

DRAFT PROGRAMME

SUPPORT PROGRAMME FOR ALBANIA IN 2001

1. IDENTIFICATION

Beneficiary state:	Albania
Programme:	Council Regulation (EC) No.2666/2000
Year:	2001
Cost:	€ 35.5 Million
Expiry date:	31.12.2003 contracting 31.12.2004 disbursements
Group:	AA
Sector:	M
Budget line:	B7-541
Implementing Body:	European Commission

2. SUMMARY

The purpose of the assistance is to support the participation of Albania in the Stabilisation and Association Process (SAP).

The main specific objectives of this assistance are: contributing to enhance Albania's capacity in terms of security and public order, strengthening rule of law, good governance and respect for human rights, creating conditions conducive to regional co-operation, strengthening public finances, increasing customs and tax revenues, strengthening of standards and certification, strengthening of aid co-ordination, improving local community development and enhancing the quality of university education.

This proposal consists of the following sectors and priorities.

<u>SECTOR I: Justice and Home Affairs</u>	€16.0 m
Priorities:	
Police & Public Order (<i>Annex 1</i>)	€10.0 m
Integrated Border Management (<i>Annex 2</i>)	€ 1.5 m
Judicial System; Prisons (<i>Annex 3</i>)	€ 3.5 m
Asylum & Migration Management (<i>Annex 4</i>)	€ 1.0 m
<u>SECTOR II: Institution building</u>	€ 7.0 m
Priorities:	
Customs (<i>Annex 5</i>)	€ 2.0 m
Public Finance	
▪ Public Internal Financial Control (<i>Annex 6</i>)	€ 2.3 m
Standards & certification (<i>Annex 7</i>)	€ 2.0 m
Aid Co-ordination (<i>Annex 8</i>)	€ 0.5 m
Small Scale Operations (<i>Annex9</i>)	€ 0.2 m
<u>SECTOR III: Economic Development</u>	€10.0 m
Priorities:	
Local Community Development (<i>Annex 10</i>)	
<u>SECTOR IV: Education</u>	€ 2.5 m
Priorities:	
Tempus (<i>Annex 11</i>)	

Maximum available:	€35,5 Million
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The Albanian authorities provide in the national budget for operational costs related to the implementation of all EC funded programmes included in the 2001 Action Programme, without prejudice to any agreed co-financing arrangements.

3. GENERAL BACKGROUND

3.1. Past EC Funding

Since 1991, Albania has benefited from a total Community assistance of € 1 020 million of which € 85 million are loans from European Investment Bank. From 1991 to 1993, a total of € 318 millions were provided as emergency and food aid (€ 198 million through PHARE and € 120 million through FEOGA). From 1994 to 1996, PHARE provided € 190 million in grants to support the Albanian economic reform. After the crisis in 1997, EC support concentrated on fewer priorities and focused on the re-establishment of the rule of law (police, customs, justice, and public administration) and to support the development of basic infrastructures (transport, water supply, Local Community Development). In 1999, the PHARE programme provided specific budgetary support to

alleviate the cost for hosting refugees from Kosovo, and 97 million were allocated for Humanitarian aid through ECHO.

Overview:

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Total 1991-00	2001*	Total 1991-01*
Albania												
Overall PHARE assistance												
10.0	110.0	75.0	49.2	88.0	53.00	68.9	42.5	101.5	33.4	631.5	37.5	669.0
FEOGA (DG Agriculture)												
	120.0									120.0		120.0
Humanitarian Aid (ECHO)												
	2.0	0.5	1.7	1.2	1.7	16.3	12.0	97.0	3.4	135.8		135.8
Food security (DG Development)												
						10.8		5.7		16.5		16.5
Macro-Financial Assistance (DG Economic and Financial Affairs)												
								20.0		20.0		20.0
Democracy & Human Rights												
				1.0	0.6	0.4	0.8	0.2	0.5	3.5		3.5
Other actions												
	0.3	0.6	1.1	0.4	n.a	n.a	n.a	2.6	1.9	6.9		6.9
OSCE elections support												
						1.5				1.5		1.5
EIB loans												
				29.0			22.0		34.0	85.0	40.0	125.0
Total EC assistance												
10.0	232.3	76.1	52.0	119.6	55.3	97.9	77.3	227.0	73.2	1,020.7	77.5	1,098.2

n.a. = not available

* forecast

June 2001

3.2 Socio-political issues¹

In the early years of its transition since 1991, Albania showed an impressive record. However, initial steps on the road of reform were strongly affected by a severe socio-economic crisis in 1997, which led to the collapse of the institutional order and meant a serious setback to the reform process. The difficult regional situation, particularly the Kosovo crisis in 1999 which provoked a huge flow of refugees into Albania (almost 500,000), together with a conflictive internal political life and rather weak state institutions have prevented Albania to achieve a greater degree of reform and development during the last decade.

¹ This section and the following section provide a general background to Albania. The background relating to the proposed specific interventions is included in the Annexes.

Since 1997, Albania has made major efforts to restore law and order, reform economic and social life and to open Albania to the region and the EU. There has been an overhaul of the legal system and serious efforts are being made to align legislation with EU standards. In political terms much has been done to reform the electoral system to ensure that the elections can be run in accordance with OSCE standards and Parliament and political life function normally.

Political stability was maintained during the run-up to the general elections in summer 2001. The political unrest on neighbouring Macedonia has not so far had a major impact on Albania but escalation might jeopardise stability and dampen, among others, the expected growth in foreign investment.

In its foreign policy, Albania has played a positive and constructive role on regional issues, notably as regards Kosovo, Southern-Serbia, FYROM and Montenegro. It actively participates in a wide variety of regional co-operation activities.

Yet, a number of serious problems remain. The main difficulties lie in the functioning of the judiciary, the police, widespread corruption, a large grey economy and lack of capacity to implement laws. In particular, law enforcement agencies need to be better informed of their obligation to respect human rights, and judges and prosecutors need to be better trained in the application of human rights legislation. In addition, the judiciary's ability to perform satisfactorily is hampered by a lack of resources, a lack of training, a widespread corruption and frequent political pressure.

The specific situation of Albania on a traditional smuggling route, a rough and uneasily controllable terrain and strong connection through immigration make the country highly vulnerable to criminal threats. Even if authorities are really committed to change, their efforts need heavy support to accelerate the implementation of the legal reforms and reorganisation of the police.

Civil society in Albania suffers from insufficient financial resources, lack of advocacy skills, and an overly competitive –often divisive- attitude towards one another. There is little interface between civil society and the government, despite some, limited initiatives by the latter to enhance dialogue.

The right to property is legally guaranteed but remains ill defined due, inter-alia, to incomplete land registration. This leads to frequent disputes and constitutes a serious impediment to the creation of a functioning property market -including a land market- which, in turn, discourages investment and holds back the development of agriculture.

Emigration is an important phenomenon in Albania, which has a significant economic effect in two ways – the brain drain is depriving Albania of people who

could contribute to its development but emigrants' remittances substantially contribute to the Albanian economy. Illegal migration proceeding from Albanian is a major source of concern for the EU authorities.

Migration flows from rural areas to the main Albanian cities have substantially increased, especially since the 1997 crisis. Slum-like conditions have been created, lacking urban infrastructure and services (adequate water and power supply, proper sewage, schools). This sudden urbanisation has been accompanied with significant problems of social exclusion. The most vulnerable group seems to be that of children dropped out from school, which risk to enter organised crime circles.

Enrolment rates in education, especially at the secondary level have fallen since 1990. This decline reflects deterioration in the quality of education, the diminishing relevance of traditional forms of vocational and technical training, as well as the increased opportunity costs of attending school.

The reforms and achievements carried out during the last years have not yet had a widespread effect on the Albanian society. Albania remains one of the poorest countries in Europe. One fifth of the population is living on less than € 1.2/day. Poverty in the north and rural areas is widespread, with 90% of the population living below the poverty line and unemployment levels are high, both in urban and rural areas. Social benefits have, in real terms, constantly decreased over the last 10 years, partly due to the Albanian attempt to keep its budget under control. Furthermore, quality of education has substantially deteriorated over the past years.

The Growth and Poverty Reduction Strategy (GPRS), launched by the Government of Albania in November 2000, focuses on sustainable growth that benefits all Albanians. The GPRS covers a three-year period and includes (i) an assessment of the situation, (ii) growth and poverty reduction goals, (iii) plans for obtaining the goals: policy changes, institutional reforms, programmes and projects and (iv) targets and indicators to monitor progress. The GPRS will contribute to Albania's aspiration to move towards a Stabilisation and Association Agreement with the European Union. The Strategy is being elaborated through a broad-based participatory process involving the Government, Parliament, civil society, local communities, donors and other.

Albania will need to accelerate reforms, notably to achieve further economic progress, fight poverty and social exclusion and to gradually increase social protection. To do so, Albania will also need to pay attention to basic, necessary conditions for socio-economic development, inter alia, to strengthen public order, fight against crime, fraud and corruption and ensure the implementation and enforcement of the rule of law.

3.3 Socio-economic issues²

In 2000 the Albanian GDP grew by 7.8% with respect to the previous year, above the initial forecast of the authorities (7%), but in line with growth rates reported for 1999 (+8%) and 1998 (+7.3%). Construction and services sectors, more particularly transport, mainly contributed to this increase. Despite the drought that affected Albania as most of the Western Balkans, agricultural output, which still accounts for more than 50% of GDP, increased by some 5% in 2000.

As for economic policy, positive developments were registered in the fiscal area in the year 2000. Owing to a sharp increase in tax revenues (26% increase in 2000 with respect to 1999, essentially due to improvements in the efficiency of tax and customs administrations), the fiscal deficit is reported to have decreased from 11.5% of GDP in 1999 to 9.2% in 2000. As a consequence, foreign financing of the deficit, which has predominantly taken the form of grants or concessional borrowing, decreased from 6% to 4.3% of GDP. Furthermore, the large amounts of privatisation receipts (1.7% of GDP for the year as a whole) allowed for a sharp reduction in domestic borrowing (3.2% of GDP). On the expenditure side, the implementation of the 2000 budget was satisfactory, although progress is still needed to improve co-operation between ministries. A significant improvement in the reform of public expenditure management has been the adoption of the Medium Term Expenditure Framework (MTEF) covering the period 2001-2003.

Monetary policy continued in line with the requirements of the IMF programme. A relatively restrictive monetary policy, coupled by significant increases in productivity, contributed to keep inflation under control. Due to the pick-up in oil prices and the energy crisis which emerged in the last quarter of the year, inflation in 2000 rose to 4% on an end-of-year basis (compared to -1.0% in 1999). After having slightly decreased in the first months of 2001, the inflation increased again, partly because of the crisis in neighbouring Macedonia which is a net exporter of agricultural products to Albania, to reach 4,1% in August. The central bank has abandoned its direct control over credits, which, together with the recovery of the economic activity, has contributed to a significant increase in credits granted by banks to the private sector. Low inflation and a comfortable level of foreign exchange reserves equivalent to some 5 months of imports contributed to the stability of the exchange rate of the Lek. In the course of 2000, the Lek depreciated slightly against the dollar, while remaining substantially stable vis-à-vis the Euro. This trend has been confirmed in the first half of the year 2001.

Reform of tax collection, which contributed to an increase in tax revenues recalled above, has progressed significantly. Concerning customs revenues, main measures taken included changes in key personnel in the major customs houses, better control of goods in transit and regular revision of reference

² This section provides a general background to Albania. The background relating to the proposed specific interventions is included in the Annexes.

prices. As far as domestic taxes are concerned, improved enforcement led to a significant increase in the number of registered VAT and small business taxpayers. A better co-ordination between tax and customs administration also contributed to a reduction in tax evasion.

A further strengthening of the external position was registered in 2000, reflected in higher official exchange reserves. Increased imports, owing to vigorous demand and electricity imports, as well as reduced exports, mainly due to disruptions in the mining sector, led to a worsening of trade balance, which reached some USD 800 million, equivalent to about 21.5% of GDP (18% in 1999). As it has been customary since the beginning of the transition, strong inflows of remittances from Albanians living abroad – estimated at about USD 440 million in 2000 - partly compensated for the trade deficit, leaving the current account deficit roughly unchanged (USD 260 million or 7% of GDP). The significant increase in foreign direct investment (USD 140 million in 2000, compared to USD 50 million in 1999), which was largely due to revenues from the privatisation in the telecommunications sector, contributed to the sharp increase in foreign exchange reserves (4.4 months of imports by end-March 2001).

Albanian budgetary expenditure as a percentage of GDP is currently around half of its 1990 level. This decline has resulted from economic and structural reforms, i.e. a more limited role of the government (appropriate to a market economy), a considerable reduction of personnel in many public services and attempts to reduce the budget deficit. Good progress has been recently made in the reform of public expenditure management with the adoption of the Medium Term Expenditure Framework (MTEF). The MTEF will be revised on a regular (yearly) basis. It identifies the following key areas of expenditure: health, education, social protection, transport and public works (other than transport).

It is to be noted that the Albanian state budget continues to depend to a very large extent on foreign financing, which is even expected to increase in the coming years according to the MTEF (from 14% of the overall budgetary resources in 2000 to 18% in 2003).

An important issue to be addressed by the Albanian authorities is the resolution of the dilemma of increasing salaries within the Public Administration (and therefore increasing public expenditure in this area), and prosecuting simultaneously a sound economic policy, in line with IMF requirements. Currently, the low salaries of the public administration are at the origin of high rotation, low quality of personnel and difficulties for the recruitment of highly qualified staff. This issue needs to be gradually overcome.

Albania has made considerable progress during recent years to introduce a liberal and open trade system. In September 2000, it became a member of the WTO and is therefore committed to trade liberalisation. Albanian exports are normally free of restrictions. Tariff duties on imports are being progressively reduced. The highest rate of customs duty is now 15% (having been reduced to 20% in 1999, to 18% in 2000). Albania has also abolished quantitative restrictions or measures having an equivalent effect.

Albania has an important trade deficit, particularly with the EU, which represents 94% of its exports and 77% of its imports (2000 figures). Main trade partners for Albania are Italy and Greece. As customary since the beginning of the transition, remittances from Albanians living abroad partly compensate this trade deficit.

Albania has established bilateral Agreements on Economic Co-operation and Trade with Bulgaria, Croatia, FYROM, Greece, Italy, Romania, Slovenia and Turkey. It has also concluded agreements for the reciprocal promotion and protection of investments with these countries. With FYROM negotiations are underway on a Free Trade Agreement (FTA) and discussions are entering the final stage. Today, Albanian export capacity remain extremely limited, mainly due to scarce industrial and agricultural production, insufficient product quality and poor distribution networks.

FDI investment in Albania remains limited mainly due to a relatively insecure investment environment, poor infrastructure, heavy administrative procedures, and corruption in the public administration and judiciary and relatively high taxes. However, for the year 2000, FDI in Albania is estimated at € 153 million, twice the 1999 figure, notably due to successful privatisation operations. Albanian FDI forecasts for 2001 are set at € 150 million, counting also on a strong contribution from the privatisation process.

According to the Albanian Law on Foreign Investments, all foreigners (either physical or juridical persons) have the right to engage in different economic activities in Albania without needing permission or authorisation. They have the right to transfer all funds in currency and any item related to their investment out of Albania. The law also grants foreign investors legal protection on disputes between them and Albanian parties. However, this legislation is also affected with the current limitations in Albania for proper implementation and enforcement of legislation.

In order for Albania to encourage domestic investment and to successfully attract foreign investment, public order must be ensured, the efficiency of the public administration and judiciary substantially enhanced, and corruption, fraud and grey economy substantially reduced.

Recent reforms in the economic field have been positive. Trade liberalisation, price liberalisation, privatisation of SMEs, improvement of fiscal sustainability through better customs and tax services, are areas where clear progress has been made. However, more needs to be done in order to ensure economic stability, and to achieve further economic progress.

4. PROGRAMMING CONTEXT

4.1 The current situation

Since 1991, the successive Albanian governments have placed European integration high in their respective political agendas and, in 1992, a Co-

operation and Trade Agreement between the EU and Albania entered into force on 1 December 1992. However, the conflictive elections of May 1996, together with the deep socio-economic crisis of 1997 (the so-called “pyramidal schemes crisis”) delayed a possible further development of the relations between Albania and the Community. Already in the framework of the SAP, the Commission presented in 1999 a Feasibility Report ³, which concluded that, despite progress made since the 1997 crisis, Albania was not yet in a position to take on far reaching contractual obligations with the EU.

Two years later, however, on the basis on progress achieved by Albania, the Commission concluded, in its report on the work of the EU/Albania High Level Steering Group of June 2001⁴, that taking into account political, economic, regional and SAA-related technical factors, it is appropriate to proceed with a Stabilisation and Association Agreement with Albania. The Gothenburg European Council of June 2001 welcomed the Commission’s report and invited the latter to present draft negotiating directives to the Council for the negotiation of a SAA with Albania, if possible before the end of 2001.

4.2 The programme rationale

The purpose of the assistance is to support the participation of Albania in the Stabilisation and Association Process (SAP).

4.3 The programming criteria

The main criteria are:

- To assist in the reform of sectors which will allow the country to comply with the obligations of a future Stabilisation and Association Agreement
- To ensure that the programme is in line with the Government’s own priorities
- To intervene in sectors where the EU has a comparative advantage
- To ensure there is no overlapping with activities undertaken by other donors

4.4 The choice of sectors

The sectors have been selected by reference to the priorities established in the SAP and an assessment of the challenges facing the country and the areas in which the European Community enjoys a comparative advantage as a donor. The sectors and priorities have been discussed with the Government. Full account has been taken of the activities of other donors.

5. IMPLEMENTATION

³ COM 599 final (1999)

⁴ COM 300 final (2001)

This programme will be implemented under the responsibility of the European Commission.

The selection of contractors will be carried out in conformity with the Practical Guide to EC External Aid.

A Financing Agreement corresponding to this Financing Proposal will be concluded with the counterpart authorities.

The contracts for services, works and supplies shall be concluded in accordance with the contract award procedures laid down in the "Manual of instructions for contracts concluded for the purpose of Community co-operation with third countries" (adopted by the Commission on 10 November 1999). With regard to tendering and contract award procedures, the provisions of Financial Regulation, Council Regulation 2666/2000 and the Manual of Instructions mentioned above are to be adhered to in all cases.

6. INDICATIVE DISBURSEMENT SCHEDULE (M€CUMULATED)

Sector	Jan 02	Mar 02	Jun 02	Jul 02	Sep 02	Oct 02	Dec 02	Jan 03	Mar 03	Apr 03	Jun 03	Jul 03	Sep 03	Jan 04	Mar 04	Jul 04	Sep 04	Dec 04
JUSTICE AND HOME AFFAIRS																		
- Police & Public Order: investment institution building					1,0 3,0				2,0				3,0		4,0 6,0			
- IBM					0,5				1,0				1,5					
- Judicial System – Prisons:invest institution building					0,2				1,3				1,6					2,9
..... other					0,1				0,1									0,3
Supervision Fushe Kruja					0,05				0,1				0,1					0,1
- Asylum & Migration: investment institution building					0,3 0,1				0,6 0,2				0,3		0,4			
INSTITUTION BUILDING																		
- Customs		0,6				1,2		1,8		2,0								
- Public Internal Financial Control					1,3				1,5				1,8		2,1		2,3	
- Standards and Certification					1,2				1,4				1,6		1,8		2,0	
- Aid Co-ordination					0,3				0,45				0,5					
- Small Scale Operations					0,2													
ECONOMIC DEVELOPMENT																		
- Local Community Development	0,1			0,8				2,3				4,3		6,8		8,5		10
TEMPUS			1,6						2,1						2,5			

7. MONITORING, EVALUATION AND AUDIT

This programme will be monitored and supervised by the European Commission who shall:

- a) Monitor the implementation of the programme on the basis of regular reports;
- b) Carry out regular monitoring and evaluations to follow the progress of the programme and its components as well as ex-post evaluations after the completion of the programme.

- c) The accounts and operations of the programme components will be checked at intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the European Commission, including the European Antifraud Office (OLAF) and the European Union's Court of Auditors.

The rules on monitoring, evaluation and audit apply to all programmes as described in the Annexes 1-11, in accordance with the CARDS Regulation.

8. RISKS AND ASSUMPTIONS

Risks

The Programme will be implemented in a complex and fragile environment, and its successful completion will be dependent upon a number of conditions. The principal risks which may affect the implementation of the Programme:

- The possibility that a new political or military crisis might erupt in the region, which might threaten the stability of the State of Albania, or might inhibit the inter-regional or cross-border co-operation.
- The possibility that the international community might become frustrated by the lack of progress in the reform process and consequently withdraw or reduce their financial support to Albania
- The Recipients of the assistance lack the institutional, budgetary and human resource capacity to support the implementation of the Programme.

Assumptions

This programme is predicated on the assumption that the Albanian Government will continue its efforts in:

- Ensuring public order and efficiently combating organised crime, fraud and corruption
- Enhancing the implementation and enforcement of the rule of law, notably through and improved public administration and judiciary
- Further improving socio-economic situation
- Ensuring progressive approximation towards the Community acquis, in order to be in the position of the proper implementation of a SAA and to continue its gradual integration in Community structures.

- Enhancing democratic stabilisation, notably through support to the improvement of the electoral system and the strengthening of civil-society.
- Committing itself towards the reform process.

Overall conditionality

- In addition to the specific conditionality specified in the annexes, the assistance covered by this Support Programme for Albania in 2001 is subject to respect for the rule of law, human and minority rights and fundamental freedoms and the conditions defined by the Council in its conclusions of 29 April 1997.
- Moreover, in accordance with Framework Agreement signed between the European Commission and the Government of Albania on 1st September 1992, the Government must ensure that any assistance provided under this programme will be exempted from VAT, custom duties and equivalent taxes or charges.
- The Government of Albania will give the necessary financial and human resources to ensure a proper implementation of the programmes described in the present Support Programme for Albania in 2001.
- In the event that the general and/or specific conditions mentioned in the present Support Programme for Albania in 2001 are not fulfilled, the Commission may suspend or cancel all or part of the programmes.
- Coherent linkage with the programmes of other donors will be continuously co-ordinated and monitored.