over 90 per cent are subsidised by the state. All are in difficulties and only provide a minimal service. Restructuring and privatisation on the basis of voucher sales, leasing or concession contracts are under preparation. EU Phare is contributing to the repair of water supply systems in Gjirokaster and Fier.

Under a Stability Pact "Quick Start" project, the water supply and waste-water system in five cities (Vlore, Fier, Sarande, Lezhe and Gjirokaster) is to be rehabilitated at a cost of € 27 million funded by the EC. A Near-Term project covering municipal water and waste-water systems in Durres, Fier, Lezhe and Sarande will cost a total of € 65 million, with the World Bank contributing € 35 million.



# Financial sector

*The financial sector has made progress in recent years. The Central Bank has established good supervision. Only the Savings Bank, which accounts for 80 per cent of all deposits, has yet to be privatised, and the process is proceeding well through cooperation with IFIs. Privatisation is key to addressing the challenges of banking sector development.*

Albania's financial sector is underdeveloped, but public confidence in the banking system is starting to improve for the first time since the disastrous pyramid scheme crisis of 1997 that deprived many Albanians of their savings. Banks are nervous of lending in an atmosphere of poor loan security. Other major challenges include the need to improve corporate governance and management capability, and to increase competition between commercial banks. However, in cooperation with international financial institutions the government and the Central Bank are making a strong effort towards creating the conditions for an effective banking sector, with the objective of improving intermediation between savers and businesses.

## Banking sector

Under a new banking law of February 1996 the central bank, the Bank of Albania (BoA), gained legal independence. The two-tiered system consists of the BoA on the first level, and all other banks on the second. There are no restrictions over foreign ownership on the second level. Following introduction of new banking regulation in July 1998, private banks are required to have a minimum capital of Lek 700 million and must be incorporated as joint-stock companies.

In order to foster competition in the financial sector and improve the supply of credit to enterprises, since 1994 the Central Bank has granted licences to 11 new banks. It scrapped minimum rates for lek deposits in three stages, abolishing its minimum rate for six-month deposits in May 2000, the 12-month rate in July and finally the three-month rate in September. However, given the situation in the country, banks remain reluctant to extend credit, preferring instead to buy treasury bills. The central bank is also working towards establishing internationally accepted accounting standards for banks and is planning to introduce a real-time gross settlement system for payments within two years.

Recent improvements to the infrastructure of the financial sector include a Law on Secured Transactions which came into effect on 1 January 2000, the establishment by the BoA of a Credit Information Bureau to facilitate selection of creditworthy customers, and a reorganisation of the Institute of Statistics (Instat) to collect and publish economic statistics to

international standards. Banking supervision and regulation has made strong progress, with prudential regulations broadly in line with Basel core principles.

## Bank privatisation and restructuring

The government and the BoA are determined to address the structural weaknesses of the financial sector, specifically through privatisation, which it is hoped will improve low standards and high bad debt ratios in the Savings Bank. With the support of the IMF, the World Bank, the IFC and the EBRD, they have embarked on a policy aimed at:

- restructuring and privatising the Savings Bank by the end of 2001,
- opening up the market to private banks supported by reputable strategic investors, and
- establishing a competitive and well-regulated domestic financial market operating under the close supervision of an independent central bank.

This strategy is well under way. The sale by the government of the second-largest bank in the country, the National Commercial Bank (NCB) to Kentbank of Turkey, the EBRD and the IFC, was signed in June 2000. Kentbank bought a 60 per cent stake in NCB, with the EBRD and IFC each taking 20 per cent. The privatisation was a positive example of excellent cooperation between the government and the IFIs. The IMF played an important role in setting policy priorities and the timeframe for the privatisation. The World Bank provided the resources for restructuring, bringing the bank to the point of sale. The EBRD and the IFC helped in the marketing of the assets and provided investor confidence by themselves investing. (See *Case study* below.)

This leaves only the **Savings Bank**, the largest bank in the country with by far the widest branch network and deposit base, in state hands. It too is being prepared for privatisation and bids will be invited in 2001. Once again, the same model of cooperation with IFIs is expected to be followed. A government recapitalisation to cover the negative capital of this bank will take place before the privatisation. The sale is unlikely to take place until the latter half of the year, in view of the bank's poor profitability. A strong strategic investor will ensure the transfer of skills needed to create an effective institution operating

according to market principles and imposing financial discipline on the enterprise sector, as well as setting high standards of corporate governance and business practice.

The Savings Bank was formed in 1991 and is the country's largest bank, controlling some 80 per cent of deposits in all Albanian commercial banks, amounting to US\$ 1.2 billion. It has a network of 30 branches around the country. It is the pillar of the payment system in Albania and acts as the agent for the state treasury throughout the country. It is primarily a deposit-taking institution and it invests its large deposit base nearly exclusively in Treasury bills.

In October 2000 the process of privatisation of the Savings Bank entered a new stage, when the law on its privatisation was approved and the restructuring plan adopted. Tenders were then completed with World Bank assistance for legal, accounting and operational leaders. The Ministry of Finance has called for a legal and transparent privatisation process conforming to international standards. The US Department of Treasury has placed an adviser at the ministry to follow and ensure this process. Meanwhile, a western co-management team, paid for by the World Bank and EU Phare, has been helping the Savings Bank to prepare for privatisation.

The World Bank has also been helping with banking reform, not least through a US\$ 70 million soft loan. The first US\$ 30 million tranche has been released, and the Bank Asset Resolution Trust, a bad loans agency, has been established. It is also running a Financial Sector Institution Building technical assistance project worth US\$ 6.5 million. The project has a wide scope, and its aims include providing management advisors, privatisation advisors and an audit for the Savings Bank, implementing an inter-bank payments system, developing national accounting standards, auditing the loan collection agency, establishing a credit information bureau and helping to develop the insurance sector with new skills and services. USAID is also helping with restructuring of the banking system, and with capital market development, by assisting with the development of trading, clearance and settlement mechanisms needed to ensure proper regulation of the market.

Private ownership of banks within a competitive and well-regulated environment will improve the access of small businesses to banking services through more effective use of the banks' branch networks. At present, branch networks are very limited (largely for lack of transport and telecommunications infrastructure).

### **Foreign involvement in the banking sector**

The NCB and the Savings Bank dominate Albania's banking sector, accounting for over 80 per cent of total banking assets. However, there are also 11 partly or wholly foreign-owned banks operating in Albania, several of which have started to open branches outside Tirana. Their level of lending activity is low, but is increasing following the extension of various credit lines by IFIs such as the EBRD and donors such as Italy and Greece. Licences are issued by the BoA.

The first joint venture bank was Banca Italo-Albanese (BIA, also known as the Italo-Albanian Bank) established in 1994 between the Banca di Roma and the NCB with a minority participation by the EBRD. BIA is now the largest private bank in the country, with a sound balance sheet and a growing loan portfolio. The NCB's share was transferred to the Ministry of Finance in advance of its privatisation. The only other joint venture is the Arab-Albanian Islamic Bank (originally between the NCB, which has now transferred its shares to the Ministry of Finance, and several Arab investors).

Other foreign banks present in Albania include Tirana Bank (Greece), which has branches in several cities, three other Greek banks – Alpha Credit, the National Bank of Greece, and the InterCommercial Bank; the American Bank of Albania, which is gaining a reputation as an issuer of tender and customs guarantees, has established a housing purchase credit scheme, and is administering an agricultural credit line funded by the World Bank and a credit guarantee product funded by the IFC; Dardania Bank (established by private investors from Kosovo); the Bulgarian First Investment Bank and FEFAD (see below).

The expansion of the banking system through the licensing of new foreign banks is gradually increasing competition and improving the quality of services, as well as helping to develop banking infrastructure and attracting foreign capital.

# National Commercial Bank privatisation

As one of Albania's two state-owned banks, the NCB traditionally was the main provider of credit to, and deposit-taker for, the corporate sector, both state-owned and private. It has a network of 10 branches based in the country's eight main cities (with three branches in Tirana). Along with the Savings Bank and the now liquidated Rural Commercial Bank, the NCB has suffered from inefficiency, with poor accounting standards and limited experience in techniques such as risk assessment and portfolio management. As a result a high proportion of financial transactions in Albania take place outside the banking system, with only about 10 per cent of companies actually using the banks.

The process towards privatisation started with thorough restructuring. In late 1996, 22 of the NCB's poorly performing branches were transferred to the Savings Bank, leaving it with the main 10. From 1997 through 1999 staff numbers were gradually reduced from 1,236 to 477. In July 1998 the Ministry of Finance and the World Bank appointed management consultants International Development Ireland to provide managerial and technical assistance, and to be involved in major policy decisions. The consultants' main activities concerned loan classification and recovery, improving accounting practices, treasury and liquidity management, and handling foreign exchange operations. In August 1998 the NCB was disallowed from engaging in any new lending until the privatisation process was completed. Comprehensive financial restructuring is also taking

place to clear the NCB of its bad loan portfolio (totalling over US\$ 70 million), which was transferred to the bad loans agency, the Bank Asset Resolution Trust, in advance of privatisation.

Once the World Bank had helped the Ministry of Finance to prepare the privatisation strategy, the plan was approved by parliament in December 1998. An international open tender was announced in January 1999, and in February five banks were invited to tender. On 25 April Kent Bank of Turkey was declared the winner.

The EBRD and the IFC had already stated their intention to participate in the privatisation by each buying 20 per cent minus one share of the NCB's capital while Kent Bank has acquired 60 per cent plus two shares. All investors have subscribed pro rata in a capital increase, resulting in NCB's having capital of US\$ 10 million. This was designed to strengthen the bank's capital base, provide funds for its restructuring, help it to expand its activities, improve its funding maturity structure, and in the process give confidence to the strategic investor. The privatisation process was completed in October 2000.

Kent Bank is part of the Suzer Group, Turkey's fourth largest industrial group. Until 1997, its main focus was on corporate customers, but more recently it has increased its retail activities and has established a large network of branches throughout the Istanbul region. Its involvement with the NCB will strengthen Albania's banking sector by

promoting international banking standards and modern banking services, providing a channel of funds to private enterprises. The privatisation of NCB will also set standards of corporate governance, encourage competition which may attract other foreign investors, and help to stimulate further privatisation.

Of the NCB's about 36,000 clients, half are private companies, 30 per cent are state-owned institutions, and the rest private individuals. The NCB's strategy is to focus on the SME and retail banking market and it will aim to be the leading bank for the Albanian market. There is strong potential in the SME market and also in retail, which is very underdeveloped in Albania. The NCB has identified several new products and services for which there is market demand, including cash payment and money changing services within customs areas, and foreign exchange trading – most of which currently takes place on the streets for lack of bank facilities to handle it. Another gap in the market is to provide a trade financing capability for the needs of SMEs. The bank may also extend its activities into Kosovo, if such a presence becomes appropriate. Other post-privatisation activities will include branch rationalisation and investment in IT.

With its successful privatisation, the NCB is now well on the way to becoming a modern bank capable of becoming Albania's leading universal financial institution, and providing for the urgent needs of the SME and retail sectors.

### Non-bank financial institutions

A law on investment funds was enacted in 1995 in preparation for voucher privatisation. These funds may be joint stock companies involved in investment or reinvestment, or may hold or exchange privatisation vouchers. The minimum capital requirement is the equivalent in Lek of US\$ 20,000. Normally the organisation of an investment fund follows the rules found in the company law for joint stock companies, except for some specific rules and regulations specified in the investment law. Investment funds have been created to buy vouchers from citizens and use them to build equity portfolios in privatised enterprises. The funds are not allowed to exceed a 10 per cent ownership stake in any one company or own more than 10 per cent of the total amount of distributed vouchers.

### Stock exchange

A stock exchange was established in May 1996, but trading is negligible, limited to government bonds, treasury bills and privatisation vouchers. A special securities commission exists to regulate trading activity. Auctions of treasury bills of three, six and 12 months' maturities are held twice a month. The market is thin and highly segmented. USAID has assisted in developing the institutional and regulatory capacity of the Securities Commission (which received extensive training) as well as the stock exchange, but its work was delayed by the events of 1997 and has been scaled down.

Encouraged by growing interest in treasury bill auctions from both foreigners and Albanians, the stock exchange hopes the law on investment funds will help channel money into legitimate, well-regulated funds. There are also hopes to bring some of the foreign exchange market (presently conducted largely on the streets) onto the stock exchange, to help establish some order in the foreign exchange market. The bourse has been working on a project with the German stock exchanges and Germany's Credit Agency for Reconstruction (KfW) to formalise the foreign exchange market.

### Insurance

Legislation also exists on insurance and reinsurance activities, establishing a modern insurance system. Although foreign insurance companies may operate through branches in Albania, none of them have entered the market as yet. The state insurance company, the National Institute of Insurance (INSIG), is regulated by the Privatisation Law for large companies and is to be privatised by the end of 2001 following the same model of co-operation with IFIs developed for the NCB. It has branches in 28 districts of Albania. Licences for insurance and reinsurance

companies are granted by the Insurance Supervisory Commission. Two private local insurance companies have been licensed since 1998: SIGMA and SIGAL.

### Selected sources of financing for SMEs

Until the banking sector becomes fully developed, it will remain very difficult for Albanian SMEs to get financing, though about 98 per cent of enterprises consist of 10 employees or fewer, accounting for 40 per cent of employees in the enterprise sector. Most enterprises rely on past savings and remittances from family members abroad in order to establish or expand businesses.

Several initiatives sponsored by international financial organisations and bilateral agencies exist to try to address problems related to SME development. The EBRD in particular gives high priority to support to the SME sector, not only by helping the government to restructure and privatise the banking sector, but also through support to foreign-sponsored banks that aim to expand their operations and pursue an active lending policy. It has also contributed direct support to SMEs. Other IFI action involves efforts to establish effective legislation on secured lending and to improve the operation and enforcement of the mortgage registration system.

Some examples of IFI initiatives to provide sources of financing for SMEs – and at the same time to strengthen the banking sector – follow.

The **Albanian American Enterprise Fund** (AAEF), supported by USAID funding, was created in 1995 and capitalised at US\$ 30 million. By early 2000 it had invested US\$ 25 million in some 30 projects in both loans and equity. The American Bank of Albania, created by AAEF with an equity investment of almost US\$ 5 million, began operations in late 1999. The AAEF invests in projects aimed at expanding production in any sector of the economy, typically in a range of US\$ 300,000 to US\$ 1.5 million. See the AAEF's web site at [www.aef.com](http://www.aef.com) for more details.

In July 1999 the EBRD made a € 1.2 million equity investment in the **Foundation for Enterprise Finance and Development** (FEFAD) Bank, a commercial bank which specialises in the micro and small enterprise sector. Other shareholders who helped with the recapitalisation include the IFC and International Micro Investitionen (IMI, an investment group based in Frankfurt). FEFAD was established by Germany's Kreditanstalt für Wiederaufbau in January 1996 as a financial services agency, and was converted into a commercial bank in

March 1999, which will allow it to broaden its range of financial services. It is based in Tirana, with branches in Durres and Fier, and has returned a profit at the end of each year of operation. Its loans range from US\$ 100 to US\$ 200,000, providing a rare source of financing for small private sector firms. Following the new injection of capital from the EBRD, IMI and the IFC, FEFAD Bank's capital is now equivalent to US\$ 5.1 million. By the end of 2000, FEFAD had made 4,488 loans for US\$ 33,090,828 (€ 35,566,021.93).

**The Albania Reconstruction Equity Fund (AREF)** is a special equity fund, co-financed with Italy, aiming to provide risk capital primarily to SMEs already operating in Albania who are planning to rebuild or expand their facilities. The fund became operational in December 1998, and will acquire equity stakes of up to 25 per cent. It aims to reach about 20 to 25 companies. The EBRD is contributing US\$ 7 million to the Fund, which is the first non-banking financial institution in Albania to provide local enterprises and foreign investors with equity financing. Other contributors are Italy (US\$ 7 million) and the Banca Popolare di Bari, which will co-invest pro rata in each of the Fund's portfolio SMEs up to a total of US\$ 500,000. General management and operation is being handled by a consortium led by Economisti Associati s.r.l. of Italy, the US Small Enterprise Assistance Fund and Banca Popolare di Bari. The Fund also benefits from a US\$ 3 million technical cooperation fund, provided by the Italian government. This is being used to finance its operating expenses and other costs, including the Fund's management fees.

In July 1997 the EBRD allocated US\$ 6 million to the Banca Italo Albanese under a framework facility named **the Albanian SME Recovery Credit Line**. The facility was set up to finance in particular the recovery plans of foreign-sponsored companies operating after the 1997 crisis. It has been designed to operate in conjunction with a World Bank project aimed at providing political risk guarantees to foreign investors.

Other initiatives include credit lines supported by the EIB, the Greek government and BESA, a micro-lending agency established by the World Bank and other foreign donors. PHARE has initiated a programme of Regional Business Agencies (RBAs), which provide training and consultancy services for local entrepreneurs. These are supported by other donors such as USAID and Germany's GTZ. In late 1999 donors including UNDP conducted a survey of institutional obstacles to SME growth as a contribution to policy dialogue.

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**The South-East Europe Enterprise Development (SEED)** is an IFC initiative designed to support the development of SMEs in south-eastern Europe (Albania, Bosnia and Herzegovina, FYR Macedonia and Kosovo). By December 2000 funding commitments totalled US\$ 20 million, with a further US\$ 13 million to be secured over the five-year life of the programme. The IFC is providing funding and also the management team to implement the SEED. Main aims include outreach to regional investment funds for potential pipeline development, investment preparation and post-financing services, creation of business centres to support Internet-based learning among SMEs and their support institutions, development of advocacy groups for SMEs, local training and technical assistance towards developing a local consultancy capacity for SMEs, development of enterprise zones, and leverage of undisbursed international funds towards SME development. In Albania, the IFC is investing in a Loan Guarantee Facility. The SEED has negotiated a local agent contract where it will oversee the issuing and regular supervision of the Guarantee. The SEED plans to sign a contract with the IFC to cover all local costs and some regional office costs. The Loan Guarantee Facility will allow it to operate closely with the companies in the loan portfolio and form direct client relationships for further developmental assistance.

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# EBRD activities in Albania



*As at 31 December 2000, the European Bank for Reconstruction and Development (EBRD) had approved 12 investments in Albania, totalling € 102.6 million for projects with a total value of € 310 million. The portfolio consists of eight investments in the private sector and three in the public sector.*

The EBRD's strategy focuses on supporting private sector investment, and in particular greenfield projects, on promoting the development of the financial sector through the establishment of new private financial institutions, and on developing key infrastructure projects in the telecommunications, energy, transport and industrial sectors.

The EBRD is closely collaborating with other multilateral institutions and bilateral donors in the framework of the Stability Pact for South Eastern Europe. It has an important role to play as a direct investor and as a catalyst for additional investment by others into the Balkan countries. In this context the EBRD has already approved two investments in Albania as quick start projects for the reconstruction of the power sector and the rehabilitation of the east-west road corridor, totalling € 40 million. Other important infrastructure projects are being considered for financing under the Stability Pact as medium-term projects.

## Strengthening the financial sector

The Albanian financial sector is still at an early stage of development. The sector has already been strengthened by the arrival of several foreign banks. The EBRD participated in the creation of the first private bank in Albania, Banca Italo-Albanese, which started operating in 1993. The EBRD will continue to strengthen the financial sector by encouraging strategic investors to invest in Albania. In particular, the EBRD:

- is participating in the capital of the Albania Reconstruction Equity Fund;
- has extended a credit line to a private bank to support the development of small and medium-sized enterprises (SMEs);
- has made an equity investment in FEFAD Bank;
- in cooperation with the government and a strategic investor, has participated in the privatisation of the National Commercial Bank;
- has extended a trade facilitation programme to two local banks; and
- is considering the assistance it may provide, along with other international financial institutions, for the restructuring and eventual privatisation of the Savings Bank.

## Promotion of private sector projects

The EBRD intends to continue playing a leading role in promoting, screening and financing private investment projects, focusing in particular on the manufacturing and tourism sectors.

The EBRD is also assessing several private sector investment proposals in a variety of sectors, such as agro-industry, energy and construction materials.

Large-scale privatisations remain among the main operational priorities. The EBRD continues to pursue negotiations with potential strategic partners. The Bank intends to actively support post-privatisation investments.

## Critical infrastructure development

The EBRD will continue to concentrate on key infrastructure required to support private sector development. Targeted sectors are transport, telecommunications and energy. The EBRD is encouraging the promotion of infrastructure projects by private project sponsors whenever possible. In the transport sector, in November 1999 the EBRD approved the financing of a 30-kilometre section of the east-west road corridor project, which involves the upgrading of a 220-kilometre road connecting the port of Durrës to the FYR Macedonian and Greek border further east.

In the telecommunications sector the EBRD is focusing on supporting the pre-privatisation process of the state operated Albanian Telecom and will also consider taking part in its upcoming privatisation. The EBRD has financed a technical cooperation project for the preparation of the Telecommunications Regulatory Framework. During 1999 the EBRD approved the restructuring of two projects signed in 1994-95 with the Albanian Power Corporation for the upgrading of hydropower plants and power transmission and distribution. The new project, involving a wider scope, combines the previous two projects in a financing package of € 30 million from the Bank.

## Approved projects as at 31 December 2000

### Private sector

#### Coca-Cola Tirana s.r.l.

In July 1994 the EBRD made an equity investment of US\$ 2.9 million in a joint venture establishing the Coca-Cola Bottling Enterprise Tirana sh.p.k. (CCBET) as Albania's first local producer of soft drinks. The joint-venture partners are Aziende Commerciali Industriali Estero of Italy, the Coca-Cola Export Corporation, a subsidiary of the Coca-Cola Company (US), and Invest p.f., an Albanian state-owned organisation. The bottling plant is contributing to local employment, having created about 500 private sector jobs over three years, both directly at the bottling facility and indirectly through jobs generated at CCBET's suppliers, distributors and retailers. The EBRD's investment has co-financed the construction of the bottling facility, which is located just outside Tirana, and which is engaged in the production, packaging, distribution, marketing and sale of Coca-Cola and other soft drinks for the entire Albanian market.

#### Hotel Rogner Europapark

In January 1994 the EBRD granted a loan of US\$ 12 million for the construction of a three-star hotel in central Tirana by Rogner, a private Austrian construction group. The Bank has also taken 28 per cent equity holding in the company. Fully equipped with offices and conference facilities, the hotel meets the requirements of visiting missions, delegations and businessmen. Rogner is also involved in the management of the hotel, and is the main shareholder in Golden Eagle, a company created to build and operate the hotel.

#### Tirana International Hotel

In March 1995 the fully renovated Tirana Hotel opened its doors on Skanderbeg Square in the heart of the Albanian capital. The renovation was the result of an agreement signed in October 1993, under which the EBRD granted a loan of € 10 million and made an equity investment of € 0.83 million in the hotel. Other shareholders are Albturist (the state tourism enterprise), Di Vincenzo Estero (the international division of Di Vincenzo Dino, an Italian construction company), Simest (Italy), INSIG (the Albanian insurance institute) and the Savings Bank of Albania.

#### Banca Italo-Albanese

In December 1994 the EBRD made a US\$ 2.5 million equity investment in Banca Italo-Albanese (BIA), representing 20 per cent of the bank's capital. Albania's first private bank, BIA was originally a joint venture between the National Commercial Bank of Albania (now privatised, and whose shares have been

transferred to the Ministry of Finance) and the Italian Banca di Roma. Since it started operating in July 1993, it has provided reliable commercial banking services and has focused on foreign trade and lending to SMEs.

#### SME Recovery Credit Line

The EBRD has established a credit line facility with BIA for a total amount of US\$ 6 million. This facility consists of a five-year bank-to-bank loan with two components. The first is a US\$ 3 million SME sub-loan which will enable the bank to lend in hard currency to SMEs to increase working capital and investment financing, thus supporting the recovery of the private sector in Albania. The credit facility is complemented by the Albanian Guarantee Agency (AGA), which will provide guarantees to private sector entities to cover political risk in Albania. The second component is a US\$ 3 million housing sub-loan to be extended to private individuals for the purpose of buying or renovating their principal residence.

#### Albania Reconstruction Equity Fund

The EBRD is contributing US\$ 7 million in equity financing to the Albania Reconstruction Equity Fund established to assist business development in the local private sector in Albania. The Fund, totalling US\$ 14 million, will provide equity financing to support SMEs, helping to restore confidence in the economy. The Italian government is also participating in the Fund with US\$ 7 million.

#### FEFAD Bank

In July 1999 the EBRD became a shareholder in FEFAD Bank, which took over from the previous FEFAD Foundation, specialising in micro credit lending. The EBRD's investment amounts to € 1.2 million. Other shareholders are: Germany's Kreditanstalt für Wiederaufbau; the International Finance Corporation; and IMI, a German investment fund. FEFAD Bank is supporting the emergence of the private sector in Albania by ensuring that micro and small entrepreneurs have permanent access to formal sector financing. It is playing a very important role within the Albanian financial sector since no other financial institutions currently supply credit to micro and small businesses.

#### National Commercial Bank

In June 2000 the EBRD, the IFC and Kentbank of Turkey made a € 9.76 million equity investment in the National Commercial Bank (NCB) for privatisation. The EBRD's equity investment is € 2.3 million, representing 20 per cent minus one share of NCB's share capital. This was the first privatisation in the banking sector in Albania and the first major privatisation in

the country since the collapse of the communist regime in the early 1990s. The privatisation of NCB is aimed at transforming the bank into a modern institution capable of becoming a leading universal financial institution in Albania, with particular emphasis on retail banking and SME lending.

### **Trade Facilitation Programme**

In February 2000 the American Bank of Albania (ABA) joined the EBRD's Trade Facilitation Programme (TFP), a guarantee facility set up to help local banks increase their access to international banks' trade credit lines for the benefit of local businesses. BIA also joined the TFP in January 2001. Under this facility the EBRD has committed to guarantee letters of credit issued by the ABA and the BIA up to an overall limit of € 1 million and € 2 million respectively.

### **Critical infrastructure projects**

#### **Albanian Telecom**

In December 1992 the EBRD made a loan of US\$ 10 million to Albanian Telecom to help finance the modernisation and expansion of the telecommunications system in Albania. The network expansion was designed to almost double the number of automatic subscribers in Albania, increasing the telephone density from 1.45 lines per 100 inhabitants to 2.25.

The total cost of the project was € 44.77 million, with contributions in the form of concessionary equipment and monetary support from Norwegian Telecom and the Norwegian, Swiss and Italian governments. The project was supported with technical assistance, funded by the EBRD and EC Phare.

#### **Power sector reconstruction**

In November 1999 the EBRD approved a € 30 million loan to Korporata Elektro-energetike Shqiptare (KESH), Albania's electricity utility. The loan will replace two existing loans with KESH for the Drin River cascade rehabilitation project (€ 15.7 million) and the transmission and distribution project (€ 10 million). These could not be implemented as envisaged because of the impact of the pyramid scheme crisis and the Kosovo war on the Albanian power sector. Under the new project, future disbursements are linked to the successful implementation of a co-management contract with a qualified power utility. The main step taken towards accomplishment of this condition was the signing of just such a co-management contract with Italy's ENEL in August 2000. The project will enable KESH to increase the availability and reliability of power supply, with lower downstream costs stimulating industrial activity. It will also help to improve energy efficiency by reducing

technical and non-technical losses and lead to the introduction of private management for the sector. In the longer term the management contract should pave the way for full privatisation. The project will be co-financed by the Japanese Bank International Corporation, the Austrian government, the Swiss government and KESH.

#### **Emergency road rehabilitation**

A loan of € 10 million to the Ministry of Transport will finance emergency improvements to the Elbasan-Librazhd section of approximately 30.5 kilometres of the national East-West road corridor between the port of Durres and the border of FYR Macedonia. The project will contribute to the modernisation of this road corridor and provide additional capacity to meet growing regional demand on this key route for transit traffic. It will significantly improve communications in south-eastern Europe. Grant money will be provided by the Albanian government, the Central European Initiative and EU-Phare. Italian Co-operation has also applied to contribute grant funds.

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## Approved projects, as at 31 December 2000 (in € million), exchange rate as at 31 December 2000

Operation name	Sector	Total cost	EBRD debt	EBRD equity	EBRD total
<b>Private</b>					
Albania Reconstruction Equity Fund	Financial	20.24	0	8.13	8.13
SME Recovery Credit Line					
Banca Italo-Albanese	Finance	7.11	7.11	0	7.11
National Commercial Bank	Finance	2.30	0	2.30	2.30
Tirana Hotel	Tourism	18.37	10.04	0.83	10.87
Coca-Cola Tirana S.R.L.	Agribusiness	18.53	0	2.52	2.52
Hotel Rogner	Tourism	23.71	13.82	2.04	15.86
Banca Italo Albanese	Financial	14.82	0	1.96	1.96
FEFAD Bank	Financial	1.20	0	1.20	1.20
Trade Facilitation Programme					
American Bank of Albania	Financial	1.00	1.00	0	1.00
<b>Subtotal</b>		<b>107.28</b>	<b>31.97</b>	<b>18.98</b>	<b>50.95</b>
<b>Public</b>					
Road Rehabilitation Project	Transport	95.7	10.0	0	10.0
Albanian Telecom	Telecommunications	48.63	11.67	0	11.67
Power Sector Reconstruction	Power and Energy	58.0	30.0	0	30.0
<b>Subtotal</b>		<b>202.33</b>	<b>51.67</b>	<b>0</b>	<b>51.67</b>
<b>Approved projects total</b>		<b>309.61</b>	<b>83.64</b>	<b>18.98</b>	<b>102.62</b>
of which private					50%
of which public					50%