

World Bank Group

ALBANIA: POLICY BRIEFS

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Albania: Macroeconomic policies

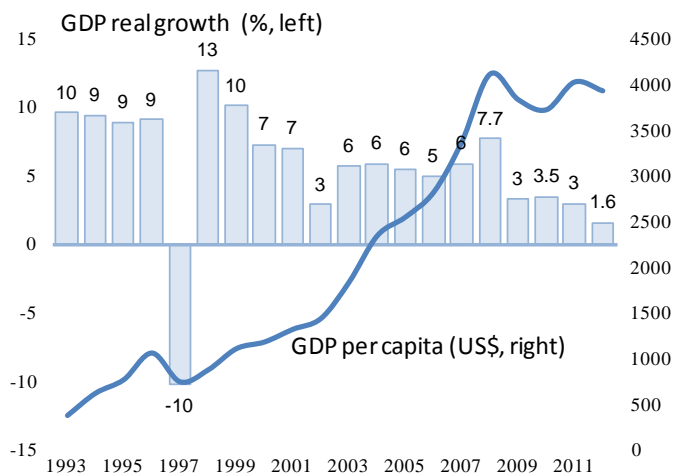
July 2013

Policy Brief

Background

Albania's sustained high economic growth in the decade prior to the 2008 global financial crisis helped it achieve a middle income status and reduce poverty. During 1998-2008, annual growth averaged 6 percent in real terms with a fivefold increase in per capita GDP to above US\$4,000. Although this period of strong growth was not matched by the same level of employment creation, it was successful in terms of poverty reduction. Absolute poverty dropped from 25.4 percent in 2002 to 24 percent in 2005 and further down to 12.4 percent by 2008.

Figure 1: Real growth and GDP per capita (US\$, right)



Domestic demand was the main driver of growth during this period of transition. The growth of sectors such as construction, industry and services took over the low-productivity agricultural sector, pushing employment out of agriculture to higher productivity sectors. These sectors grew by between 10 and 20 percent in real terms in the decade before 2008, driven by strong domestic demand, and workers' remittances and other various inflows. Industry growth initially relied

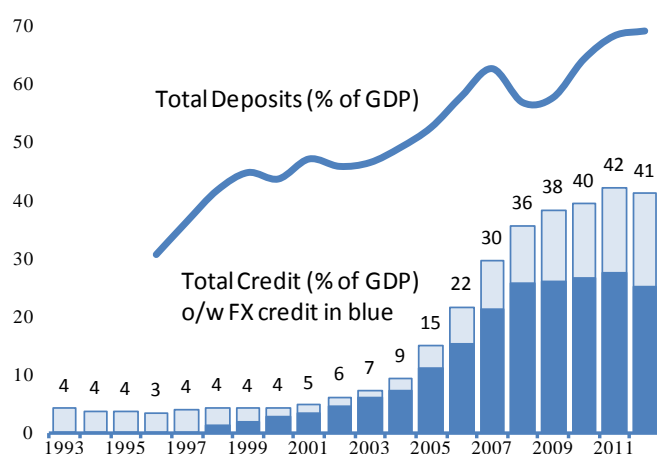
on textile and shoe manufacturing, and later on construction materials (mostly cement production) and a revival of mining and oil sector exports. Agriculture lost ground as people transitioned to industry and services sectors and a as lack of investment and land fragmentation took their toll.

The global financial crisis of 2008 brought to an end Albania's growth model based on domestic demand. Although it has been able to avoid recession, Albania was hit hard by the crisis. The crisis led to lower remittances and other flows, which in turn contributed to lower growth particularly in the construction sector which has since experienced a sharp decline. GDP grew by an average of below 3 percent between 2009-2012, mainly on the back of basic services and the extracting industry which sought markets outside the EU. The Eurozone crisis further compounded the challenge of recovery. With its close links to the Greek and Italian economies via exports, remittances, and financial flows, Albania has borne the brunt of the Eurozone sovereign debt crisis. Domestic demand has remained weak, and with the Eurozone crisis lingering, growth in Albania is projected to remain modest, averaging just 2 percent between 2013 and 2016.

The financial sector has remained largely stable since the crisis but a continued deterioration of banks' loan quality has restrained credit growth. During 2001-2011, Albania saw a rapid growth of credit to the private sector, with credit rising from 4.7 percent of GDP in 2001 to 39 percent of GDP in 2011. While credit growth slowed following the global crisis, the limited reliance on credit lines from abroad prevented a sharp drop in credit activity in Albania. However, the crises have led to a sharp rise in non-performing loans (NPLs), from 6.7 percent in 2008 to 22.7 percent at end-September 2012, one of the highest levels in the region. The banking system is relatively well-provisioned, as the ratio of provisions to total loans has increased four-fold since 2007. However, this increase in provisions has impacted banks' financial performance, resulting in

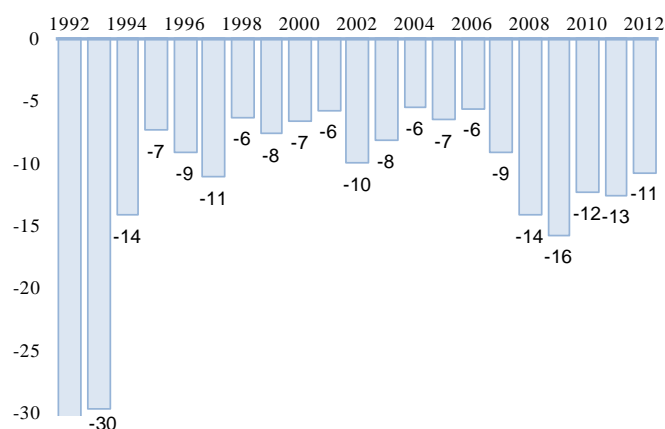
declining returns. As of September 2012, the overall banking sector capitalization was 15.9 percent and deposits exceeded pre-crisis levels (having recovered steadily from a sharp drop in 2008). Difficulties faced by banks in the execution of their collateral have kept NPLs high, bringing credit growth to a virtual standstill.

Figure 2: Credit and Deposits



Albania's current account deficit (CAD) has remained high. The CAD hit a maximum of 15 percent of GDP in 2008 as a result of large public investments which led to a spike in imports of machinery and equipment, financed through foreign loans. Since then the CAD has declined to 10 percent 2012 in line with the moderation of large public investments and lower remittances, which led to lower imports.

Figure 3: Current account balance (% of GDP)

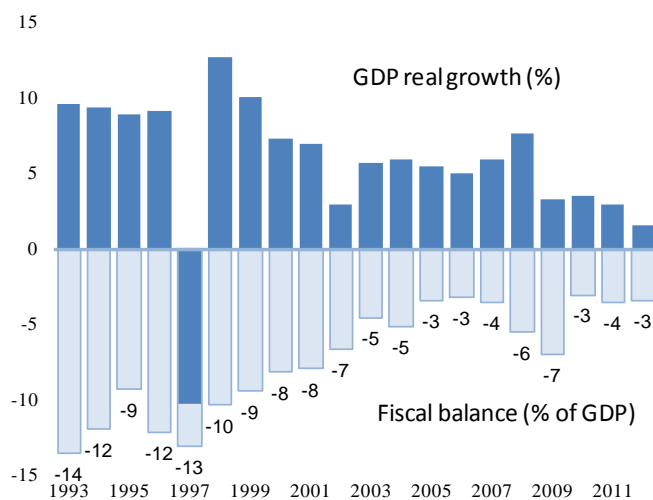


Albania's net exports have not improved much since the early transition, with growing exports offset by rising imports. A large share of the trade balance is driven by imports of raw materials and machinery for domestic production. However, Albania is also a net importer of traditional consumer goods like food and textiles despite having a potential to be a net exporter in these areas. About half of the trade deficit has been covered by remittances. FDI, with the exception of privatization receipts, has been modest, financing only a fraction of the CAD.

Fiscal Consolidation

Fiscal policy has remained pro-cyclical, and public debt has increased since the crisis. With the exception of the 1996-7 turbulence, the fiscal deficit was on a declining trend until 2007. As a result of strong growth in GDP and improvements in revenue administration public debt too declined from 62 to 53 percent of GDP between 2003 and 2007. The trend, however, reversed in 2008 due to the crisis, as well as elevated public investments (mainly on roads) and increases in public salaries and pensions. The resultant rise in fiscal deficits, combined with a 10 percent depreciation of the Lek, brought public debt levels close to 60 percent of GDP, the legal limit set in 2008.

Expenditure restraints have been insufficient to stabilize or reduce public debt. In 2010 and 2011, with fiscal revenues considerably below the plan, the Government cut expenditures heavily at mid-year (more than 1 percent of GDP) to keep public debt under the 60 percent limit. However, energy shortage in 2012 and the need for government support to the power generation company (in the form of guarantees) led to the removal of the debt ceiling. In December 2012, the parliament approved the removal of the 60 percent ceiling from the organic budget law, without proposing any other fiscal or debt anchor. Albania's 2013 budget targets a general government fiscal deficit of 3.4 percent and foresees a further increase in public debt.

Figure 4: Real growth and fiscal deficit

In addition, government has since the crisis accumulated sizable payment arrears for public works and VAT reimbursements. The ambitious agenda of public investments put forward in 2007 was based on the anticipation of much higher fiscal revenues than what turned out to be the case, in particular following the global financial crisis in 2008. Despite declining revenues and reduced budgets for public investment, many public works continued at the same pace as initially planned. Contractors continued to carry out public works often through commercial banks lending. While the unpaid claims could not be identified in the treasury due to lack of a multiannual commitment system, arrears began to show up with some delay. In some cases, the public payment arrears adversely affected private sector liquidity and contributed to increasing level of NPLs. In 2013, the authorities have used the bulk of the privatization proceeds to clear part of arrears in public works. More important than reducing the stock of accumulated arrears, however, is the prevention of future arrears by implementing a sound commitment control mechanism in the treasury. While the MOF has made some progress in instituting a commitment control system, further work remains to have a fully functional and effective system in place.

Lowering public debt over the medium-term remains critical to macroeconomic stability and growth. Albania's public debt is among the highest in

Eastern Europe. A high and growing public debt poses a risk in both in terms of rollover risks and elevated interest costs. Interest expenditures, at around 3.5 percent of GDP, are already much higher than in other SEE countries, crowding out more productive spending and representing a major source of vulnerability for the budget. Increased public borrowing would also damage growth prospects by crowding out the private sector. At the moment the borrowing space in the domestic market for the government is less than 1 percent of GDP, which means that a higher deficit financed domestically will crowd out private sector borrowing, further constraining the fragile growth and recovery.

A sustained reduction in the public debt will require structural reforms. The growth rate-interest rate differential under the current macroeconomic outlook implies an adverse - and potentially explosive-debt dynamics. With Albania's medium-term growth rate of around 2.0 percent and an average real interest rate on its current public debt of 2.3 percent, the public debt to GDP ratio is set to grow rapidly unless underpinned by fiscal consolidation. In addition to a sustained reduction in the fiscal deficit, reducing public debt requires structural reforms over the medium term, including reforms in pensions, energy, public administration, and tax policy and administration to create opportunities for fiscal saving as well as increase the efficiency and effectiveness of public spending.

Recommendations / Way forward

Supporting and strengthening the fragile recovery and growth in Albania requires a shift from domestic demand driven growth to export-oriented growth. With fiscal space exhausted and the role of monetary policy circumscribed, little can be done at present to revive domestic demand through macroeconomic policies. Indeed, on the fiscal front, the risks of the elevated level of public debt—both through rollover risks, high interest expenditures and crowding out of the private sector borrowing-- for macroeconomic stability and growth are so high that the priority must now shift to a fiscal consolidation to reduce public debt over the medium term.

The fiscal consolidation will need to be accompanied by a fiscal rule to put in place a new fiscal anchor as well as strengthen the financial discipline. For growth, the way forward must be to tap external demand which for a small economy like Albania remains an important source of growth. For this Albania needs to accelerate structural reforms in at least three areas: (i) improving the quality of governance and rule of law; (ii) strengthening the quality of human capital (education and skills); and (iii) overcoming infrastructure bottlenecks, in particular in the power sector.



Albania: Financial Sector: Risks and Priorities

August 2013

Policy Brief

Summary

With the ongoing Eurozone problems, Albanian economy experienced slower economic growth in 2012 which has negative implications on its financial sector growth. The lowest credit growth during last decade has been recorded in 2012. Sluggish GDP growth significantly influenced construction sector with continued contraction in 2012 and resulted reduction of real estate prices. The unfavorable macroeconomic environment will likely continue throughout 2013 given unceasing problems in neighboring European countries.

In line with weak credit growth, non-performing loans continued to grow sharply, reaching 23.7 percent at end-2012, and rising slightly more in early 2013. The resolution of NPLs remains one of the most important issues to which the authorities should (further) concentrate their efforts. Though several key changes to the civil procedure code were passed in Parliament in April 2013, the practical implementation of those changes remains to be realized as the changes are only effective in September. Moreover, early bailiff reforms need to be enhanced and different interpretations of tax code continue as one of the main obstacles for NPL resolution as well.

In a bid to stimulate lending growth in the country, the Bank of Albania has adopted a package of liquidity and capital incentives, with new mechanisms of loan restructuring. Though these measures could facilitate credit growth in select banks, it is unlikely that they would trigger enhanced credit growth system-wide, as the real problem seems to be tepid demand for new borrowing on the back of slow economic growth.

To enhance the analytical framework for accessing the financial system stability, the Bank of Albania has designed and began to calculate the Financial Systemic Stress Index. “Bottom Up” stress testing methodologies for commercial banks have been finalized. Based on results further work would be accomplished aimed at convergence of banks’ “Bottom up” with the central bank’s “Top down” stress-test methodologies.

Given both economic and until recently, political uncertainties in the country, the growth of the banking

system and the financial sector as a whole will remain an issue throughout 2013. Weak external environment, forecasted low GDP growth and rising NPLs collectively create significant uncertainties in the country both for banks and economic agents, and hence restrict both demand and supply sides of credit growth.

Following the request of Albanian authorities in early 2013, a full scope Financial Sector Assessment Program (FSAP) will be jointly undertaken by World Bank and IMF in 4Q2013. The last FSAP was conducted in 2005 hence the thorough analysis of the financial sector developments after 2008 crisis would prove both timely and valuable for country authorities.

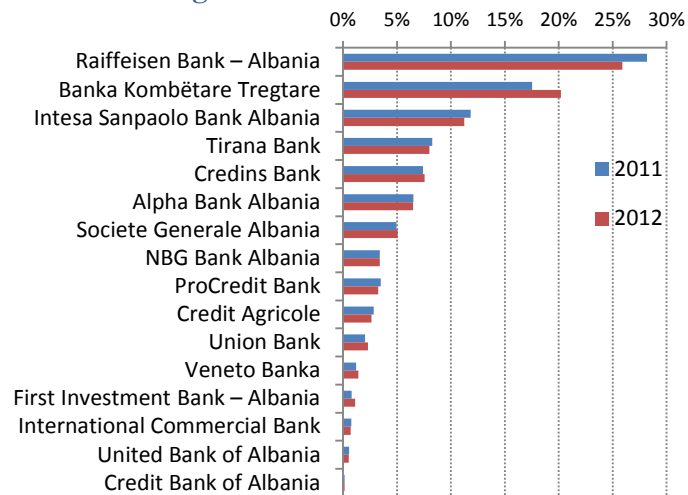
Financial sector risks and development challenges

No major structural changes has been noted in the year 2012 in the Albanian financial system as banks still dominate with 94 percent market share of financial assets. Although as a result of continuous deleveraging some minor improvements in the bank concentration has been recorded, the biggest bank (Raiffeisen) still holds 25.9 percent of the market share, down from 28.2 percent in 2011 (Figure 1). Out of 16 operating banks, the largest 5 banks together hold 73 percent of the market share in assets, whereas the majority of banks are small with each one having less than 5 percent of the banking system assets. The transformation of three branches of Greek banks into subsidiaries in 2012 is complete. Greek, Italian and French owned parent banks cumulatively have held about 64 percent of the market at the end of 2012. Liquid assets to total assets ratio is overall stable across different types of banks with Greek banks being at the lowest level (Figure 2).

Driven largely from deleveraging pressures, European parent banks sought the repayment of liabilities and restructuring of the assets with their respective subsidiaries during 2012. The most negative influence of deleveraging in 2012 has been recorded in the government securities market, wherein Raiffeisen withdrew from the Albanian Government debt auctions. The high level of liquidity in banking system and the strong support by the BoA helped to overcome the problem and keep the market interest rates volatility to the lowest possible level. The establishment of investment fund had positive effect as well,

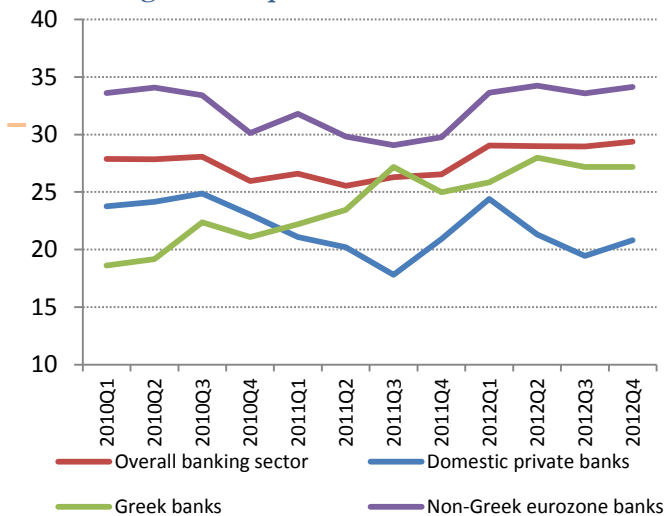
as Raiffeisen shifted ALL 12.4 billion (approx. \$117.5 million) government securities from its portfolio in favor of individual investors at the fund by end-2012.

Figure 1. Asset Share of Banks



Source: Bank of Albania

Figure 2. Liquid Assets to Total Assets



Source: Bank of Albania

Overcoming some challenging developments, the banking system has mainly remained stable with higher capital adequacy and liquidity coverage than in 2011 (Table 1). The slight growth of both capital and liquidity buffers is owing to banks' more conservative lending behavior, which mirrors the subdued economic growth in Albania. The low GDP growth has been coincided with the lowest recorded credit growth of 1.8 percent, down from 15.5 percent in 2011 (Table 2). Though deposit growth diminished as well, it is still much higher than credit growth, at 7.3 percent in 2012 (13.3 percent in 2011). Loan to deposit ratio continued to shrink during 2012 to 58.3 percent.

Although the provisions to total loans continue to grow, it had minor influence of banks' profitability, where early signs of recovery have been recorded. Banks' profitability has stayed flat or declined, in particular towards the Greek banks, which continue to reflect sharply negative trends

Table 1. Key Prudential Indicators of the Banking System

	2007	2008	2009	2010	2011	2012	Mar. 2013
Capital Adequacy							
Total regulatory capital to risk-weighted assets	17.1	17.2	16.2	15.4	15.6	16.2	16.8
Tier I regulatory capital to risk-weighted assets	16.0	16.3	15.3	14.5	14.3	14.6	15.2
Asset Quality							
NPLs/loans	3.4	6.7	10.6	14.1	18.8	22.5	23.7
Provisions/ NPLs	47.9	42.8	50.3	51.6	51.8	55.5	55.5
Provisions/ loans	1.6	2.8	5.3	7.3	9.7	12.5	13.2
Liquidity							
Liquid assets to total assets	49.8	42.8	26.9	25.0	26.5	29.4	29.1
Liquid assets to short term liabilities	55.7	48.3	31.4	30.6	33.1	36.7	36.1
Loan-to-deposit ratio	46.4	61.5	64.8	60.1	61.3	58.3	58.2
Earnings and Profitability							
ROA	1.5	0.9	0.4	0.7	0.1	0.3	0.5
ROE	19.6	11.4	4.6	7.6	0.8	3.8	5.2

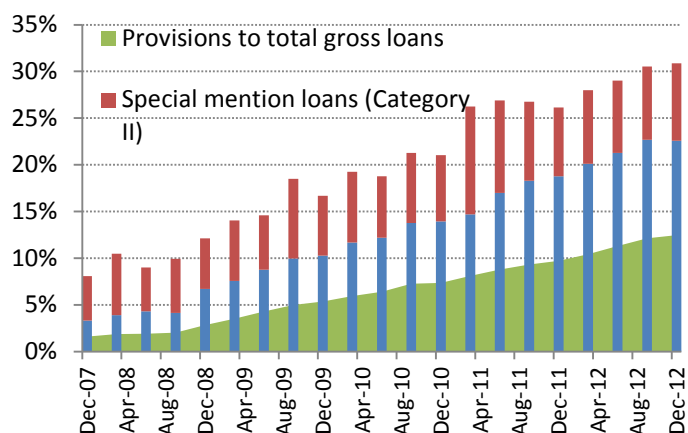
Source: Bank of Albania

Table 2. Basic Indicators of the Banking System

	2008	2009	2010	2011	2012
Assets/GDP	76.7	77.5	80.0	85.4	91.0
Assets Growth (yoy change)	12.4	6.3	11.8	13.1	6.1
Deposits/GDP	59.3	60.7	66.0	70.7	76.0
Deposit Growth (yoy change)	2.4	7.6	17.6	13.3	7.3
Credit/GDP	36.5	39.3	39.7	42.8	44.3
Credit Growth (yoy change)	35.7	13.4	9.1	15.5	1.8

Source: Bank of Albania

Capital adequacy of the system reached 16.8 percent as of March 2013, which should be sufficient to absorb further negative risks in the system, though the growing NPL ratio and resulting provisioning could have negative effect on the capital buffers in the future. The quality of loan portfolio worsened even further since 2011 with NPLs reaching 23.7 percent in the March 2013, the highest for the region. These developments may represent a real threat for some specific banks and financial system as a whole, given that another 8.3 percent of loans belong to Category II (special mention, or "watch") and brings the total portfolio at risk to near 31 percent of total lending portfolio (Figure 3). Parallel with the survey conducted by the BoA, there are high expectations among individual borrowers that their repayment capacity will deteriorate in 2013.

Figure 3. NPLs and Provisions to gross loans

Source: Bank of Albania

The resolution of NPLs remains the most important issue to be addressed by Albanian authorities. Bank of Albania initiated a wide range of reforms in NPL resolution covering legislative, procedural and taxation issues. Recent amendments to the Civil Procedure Code endorsed by the Parliament and the Albanian government aim to shorten and simplify collateral enforcement procedures and abolish the court's right to intervene in the enforcement of foreclosing on real property. Another issue which restricts banks' ability to resolve problem debt and/or effectively execute on the collateral to gain title is the unfavorable taxation framework in the country. By BoA estimations, because of the unfavorable taxation regime, banks are continuing to keep a significant portion of unrecoverable problem loans in their balance sheets, which if solved, could lower banks' NPL ratio at least 5 to 6 percentage points¹. VAT reimbursements and public arrears remain a key issue as well to address, though apparently some portion of the arrears have recently been paid and decreased the pressure on the stock of NPLs.

In line with prudential requirements on capital coverage the Bank of Albania continued the improvement of general regulatory framework in 2012. In accordance with updated Basel Committee Principles on Corporate Governance and based on EBA guideline on Internal Governance, the BoA has adopted new regulation on core management principles for banks and foreign branches as well as criteria for bank administration approval. The concept of bridge bank was introduced as well. To enhance

¹ Tax legislation does not favor distressed debt restructuring or resolution. Thus 1) debt reductions ("haircuts") resulted from out-of-court restructurings and corporate reorganizations are considered as income and taxed as such, 2) creditors are not able to deduct haircuts as bad debts because there are no proof of unsuccessful collection efforts through judicial means, 3) sale of bad debts to a third party is considered as VAT taxable, 4) in case of reorganization through a company merger or acquisition, tax losses cannot be carried forward if shareholder change were by more than 25 percent.

the development of non-bank financial sector new regulations have been adopted early 2013 on licensing and risk management of non-bank financial institutions, micro credit organization and e-money institutions. Some prudential requirements for e-money institutions on capital institutions, safeguarding of funds and liquid assets have been imposed as well. To further facilitate competition in the banking system and to enhance new instruments of consumer protection for bank customers; a new (on-line) "shopping tool" to compare banks' prices of similar products was created by BoA.

Macro-prudential measures adopted

The high level financial stability committee became functional in Albania in 2012. Following the signing of the Memorandum of Understanding between the Ministry of Finance, the Bank of Albania, the Financial Supervisory Authority and the Deposit Insurance Agency in February 2012, the first meeting of the Financial Stability Advisory Group (FSAG) has been held, where in the FSAG secretariat has been approved and the functions of the group have been discussed. The meetings of the group are held on quarterly basis where the main developments of the financial markets and risks persistent to the system are discussed. The group is chaired by the Ministry of Finance whereas the secretariat is led by the BoA Financial Stability Department.²

BoA continued to enhance the analytical tools for the assessment of country's financial stability. To assess the inter-linkages between different market segments and to evaluate the composite impact of the stress on the economic growth the BoA designed and calculated the Financial Systemic Stress Index for Albania. The index captures the comprehensive stress in the banking sector, money market, foreign exchange rate and housing market developments. Based on the Financial Stability Board (FSB) guidelines on Recovery and Resolution Plans, in mid-2012 the BoA requested the five largest banks prepare RRP and finalized the "Bottom up" stress testing methodology for the banking system. The

To strengthen the financial stability and crisis management framework in the country, the BoA has introduced several new tools. The list of collateral for Emergency Liquidity Assistance has been widened to accept high rated FX denominated securities in case the liquidity in FX should be provided to the banking system. Government bonds with remaining 12 month maturity have been included in the list of eligible collateral, in line with T-bills. Although the present ELA provisions is sufficient to handle possible market turbulences, in case of severe shocks the BoA has the authority by law to accept other types of collateral, upon the consent of the supervisory board of the BoA.

² http://www.bankofalbania.org/web/PRESS_RELEASE_6563_2.php?kc=0,26,0,0,0

Recommendations / Way forward

The main issue in Albanian banking system remains to be the rising trend of NPLs and substantial problems for collateral execution. Although some solutions have been provided for shortcomings in the NPL resolution framework through the early phase of the Vienna based FinSAC engagement, including recent changes in Civil Procedures Code and special guidelines for loan restructuring, more should be done to expedite credit write offs and collateral execution alike. Among other improvements authorities are encouraged to consider a number of reform measures as follows:

- Specific obstacles in taxation framework need to be addressed as a first priority. Although legislative changes are required, some procedural changes in taxation guidelines could help to get to the bottom of different interpretations and treatments by tax officers and give possibility for banks to resolve their worst stale-dated unrecoverable NPLs in a short period of time without facing unfavorable taxation consequences.
- A more effective framework of out-of-court debt and corporate restructuring procedures could eliminate the obstacles and disincentives for informal restructuring arrangements.
- The real estate appraisers are another important infrastructure that should be properly structured and enhanced for effective NPL resolution.
- In spite of recent introduction of private bailiffs, modest improvements have been recorded so far in practice; the authorities can readily better align incentives to enforce the implementation of recent legislative changes.

Improvement of the BoA and FSA supervisory framework is essential to better understand and mitigate emerging risks. Off-site and on-site analysis tools should be introduced to better understand and address banks' internal structures and processes related to NPL management. Following the establishment of an investment fund by Raiffeisen bank, a more coordinated and efficient framework to supervise financial groups should be shaped. Hence to build effective consolidated supervision framework in Albania, closer cooperation and information sharing between the BoA and the FSA should be initiated. As about 67 percent of the banking system assets are held by European banking groups, much closer cooperation with home supervisors should be envisaged, especially with France and Germany, with whom the BoA does not have any agreements for the cooperation and supervisory information sharing yet.

Notable work has been accomplished to strengthen financial stability framework, but the financial stability

function is not yet legally defined as a policy target for the BoA. Although in practice the BoA effectively conducts its policies in terms of balancing the monetary and financial stability functions, it would be advisable in the future to give the BoA dual mandate on both monetary and financial stability on the legal grounds.

Practical implications of different structures of the Financial Stability framework should be enriched. The Memorandum of Understanding on financial stability is signed between BoA, Ministry of Finance, Deposit Insurance Agency and Financial Supervisory Authority. Although several meetings of the Financial Stability Advisory Group have been chaired by the Minister of Finance, the practical implications of utilizing the distribution of responsibilities and real interactions during the crisis between these institutions are not clear. Thus to strengthen the broader framework of financial stability it is advisable:

- To organize by early 2014 a broader crisis simulation exercises with the participation of all these stakeholders including possibly key banks, to identify and address the potential shortcomings of the present crisis management framework.
- To initiate discussions on back-up funding with the Ministry of Finance for possible bank capitalization needs. The introduction of bridge bank concept was good step forward to strengthen BoA's financial stability mandate by enacting a new tool for effective bank resolution. But as a funding source for the bridge bank capital, it is not clear in the annual state budget deliberately. The same issue of uncertainty of back up funding from the government exists for the underfunded Deposit Insurance Agency, though the negotiations of country authorities with the European Bank of Reconstruction and Development to arrange possible credit line as back-up financing for DIA are near concluded.

It is advisable that comprehensive regulatory framework on consumer protection and market conduct should be initiated in Albania as well. Although the BoA has introduced many new transparency and consumer protection requirement in the banking regulations, the development and implementation of a comprehensive framework for the transparent handling of consumer complaints and out of court dispute resolution mechanisms would be advisable. Financial literacy is another wing of CPFL framework where central banks are becoming heavily involved together with other stakeholders in the field. Hence, in line with consumer protection agenda, the BoA could envisage the possibility of embarking in the sphere of financial education as well.



Albania: Improving Poverty Monitoring and Social Assistance

September 2013

Policy Brief

Poverty trends and poverty monitoring in Albania

Over the first decade of this millennium, Albania has witnessed a significant reduction in poverty. The poverty incidence halved from 25.4 to 12.4 percent of the population between 2002 and 2008. The onset of the crisis is likely to have stalled the pace of this progress, however. Slower growth and the fall in remittances are likely to have contributed to moderate increases in poverty. Since 2008, there has not yet been an updated estimate of poverty, although the Statistical Office is currently processing the latest round of household survey results (LSMS 2012), with official poverty results expected to be available in September 2013. As discussed in the box below, a more regular and sustainable monitoring system of Albanian population's living conditions could play an important role in tracking the implementation of future reforms.

Box: A sustainable and effective system of monitoring living conditions

Since 2002, Albania has invested significantly in data and improved statistical capacity, with the help of donor support. The Living Standard Measurement Survey (LSMS) data provide a state-of-the-art tool to monitor multiple aspects of households' living conditions, including households' expenditure and poverty status, outcomes in health and education, access to different programs including social assistance, among others. These data have been collected at regular three-year intervals (with a four-year gap prior to the last round only), and the results took a regular pulse on households' welfare. Despite the success of the LSMS experience, a number of factors suggest that it might be time to reassess the way poverty and living standards are monitored in Albania. Such factors range from the sustainability of the LSMS model, as these surveys rely on external funding, to the need for Albania to start adopting European standards as part of the accession process. In addition, the global crisis has emphasized the importance of producing and making available higher frequency micro-economic data to enable more evidence-based policy design

and to enhance the monitoring of reform implementation, such as the ongoing reform of social assistance.

These challenges are shared by other candidate and potential candidate countries in the region. In 2009, an expert group convened by the World Bank in collaboration with Eurostat and other development partners issued a set of recommendations on the topic of poverty monitoring, which included strengthening the regular Household Budget Surveys (HBS) that these countries (including Albania) conduct yearly, and adopting a modular structure that would enable surveys to cover additional indicators of living conditions (especially those that allow the monitoring of social inclusion) without making the surveys too cumbersome to conduct. These recommendations were adopted in Bosnia-Herzegovina for the 2011 Household Budget Survey, and an assessment of their success will be available shortly. The advantage of adopting a similar system in Albania is the ability to conduct annual monitoring of poverty and inclusion indicators without depending on donors' funding. Such a system would also allow the collection of detailed indicators on topics, such as social assistance reform, where monitoring of the reform implementation is an important priority. Finally, the introduction of a regular poverty monitoring system is usually accompanied by a valuable discussion on the procedures for sharing the household survey data (e.g. HBS, Labour Force Surveys) collected by the Albanian National Statistical Agency INSTAT with experts and field researchers while respecting the guidance provided by Eurostat. Data access to third parties is an area where Albania could learn from the experience of different EU Member States so as to protect respondents' privacy in conformity with EU rules, while fostering a climate of greater transparency and accountability on statistical data production and benefiting from the analysis of independent researchers and a better informed policy debate. The World Bank stands ready to help in supporting activities to strengthen capacity in this area.

Despite recent progress, Albania continues to have higher poverty rates than many other countries in Eastern Europe and Central Asia (ECA), highlighting the importance of effective safety nets and of job creation. Using internationally comparable measures of poverty and extreme poverty incidence, Albania ranks in the poorest third of the 27 countries in the region. Therefore, improving the opportunities of people at the bottom of the distribution and providing them with effective safety nets remain important priorities. Albania has initiated important policy reforms to strengthen the effectiveness of safety nets. Less progress appears to have been made on the job creation agenda, although the lack of access to the micro-economic data from the Labour Force Survey has hindered the World Bank's ability to conduct an independent in-depth analysis of this issue. Existing studies suggest that spurring job creation in Albania would require addressing barriers to employment creation by firms, removing constraints to employability (particularly those related to skills, including strengthening the education system to promote effective learning), and lowering the barriers to the employment of specific groups (such as women, older workers, and minorities). The World Bank is currently engaged in Albania on issues of poverty measurement, statistical technical assistance, and the job agenda through different programmatic activities. These could be strengthened and further tailored to provide stronger evidence for the Government to design and monitor the implementation of the jobs agenda. However, access to data remains a strong precondition for this work to be deepened.

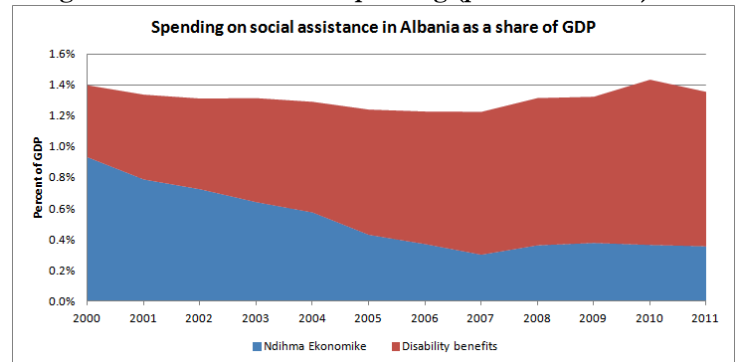
Challenges and Reforms in Social Assistance

Currently, Albania has a reasonable platform to provide social protection to its citizens through social insurance, social assistance, and employment programs. However, the lack of clarity in roles and inadequate incentive compatibility between “social insurance” (contributory) schemes and “social assistance” (noncontributory) benefits, as well as inadequate linkages across these pillars (e.g., between social assistance and employment programs) reduce the effectiveness of social policy. At the same time, low participation in the social insurance system along with changing demographics are likely to alter the relative importance of social insurance vis-à-vis social assistance schemes in the future, making greater effectiveness of social assistance programs even more vital. Pension issues are discussed in a separate brief.

While Albania's overall spending on social assistance is comparable with other countries in the region, expenditure composition has gradually shifted away from programs targeted to the poor. Albania's consolidated social assistance system spends 1.6% of GDP, which is on par with the average country in the ECA region.

Two main cash transfer programs account for the majority of this spending: disability assistance and the *Ndihma Ekonomike* (NE) program, with the latter being the main poverty-targeted social assistance benefit. However, the relative balance in spending on these two programs has shifted significantly over time in favor of disability benefits (Figure 1).

Figure 1: Social Assistance Spending (percent of GDP)



Source: WB estimates based on MOLSA Data.

The sectoral assessments showed that both social assistance programs face important challenges in key areas such as: targeting, eligibility, and coverage; benefits administration and management of information; and oversight and controls. Disability assistance benefits do not necessarily favor the most severely disabled, either by design or in terms of outcomes. Analysis of survey data indicates that 11 percent of total disability benefits are received by those who report no functional disability at all, and another 18 percent of benefits go to those with only mild disabilities. In addition, disability benefits increased faster than inflation for much of the past decade. The coverage of the poor by *Ndihma Ekonomike* (NE) program is low and falling as its budget has been squeezed by the expanding outlays on disability benefits. This means that many poor Albanians fall through the cracks of the safety net system and end up not receiving any social assistance. Low coverage of the poor under NE also reflects the distortions from the definition and implementation of eligibility criteria, excluding about 60% of those in the poorest 10% of the population. Another challenge of the two programs relates to inefficiencies in benefits administration, due to limited capacity, complex application processes, and inadequate systems for managing information. Albania currently lacks an automated national registry of social assistance applicants and beneficiaries, and benefit management is largely paper-based. Finally, oversight and controls for reducing fraud and errors suffer from weak inspection capabilities and the lack of cross-communicable databases.

Building on international experience and a technical partnership with the World Bank, Albania has already taken important steps to improve the effectiveness of social assistance programs. An ambitious reform program is in place to strengthen the design, administration, and governance of these transfers. The objectives of this reform program focus on improving the equity and efficiency of the NE program and disability assistance benefits, with the purpose of reducing extreme poverty, through

- (i) introduction of a unified scoring formula for NE eligibility that incorporates objective weights and variables that are empirically associated with poverty status to reduce errors of exclusion and to improve transparency, and revision of eligibility criteria for disability benefits to ensure they reach the truly disabled and vulnerable;
- (ii) establishment of a Management Information System (MIS) for both programs to automate and modernize benefits administration; and
- (iii) strengthening of the system for preventing, detecting, and remedying fraud and errors, which would also improve efficiency for both programs

The World Bank is supporting Albania in the implementation of the social assistance reforms through the Social Assistance Modernization project (SAMP), which supports the actual results expected from implementation of improvements in the main social assistance programs (NE and disability assistance benefits). The project uses an innovative design model where funds are disbursed upon achieving agreed, verifiable results (so-called Disbursement linked indicators or DLIs). SAMP also finances select capacity building investments to facilitate implementation of envisioned improvements, and ultimately, achievement of the intended results. In addition to IBRD financing, the Government has committed to finance the development of the IT system from the budget while the EU is expected to provide substantial additional financing to the project Technical Assistance component under IPA13 (Agreement between EU and the Government is expected to be signed by end November, 2013). The implementation progress for the project in the pre-election environment has been slow. The project has not yet disbursed against agreed results, but could begin disbursing as soon as social administrators are trained in new eligibility requirements for NE and/or the NE MIS is developed.

The World Bank is also providing technical support through programmatic analytical work on issues of poverty, activation, and jobs. The regional analytical study on Smart Safety Nets and Activation provides technical support to Western Balkan countries in strengthening their safety nets, promoting employability / productive economic engagement of able-bodied but economically inactive adults, and reducing welfare dependency. The Albania country case

study is expected to be completed in early 2014, and will examine the profiles of the unemployed and inactive, and assess the institutional capacity for activation. The World Bank's programmatic engagement on Jobs in Western Balkans will include an assessment of the availability of jobs and potential skill mismatches, which is expected to shed light on the specificities of these countries' labor markets and to provide a foundation for future advice on job creation strategies. Finally, the programmatic engagement on poverty aims to strengthen statistical and analytical capacity for poverty and more generally micro-economic analysis, ensure that policy reform is informed by appropriate consideration of the poverty and distributional impacts of the different measures, and favor regional learning through the production of regional diagnostics and knowledge exchanges.

Recommendations / Way forward

Improving Equity and Efficiency of Social Assistance

Improve equity of social assistance programs by revamping the targeting and eligibility systems to prioritize the poor and truly disabled.

It is recommended that the Government move forward with the implementation of Unified scoring formula for NE program, which was developed based on international best practices (SHORT TERM). Replacing the current eligibility criteria with Unified Scoring formula will improve coverage of the (extreme) poor under the same budget envelope¹, while improving transparency by eliminating the use of non-transparent discretionary criteria. The requisite steps to move forward with the implementation include:

- Finalization and adoption of the administrative guidelines/instructions outlining the steps in NE eligibility determination under the unified scoring formula;
- Training of the social administrators, RSSS staff, and MOLSA staff based on the clear instructions for NE administration; and
- Establishment of separate structures for NE eligibility to avoid possible conflict of interest. Eligibility and inspection functions should be clearly separated, with precisely outlined responsibilities for each function, in order to avoid any possible conflict of interest in determining NE eligibility.

For disability assistance program, ensuring benefits reach the truly disabled in the face of fiscal pressures is the priority and requires a three-pronged approach:

- **First**, maintaining the inflation indexation rule over time (and avoiding other ad-hoc adjustments in benefits levels) is crucial in order to contain ballooning costs and redress the equity imbalances in spending allocations between disability and poverty-targeted NE benefits (SHORT TERM).
- **Second**, it is recommended that the Government revise the eligibility system based on the principle of assessing the functional abilities of people with disabilities (the “Social Model”). The aim of this principle is to ensure that the benefits accrue to those that are “truly” (or more severely) disabled (MEDIUM TERM).
- **Third**, the Government can consider targeting disability benefits to the poor disabled persons, to provide protection to the truly vulnerable and

improve equity further. Rather than establishing a parallel system, the improved targeting mechanism for NE program (i.e. Unified Scoring formula) can be utilized to identify the poor/most vulnerable among the disabled individuals. Harmonization of the targeting system will also improve administrative efficiency. (MEDIUM TERM)

Improve efficiency of social assistance programs by strengthening and modernizing the administration of benefits; and mechanisms to reduce error & fraud

Establishment of national registry/Management Information System (MIS) for NE and Disability Assistance is crucial to help avoid duplications and track beneficiaries, and would significantly improve the monitoring/oversight capacity of the institutions and transparency in all aspects. The NE MIS is currently under development.

- It is recommended that the Government move forward with the development and implementation of the NE MIS and start planning for the development of the Disability Assistance MIS (SHORT TERM).
- It is also recommended that the Government consider investing in IT capacity in the relevant Ministry to manage the system effectively to not have to rely on external contractors (MEDIUM TERM).

Strengthening the system for preventing, detecting, and remedying error & fraud is key to further improve efficiency and transparency (MEDIUM TERM).

Automated information systems (as mentioned above) would enhance the accuracy of detection of error and fraud in NE and disability assistance programs. Other broad steps include (i) improve capacity of the social inspection to develop and apply risk profiles for risk-based inspections; and (ii) strengthen sanctions policy.

¹The implementation of the budget-neutral nationwide NE reforms would result in an additional one percentage point reduction in the *extreme* poverty headcount rate) as a result of more accurate identification of the extreme poor with the Unified Scoring Formula. Indeed, the envisioned targeting reforms would allow NE to more than double the coverage of the *extreme* poor (increasing it from 24.6 percent to 54.5 percent) with the same budget. The coverage of the *total* poor would also increase substantially (from 19.5 percent to 36.9 percent).

Reduce (Intergenerational) Poverty/Vulnerability by linking beneficiaries to human capital and/or activation measures (MEDIUM TERM)

Once the key elements for a well-functioning, safety net system are in place (i.e. improved targeting/eligibility, modernized benefit administration) it would be important to consider second-generation reforms to shift to more active assistance. To this end, the Government is recommended in the medium term to:

Introduce an education bonus for children of NE beneficiary families to help prevent intergenerational poverty and improve long-run poverty impacts by investing in human capital. Many countries (low-income, middle-income and even high-income OECD countries) link receipt of cash transfer assistance to school enrollment and attendance to improve the long-run impacts for strengthening human capital and reducing poverty. These mechanisms are generally referred to as “conditional cash transfers.” Such conditioning of benefits could make sense in Albania’s context, where, contrary to most neighboring countries, Albania has not achieved universal enrolment in basic education.

Link social assistance programs with employment support services to promote employability, increase self-reliance, and reduce dependency on benefits. While social assistance transfers can relieve poverty in the short-term, only productive employment can provide lasting protection against vulnerability. Many EU and other OECD countries have been enhancing the “proactivity” of social benefits programs by linking beneficiaries to incentives, social contracts, and services to promote employability and employment opportunities. These efforts take many forms, depending on the profile of the poor (barriers to work), the programs (incentives aspects), and institutional capacities.

Improving Poverty Monitoring

- *Conduct in-depth assessment of trends in poverty, employment, and social assistance receipt using the 2012 LSMS (SHORT TERM).* The 2012 data offer an opportunity to understand the contributions of different factors to the recent evolution of poverty, and to identify the role played by government policies in driving those trends/helping households cope.
- *Introduce a more regular and sustainable system of monitoring the living conditions of the population and increase data accessibility (MEDIUM TERM).* Introduction of a more effective and sustainable system of data production and analysis can be considered, building on innovative examples piloted in the region and putting Albania in compliance with Eurostat guidelines for adopting the EU acquis.
- *Identify clear priorities in the job creation agenda, building on lessons from a number of donor-led interventions (e.g. on youth employment) (MEDIUM TERM).* Sustainable poverty reduction is often achieved as a result of providing greater access to opportunities, particularly jobs, to lower-income groups. Available evidence suggests that Albania lags behind the rest of the region in terms of employability of its workforce, dynamism of its firms, and labor market participation of its women. A fuller assessment of constraints to job creation and of the needs of a still expanding working-age population will inform and facilitate the development of a medium-term job creation agenda.

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Albania: Gender Equality and Social Inclusion of Vulnerable Groups

July 2013

Policy Brief

Overview

In the past years Albania has made a great deal of progress on issues of social inclusion, and especially on some aspects of gender parity. While the government has made notable efforts in partnership with UN agencies under One UN initiatives in developing National Strategies and policies, obstacles to the inclusion of women and vulnerable groups such as youth, Roma and Albanian Egyptian minorities¹ still remain. The vulnerabilities are multi-dimensional, often incorporating a lack of access to education and healthcare, inadequate housing, and unemployment. This brief describes the situation of in women and on two vulnerable groups: Roma, and Albanian Egyptians. It describes how different forms of exclusion create vulnerabilities, including higher poverty rates among these populations. In recommendations/way forward, the brief addresses three priorities to be considered for further intervention by the government: economic empowerment of the vulnerable; promote inclusive social safety nets; and ensure access to land ownership. The World Bank will work in partnership with the government and the UN agencies particularly in the areas of comparative advantages where the World Bank's expertise could be offered.

I. Persistent Gender Disparities

Access to education

Gender disparities exist in all levels of education, with no clear-cut overall advantage of one gender over another. The fact that different genders have different rates of completion and enrollment at different levels of education, however, means that opportunities and constraints remain different for males and females, and increasing overall enrollment and

¹The Roma and Albanian Egyptian groups reject categorization as a single group and in fact are culturally different and rarely intermarry. Unlike the Roma, who is recognized as linguistic minority in Albania, Egyptians are not provided minority status under Albanian law. This implies that Albanian Egyptians do not receive constitutional protection against discrimination.

completion of education requires understanding and focusing on the differentiated needs of these groups.

While overall gender gaps in literacy and education are low, disparities appear for some population groups and for higher education. Poor rural girls are less likely to be enrolled in primary school than any other group, though their enrollment rate is still over 83 percent. However, both boys and girls, non-poor and poor, see a dramatic drop in enrollment after primary school. Less than a third of poor Albanian girls are enrolled in secondary school, and even fewer are enrolled in rural areas. Poor boys are even worse: 23 percent of poor boys are enrolled in secondary school (17 percent in rural areas). The group with the highest secondary school enrollment rate is non-poor urban girls, at 65.7 percent. Girls appear to be at a learning advantage over boys: the latest PISA findings show that girls outperform boys not only in reading, but also in math and science, which are often seen as more “male” subjects.

University education in both urban and rural areas has expanded dramatically in recent years, especially among females. The share of urban women who have completed college has doubled to more than half of their population. The share of rural women attending university has gone up by a factor of ten, though overall their tertiary completion rates remain far behind that of urban women. Men's enrollment in university education has also increased tremendously. However, there are concerns that the quality of education may be suffering because of the rapid increase in university enrollment.

Indicators for access to health services do not point to significant differences in access for males and females. However, questions remain about women's access to services in areas where transportation is limited.

Access to economic opportunities

Although the gender differences in access to education and unemployment are limited, real differences remain in the

participation rates and wages received by men and women in the labor market. These differences partly reflect gender roles, the different obligations in the household of men and women, and the different growth rate of predominantly male vs. female occupations.

Women's participation in the labor force remains lower than men's participation. Despite a large increase in women's participation in the labor force since 1991, only 56 percent of women participate in the labor force, compared to 77 percent of men.² Data shows that in the decade before 2006 the increase in female participation in labor markets stagnated while male employment increased. Firm level surveys confirm this picture, showing only 37 percent of women as full time workers, and only 9 percent of full time non-production workers being women. Women are more likely to be involved in agriculture and are less likely to be engaged in market activities and in the sectors which before the crisis experienced vigorous employment growth. While this is in line with the regional performance, only 11 percent of firms in 2007 had women participating in their ownership, against an ECA average more than 3 times as high. Albania also has a large wage gap (raw) compared to other countries in the region, with women earning around \$0.65 for every \$1 men earn.

Agency, Property Rights, and Gender-Based Violence

Women's participation in decision-making remains limited both at the national and local levels. This lack of agency is at least in part due to adherence to traditional gender norms. At the national level, the disparity is seen in women's representation in government. The share of women parliamentarians and ministers remains relatively low, although the number of female parliamentarians slightly increased after the general elections of June 2013 and the share of female ministers in the new government is yet to be determined. At the household level, evidence suggests that most women have some voice within their household on how their own earnings are spent.

Gender-based violence continues to be a serious issue in Albania, and the vast majority of victims of this problem are women. One out of every three women has been physically abused and 13 percent are survivors of sexual abuse. 51 percent and 39 percent of women have suffered emotional and psychological abuse, respectively.

Women's property rights are also less secure than those of men. Land titling and property rights policies and processes put women at a disadvantage, either because policies permit registration solely in the name of one spouse (traditionally the husband) or because the husband is thought to represent the wife when property is registered in the name of the household. For example, when illegal or informal homes are legalized and registered, the registration lists in the name of the head of household. Another example is when credit applications made by one spouse sometimes also list household properties as collateral. In cases where the credit is in default and the collateral is seized, a spouse who may not have known about the credit or its conditions may also lose access to property.

Programs where Gender Disparities could be addressed

The Albania portfolio includes examples of successful gender mainstreaming in several operations. Some examples of gender mainstreaming are:

- **Land Administration and Management Project (LAMP)** (US\$35M)
- **Secondary and Local Roads Project** (US\$20M)
- **Health System Modernization Project** (US\$15.4M)
- **Social Services Delivery Project Social Sector Development Policy Loan (DPL) Social Assistance Modernization Project** (US\$50M)
- **JSDF Youth Empowerment and Community Development Project** (US\$1.15M)

Social Inclusion of Roma and Egyptians

Roma and Albanian Egyptian communities in Albania make up more than 5% of the population of the country, with estimated population growth of about 3 % higher than that of non-Roma in Albania (OSCE 2003; World Bank 2005), and are more than twice as likely to live in poverty than non-Roma in Albania (UNDP/WB/EC Survey 2011). Despite the lack of detailed statistics, it is clear that poverty for these communities is multi-dimensional. Although the reasons for these groups' disproportionate levels of poverty are unclear, it is clear that these groups face more challenges than others in accessing secure housing and land, in obtaining reliable and adequately paid forms of income, and in accessing overall government services, including health and education.

²Data from 2009.

Housing

The majority of Roma live in informal settlements where housing is overcrowded, dilapidated, and does not include basic amenities. Only 25% of Roma families and 56% of Albanian Egyptian families possess a bathroom; only 36% of Roma households and 58% of Albanian Egyptian households have a refrigerator. 64 % of Roma households lack access to improved water source compared to 34% of non-Roma. Roma lack security of tenure and their makeshift premises are lacking building permits or title registration. Lack of tenure security is highly interrelated with a personal sense of stability and fear of possible eviction which could hinder them from exercising property rights and improving their housing conditions.

Education

One of the greatest challenges for inclusion of Roma and Albanian Egyptian populations is their lack of access to education. The data shows only 1.3% of Roma and 4.8% of Egyptians between 7 and 20 years old have secondary education, while 0.3% and 0.2% of the same groups attain higher education. Low levels of educational achievement are caused by multiple factors. When families are in income poverty, parents rely heavily on children as workforce in and outside of the household and children either do not have time or are not allowed to attend school. Children of families who have migrated to their current place of residence sometimes do not attend school because their parents have not registered in their municipality. The accessibility to public transportation and condition of local roads are also obstacles for children to continue their education. Distance from school and lack of means of transportation discourage parents from sending children to schools due to safety concerns. Poor housing and lack of sanitation at times also create barriers to education, as some children are discriminated against because of their living conditions. Overall, the lack of educational achievement then translates into difficulties finding employment.

Employment and Participation to Labor Market

Roma and Albanian Egyptians are much more likely to be employed in the informal sector – 90% of both groups work as unskilled labor in the informal economy (2012, UNDP). These types of jobs leave individuals without access to social safety nets including unemployment benefits, state economic assistance and employment services. A recent survey (UNDP/WB/EC, 2012) shows that the Roma are more likely to be employed in unskilled jobs than non-Roma;

however they are just as likely to engage in farming as the comparable sample of non-Roma, and even more likely than non-Roma to be owners of a business (15% compared to 13% of non-Roma). Low levels of education, discrimination, lack of resources and funds for entrepreneurship are underlying issues resulting in high unemployment.

Healthcare

A Roma individual can expect to live 10 years less than others in Albania. This is correlated with a number of factors including: poor sanitation, malnutrition, lack of access to hospitals, and lack of health education. In rural areas, lack of access to adequate sources of water and sanitation also create health problems. Overcrowded living conditions exacerbate the problem, making communicable diseases more pervasive among Roma settlements. Children's vaccination rates are also notably lower among Roma (89% compared to 100% coverage for non-Roma).

Access to health services (73%), and especially access to essential drugs (59%) are also lower among the Roma. Social and physical isolation are part of the reason for this limited access. In some areas, the lack of access to transportation to reach health services, and the lack of funds to pay for health costs is the cause of the limited access to services of this population.

II. Government efforts to promote social inclusion

In the past years Albania has put serious efforts to promote gender equality. The status of women has improved when it comes to the legal, policy and institutional framework. The National Gender Equality Strategy (2007-2010) and the Strategy against Gender based and Domestic Violence (2011-2015) have oriented the government, donors and civil society efforts and resources to the country needs.

Policies to foster inclusion of the Roma population include the 2003 National Strategy for Improving Roma Living Conditions. During the process of policy development, consultation was made with Roma NGOs and other civil society representatives. Subsequently, the Government joined the Decade of Roma Inclusion (2005-2015) to eliminate the discrimination and fill the gap between Roma and the mainstream society in the areas of education, employment, health, and housing. A National Action Plan for the Decade of Roma Inclusion was also developed.

Recommendations / Way forward

Addressing disparities in gender and fostering the inclusion of Roma and Albanian Egyptian populations requires fostering norms and practices that improve the status of these groups and their access to services. These issues can be addressed in specific projects and programs, in coordination with UN agencies, with the support of policies that prevent discrimination and promote the rights of the vulnerable. The recommendations below focus on three priorities that can be taken by the government in the short-term.

1. Promote economic empowerment of the vulnerable: Especially, youth, women, Roma and Albanian Egyptians, are essential for inclusive society. The Government may consider expanding the existing JSDF Youth Empowerment and Community Development Project, currently implemented in Tirana and Durres municipalities to national level. It is advisable that comprehensive approach through practical vocational training, grant support for business start-up and apprenticeship should continue to benefit the vulnerable.

Address the employment gap between men and women. This could be done through employment activities focused on girls, such as the Adolescent Girls Initiatives (AGI). It aims to help adolescent girls and young women make smooth transition from school to employment which could sometimes be hindered by household burdens and prevailing social norms.

2. Develop social safety nets accessible for all: Promote inclusive and participatory teaching. (i) Build the capacity of teachers and promote practices that avoid discrimination against vulnerable groups; (ii) Include the history and culture of Roma and Albanian Egyptians in school curricula in order for them and other students to understand their diverse background; (iii) Make classes available to teach Romani language for Roma students to preserve and protect their identity.

Make healthcare more accessible to vulnerable groups. (i) In coordination with Health System Modernization Project, provide women with access to better quality of primary healthcare. (ii) Raise awareness on managing health conditions with more information on illnesses and diseases. (iii) Make health institutions more accessible in terms of distance and costs. Eliminate illegal surcharge for medical treatment.

Ensure state assistance reaches Roma and Albanian Egyptians: Ndihma Ekonomike (NE), disability payments, unemployment benefits, and pensions should reach vulnerable populations, including the Roma and Albanian Egyptians. State assistance, supported by Social Assistance and Modernization Project, should be reformed to be more accessible and available for the vulnerable groups. In case of Roma and Egyptian populations, lack of civil registration could prevent them from being eligible for application. Civil registration and awareness-raising are promoted by UNDP on community basis. The support should be coordinated to identify those who are in need of assistance.

3. Ensure access to land ownership: Improve tenure security and access to property rights for the vulnerable. Improved land administration should be gender informed and inclusive. Vulnerable groups, i.e., Roma, women, youth, should be involved in more awareness-raising activities on the access to property rights and the benefit of property entitlements and registration process. The World Bank facilitated a regional workshop on Land and Leadership Workshop in June 2013 for six countries in the Western Balkans. During which time, the Albanian team composed of representatives from Ministry of Justice, IPRO, UN Women and Notary drafted a proposal reform plan in land administration in Albania. The Bank will continue to be engaged in this issue with the Government and open for any further opportunity of collaboration.

Set targets for inclusion of women, Roma, Egyptians and youth. Throughout its activities, the Government should consider setting targets to improve the participation of vulnerable groups in economic and social activities. Implementers should be held accountable for reaching these targets and have processes in place that make it possible for these targets to be reached.

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Albania: Pensions and Old Age Security

July 2013

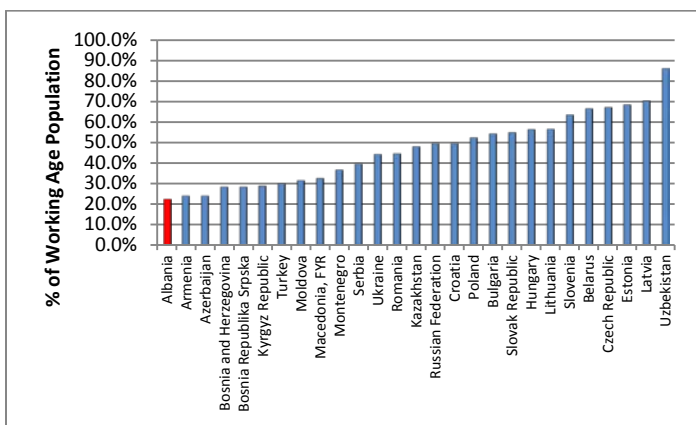
Policy Brief

Characteristics of the Albanian Pension System

The Albanian pension system, established in 1947, provides old age, disability, and survivor coverage to contributors. The system is run on a pay as you go basis with contributions from current workers being used to pay benefits for current pensioners. In addition to the main system which has some special provisions for a limited number of occupational groups, Albania has a separate agricultural pension system for self-employed farmers, where farmers make contributions on a flat-rate basis, while the government pays the remaining contribution, making the total contribution equivalent to the minimum paid by the urban self-employed.

Almost all elderly are covered under the pension program due to full participation of workers in the pension system during the socialist era. But, the number of workers making contributions to the pension system is currently low meaning that the coverage of the elderly under

Figure 1: Percentage of Working Age Population, Ages 15-64, Contributing to the Pension System



the pension program will decline in the future. Figure 1 shows that the percentage of working age population in Albania is the lowest of all the countries in the region. As a result, the total number of pension beneficiaries are currently 3% higher than the total number of pension contributors.

Overall spending on pensions in Albania is lower than the Europe and Central Asian (ECA) average but increasing. In 2010, Albania spent 6.2% of GDP on pensions, much lower than the European Union (EU) countries or than the average for ECA, by virtue of being a young country. The benefit structure is complicated, with a flat component given to all contributors with 35 years of contribution plus an additional 1% of own average salary per year of contribution. This benefit formula is prorated for those with fewer years of service. The benefit formula also contains both a minimum and maximum pension, with the maximum pension designated as twice the minimum.

Substantial pension increases have been granted in recent years. While legally, pension increases are supposed to be linked to inflation, recent increases have been far greater than inflation. In an effort to raise lower pensions further, a number of allowances were introduced which result in increased income to lower income pensioners, without raising the minimum pension which would have automatically raised the maximum pension as well. Even larger increases have been provided to the agricultural pensioners in an effort to equalize the minimum pensions in both systems, despite the high level of subsidy provided to agricultural workers. And substantial allowances for minimum pension earners often result in their receiving higher total benefits than those who receive higher pensions.

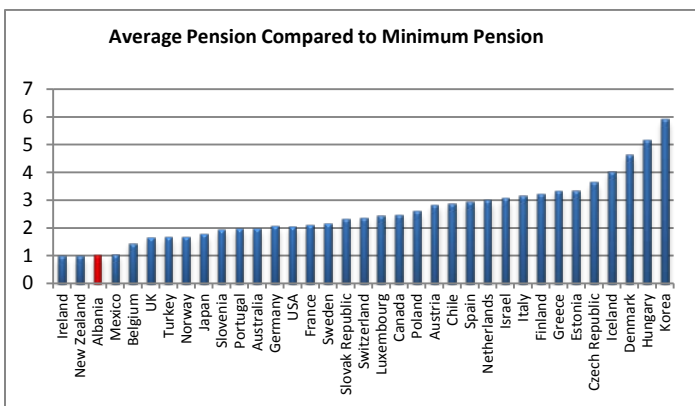
Pension contribution rates have been falling even as spending increases. Pension contribution rates, which were at a high 29.9% in 2005, were reduced to 21.6% by 2009 in two steps. The objective was to reduce informality and provide incentives for more participation in the formal labor market. While some formalization did occur, not enough occurred to avoid additional deficits in the pension system.

Key Issues

Three main characteristics of the Albanian pension system distinguish it from many of its peers in the ECA region: (i) the compression of benefits with average pensions being very close to minimum pensions; (ii) a high level of minimum pension relative to average wage; and (iii) a large and growing subsidy to the rural sector.

The pension system involves a significant amount of redistribution which reduces incentives to contribute for more years and declare full earnings. Because of the constraints on maximum pension, the average pension in the urban sector is almost equal to the minimum pension with the income from the average pension amounting to 1.03 times the income from the minimum pension, while the average income on which contributions are paid is more than twice the minimum contributory wage. Figure 2 shows how unusual such a compressed structure is relative to pensions provided in other countries. Only Ireland and New Zealand have similarly compressed structures, but their benefit design provides equal flat benefits to all individuals. While the Albanian pension system does include significant aspects of redistribution towards lower income workers, it also provides a relatively low rate of return for high income individuals, creating weak incentives to participate and/or declare full earnings.

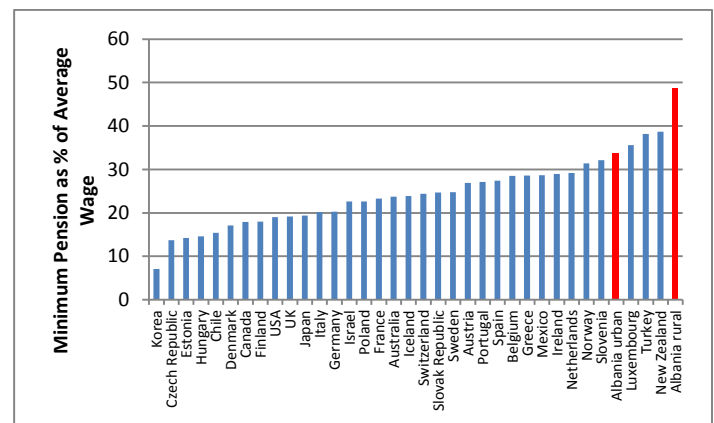
Figure 2: Average Pension Compared to Minimum Pension in OECD Countries Compared to Albania



The level of minimum pension relative to average wage is also quite high relative to other countries. Figure 3 shows that the Albanian minimum urban pension, at 34% of average wage, is among the highest in Europe. Among the OECD countries shown in the graph, only Turkey,

Luxembourg, and New Zealand provide higher minimum pensions. Since New Zealand only provides a flat benefit, it is reasonable that this might be relatively higher, but in Albania’s case, the high minimum pension is supposed to underpin a higher contributory average pension, which then results in higher pension spending than warranted. And for the rural farmers, the minimum pension is even higher, at 49% of the average contributory wage of these rural farmers, making it among the highest minimum pensions in the world. The high level of minimum pension makes it more difficult to allow differentiation of benefit levels without first lowering the ratio of minimum pension to wage.

Figure 3: Minimum Pension Compared to Average Wage in European and High Income Countries Compared to Albania



The amount of redistribution is even higher for the rural sector. Most of the parameters of the rural system are identical to those of the urban system except for contributions. The agricultural workers pay a flat rate while the Government provides the remainder. The Government contribution has amounted to around 85 percent of the total in recent years. Since contributions are largely paid by the Government, rural pensions have essentially become a social assistance benefit. The Government has plans to increase the contribution rates to equalize with urban contributions by eliminating the Government contribution rate for rural contributors, but the progress on increasing the contribution rate has been slow so far.

Other issues include (i) the ad-hoc indexation of pensions, (ii) relatively low retirement ages, and (iii) rapidly increasing disability spending. Ad-hoc indexation of pensions, above the inflation rate as legislated, have made the pension system vulnerable to political pressure and have increased the uncertainty to system

participants as well as to fiscal authorities. Retirement ages have risen to 65 for men and 60 for women, but are still low, particularly for women. In most OECD countries, retirement ages are the same for men and women. Disability spending which was initially low has been rapidly increasing, with individuals eligible for both the disability assistance benefit and the disability pension. The combination of these two benefits will in some cases be higher than the potential old age benefit, providing an incentive to qualify under disability.

Challenges Going Forward

The current system, if allowed to continue as it is, will in all cases generate fiscal deficits in the short, medium, and long run. Benefits, if provided as legislated, will be quite low. Providing more generous benefits will require even larger fiscal deficits. And a significant portion of the elderly will not be receiving pensions in the future because their current informal sector work does not give them eligibility to social insurance pensions in the future.

Should benefits be inflation indexed, as is legislated, pension deficits together with the government contribution for rural contributors will rise to 3.3% of GDP in 2025, but will still result in very low benefits to contributors. Figure 4 shows the fiscal balance of the pension system relative to GDP if the benefits are inflation indexed in the future, while Figure 5 shows the projected benefit levels as a percentage of average wage.

Figure 4: Fiscal Balance of the Pension System in % of GDP (Inflation Indexation)

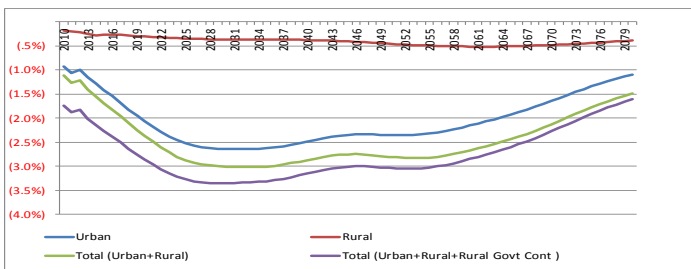
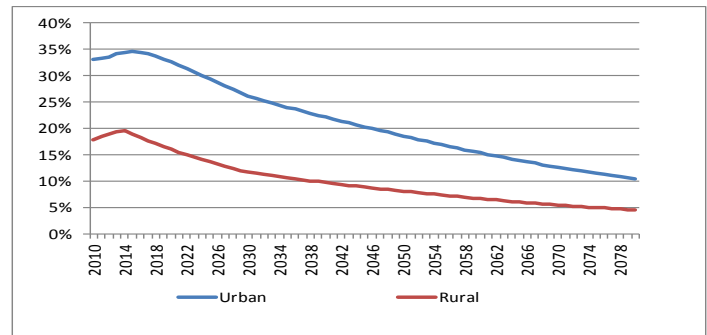


Figure 5: Projected Benefits Levels as % of Average Wage with Inflation Indexation



Should benefits be wage indexed, as has been recent practice, pension deficits together with the government contribution for rural contributors will rise to as much as 8.4% of GDP by 2058, but will pay much more reasonable benefits. Figure 6 shows the projected fiscal deficits with wage indexation, while Figure 7 shows the projected benefits. The projections suggest that there is a trade-off between fiscal sustainability and adequacy of benefits.

Figure 6: Fiscal Balance of the Pension System in % of GDP (Wage Indexation)

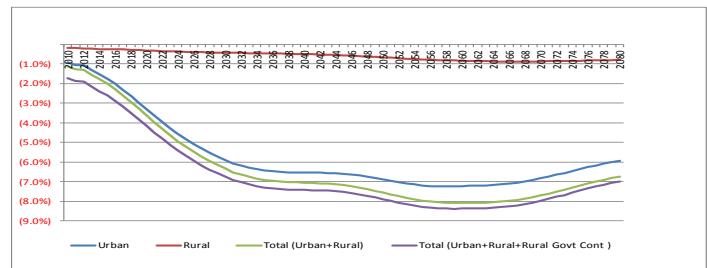
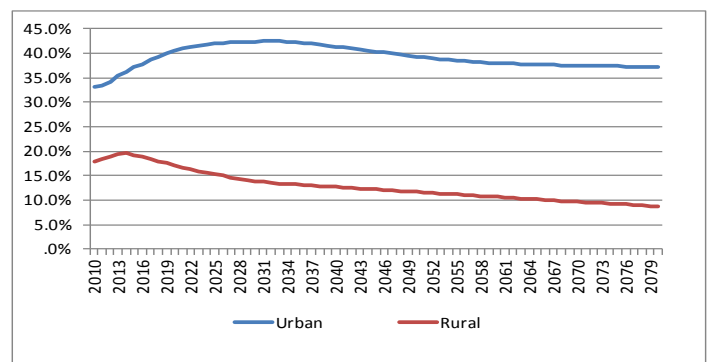


Figure 7: Projected Benefit Levels as Percent of Average Wage with Wage Indexation



Moreover, a large share of the elderly will not have access to a pension benefit in the future. Since the

participation rate in the current pension system is currently low, 56 percent of the elderly are projected to have no access to a pension benefit in the future. Since leaving a substantial number of elderly with no means of subsistence is neither socially or humanely acceptable, the Albanian Government will need to find mechanisms to provide at least minimal support to even those elderly without a pension benefit to prevent these individuals from falling into poverty.

Reform Options

Albania currently sits at a cross roads in terms of pension reform options. Pension systems worldwide are designed to prevent poverty and to replace working age earnings for the elderly and those unable to work. Some countries focus on poverty prevention while others focus on replacing working age earnings. There is a trade-off between these two objectives since focusing on poverty prevention is unlikely to provide benefits high enough to replace sufficient income for middle and high income earners, while focusing on income replacement leaves lower income earners potentially in poverty in old age. Financing for old age security often depends on which of these objectives is the main focus of the program. If the focus is poverty prevention, as in New Zealand, flat benefits are typically paid out of general revenue. If the focus is income replacement, benefits are usually paid out of contributions.

While the Albanian system currently is designed for income replacement, it is implemented as if it were focused on poverty prevention. As a result, the financing and benefit structure are not consistent. The current benefit structure is so similar to countries which focus on poverty prevention that the Government could choose to adopt a pension design which is more consistent with this focus. The Government could, alternatively, choose to re-establish a contributory system which provides reasonable income replacement. The current mix is not working and will become increasingly expensive with disappointing results. The World Bank has prepared a pension note which provides examples of how Albania could transition from the current system to either of these options. The Bank team would be happy to discuss these examples and explore other options with Government counterparts.

Recommendations / Way forward

Government will need to take a decision on whether to focus on poverty prevention or on income replacement in the pension system.

Elements of a solution will require actions in both the short-term and medium term.

Short-term priorities include:

- (i) hold the minimum pension constant in nominal terms for some time to restore the normal gap between average and minimum pensions; and
- (ii) adhere to the legislated pension increases linked to inflation only.

Medium-term priorities include:

- (i) raising retirement ages for women until they are the same as for men;
- (ii) replacing the current rural pension with a social pension which would be available to all elderly who do not have a contributory pension.

(iii) Depending on strategic decisions about whether to focus on poverty or income replacement, complementary reforms in the financial sector to facilitate voluntary savings may be required.

References:

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Main messages

Key health system performance indicators in Albania are mixed. While health outcomes are relatively strong by regional standards, financial protection of households against high out-of-pocket payments is relatively weak. There is also scope to improve health system efficiency.

A major priority for the health financing agenda should be stronger revenue mobilization and pooling of health care resources, subject to the availability of resources in a difficult fiscal environment. There is currently a high reliance on out-of-pocket payments, an inefficient and inequitable method of health finance. Regional experience suggests that the level of revenue-raising and pooling is more important than the exact institutional arrangements for doing so.

Over the past 50 years, several European countries have made a transition from primarily payroll-financed to general tax-financed health systems. Albania is now facing the option of making a similar transition. The experience in other countries has generally been positive, although the transition includes significant challenges.

Current provider payment methods rely more heavily on input-based approaches than is the case in more advanced health systems. A shift towards output-based approaches could help improve system-wide performance with respect to both health outcomes and efficiency.

Brief review of health system performance in Albania

Health system performance is commonly assessed with reference to the major objectives of the health sector. Three key goals are to improve the health outcomes of the population (with a special emphasis on the poor); to ensure the financial

protection of households against the high and uncertain costs of medical care; and to improve overall system efficiency to reduce the burden of the health budget on a government's fiscal position. Each is discussed briefly here.

Health outcomes

Life expectancy at birth in Albania had reached 77 years by 2011 (80 for women and 74 for men), which compares favorably with other countries in the region. For example, this is higher than in neighboring countries such as Serbia and Macedonia, and only about 3 to 5 years behind high-income countries such as Greece and Italy. The Mediterranean diet has been posited as a major explanation for Albania's relatively good adult health indicators. Child health indicators suggest greater room for improvement. According to the 2008 Demographic and Health Survey (DHS), infant and neo-natal mortality were 18 and 11 per 1,000 live births, respectively, both of which are slightly higher than comparable statistics for other countries in south-eastern Europe, with steady improvements during the 1990s appearing to slow down more recently.

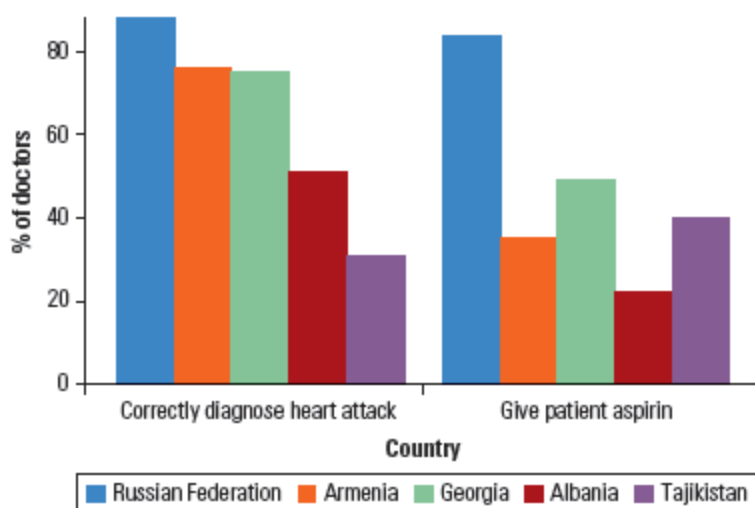
Cardiovascular disease is the major source of the disease burden. Major risk factors include tobacco use and hypertension. According to the DHS study, tobacco use among men aged 15 to 49 was 43 percent (but only 4 percent among women), higher than in most countries of Western Europe but lower than most CIS countries. The most effective measure to address tobacco use is cigarette taxation. In Albania the average share of taxes in retail cigarette prices is 53 percent (WHO 2011), much lower than in most countries in the Balkans and Western Europe (where this share is typically 75-80 percent). There is also scope to address high blood pressure among the population. Among the 15 to 49 age group surveyed in the DHS, 80 percent of women and 90 percent of men with hypertension were not aware of their status, and less than 3 percent were both aware of their high blood pressure and had it

under control through treatment. Although comparable figures for the same age group in other countries are not readily available, these findings indicate substantial room for improving health system performance for this major risk factor.

The quality of medical care at all levels is a major issue in Albania. A growing body of global evidence suggests that quality of care is highly variable across different providers, that it is often inadequate, and hence is a key reason for sub-optimal health outcomes. A cross-country survey on quality of care in the Europe and Central Asia region found that the average score of Albanian doctors was about 50 percent, indicating that they did only half of what they should do when faced

with hypothetical patient vignettes for key cardiovascular disease and neo-natal services. This was lower than in Armenia, Georgia, or Russia. In the specific case of heart attack, only half of Albanian doctors could correctly diagnose the condition, while only 20 percent would give the patient aspirin (Figure 1). Improving quality of care is thus a major priority for improving health outcomes in Albania. Achieving better quality can begin with better performance measurement of individual providers, and then using professional recognition, peer review, and possibly pay-for-performance as the basis for improving quality of care.

Figure 1: Quality of care can be improved



Source: World Bank 2013.

Note: Figure shows provider responses to clinical vignette of heart attack.

Financial protection

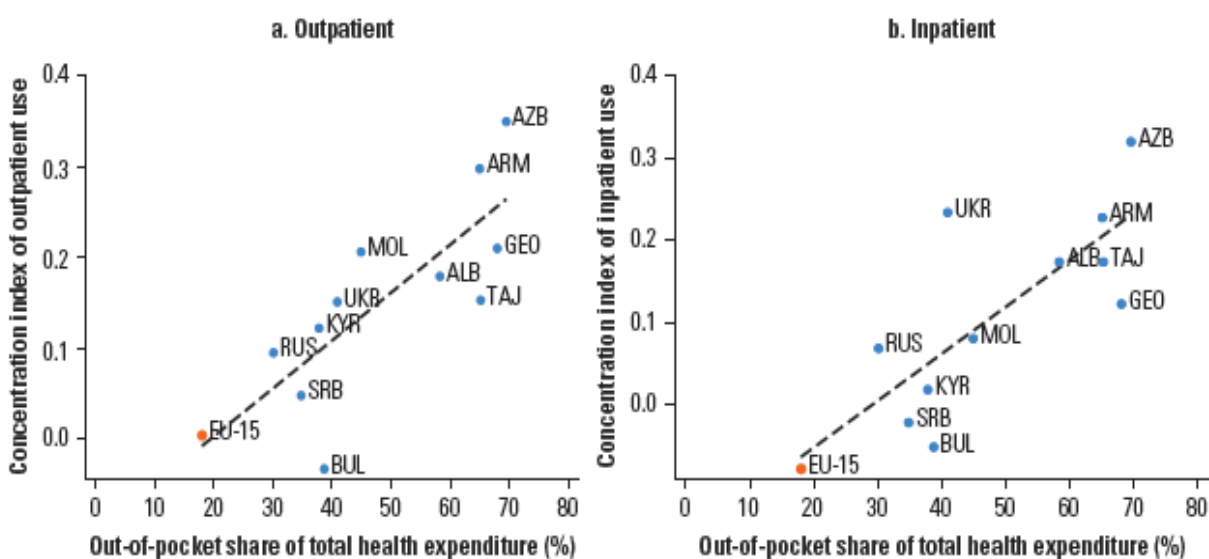
A second key objective of health systems is to provide households with financial protection against the possibility of incurring high and unpredictable costs of health care. The major focus of attention here is out-of-pocket payments (OOP) for health by households at the point of care. Key issues include how much is being spent out-of-pocket, by whom (i.e., which population groups), and what are the causes, consequences, and policy implications of these payments. The

uncertainty and potentially high cost associated with health expenditures (we typically do not know when we will become sick and how much it will cost if we do) make them amenable to risk-pooling and prepayment arrangements in order to spread risks more broadly across people and over time.

Out of pocket payments for health care are substantial in Albania, with important implications for household budgets. Health spending accounts for an average of 5 percent of

total household expenditures, compared to 3 percent in Western Europe. But more important than these averages is the wide variation. Over 16 percent of Albanian households incur health expenditures exceeding 10 percent of their total household budget, compared to less than 6 percent among EU-15 countries. A similar pattern prevails for health spending that exceeds 25 percent of household budgets. These so-called “catastrophic payments” are a common indicator of financial protection, and they suggest that Albania’s performance is among the weakest in the region. Many households also fall into poverty as a result of high medical bills.

Figure 2: Significant inequality in access to health care



Source: Ali and Smith 2012.

A combination of measures will be needed to reduce Albania’s reliance on out-of-pocket payments and improve financial protection.

One possible step is to increase government spending on health as a way to “crowd out” OOP. Additional budget resources could be spent on services currently excluded from the benefit package (e.g., certain drugs), higher salaries for health care providers, and/or the inclusion of those people who are not currently covered. However, any increases would need to be affordable within the current difficult fiscal environment, and therefore it may not be possible to enact these increases in the immediate future. However, additional government spending is not

High out-of-pocket payments also result in significant inequality in access to care between rich and poor.

As indicated in Figure 2, the degree of inequality in utilization of both outpatient and inpatient care in Albania is among the top 5 in the region, on a par with several CIS countries and much higher than in Bulgaria, Serbia, or the EU-15 (Western Europe). A key explanation for this inequality is the high level of reliance on out-of-pocket payments.

always necessary to reduce OOP. Stronger accountability of providers (e.g., both by government oversight and through steps to empower patients with information about what they should pay) can help reduce informal payments, which are very significant in Albania (World Bank 2011). Finally, about 40 percent of OOP in Albania is spent on drugs, and clear drug lists, treatment protocols, generic promotion, and price regulation can help to reduce unnecessary or wasteful pharmaceutical expenditures.

Efficiency

Governments across the European region face significant challenges to improve the

efficiency of health spending, and Albania is no different. Health spending measured as a share of GDP tends to increase steadily over time, and thus the imperative of ensuring that these resources are well spent will persist. These challenges are amplified in the current difficult fiscal environment.

Common sources of waste include excess hospital infrastructure and high pharmaceutical spending. Unlike many other countries in Eastern and Central Europe, Albania does not have a severe surplus of hospitals. Both the number of facilities and the number of hospital beds per 100,000 population is considerably lower in Albania than in most countries, including in Western Europe (WHO Health for All). However, there are potentially significant cost savings that may be attained through revised pharmaceutical policies. Retail and wholesale margins are larger than in other countries in Europe, which could be addressed through enhanced regulatory measures.¹ In general, stronger accountability and transparency in the contracting and prescription of medications would help improve value for money in the sector. Across Europe, innovative contracting methods for pharmaceuticals and closer oversight of provider behavior (e.g., well-defined drug lists, treatment protocols, etc.) are being used to strengthen efficiency in the area of pharmaceuticals, and Albania could usefully apply the lessons of these experiences.

Although major systemic reforms are sometimes considered to be the “solution” to improve health system efficiency, the evidence base is mixed, and other approaches offer at least as much promise. In particular, a significant and sometimes overlooked part of the efficiency agenda is about understanding “micro” variation in outputs and outcomes across different providers and services. For example, some doctors refer more patients to higher levels of care, order more diagnostic procedures, or prescribe more drugs than their colleagues. Similarly, some hospitals have higher readmission rates or higher mortality rates for specific types of

care than others. The organizations that pay for services should keep track of these patterns and make use of this information to address the outliers through more active approaches to purchasing care. In doing so, system-wide efficiency (e.g., by bringing poor performers at least up to the level of average performers) can be considerably enhanced.

Implications for the health financing agenda

Health financing policy frameworks highlight three major dimensions for consideration.

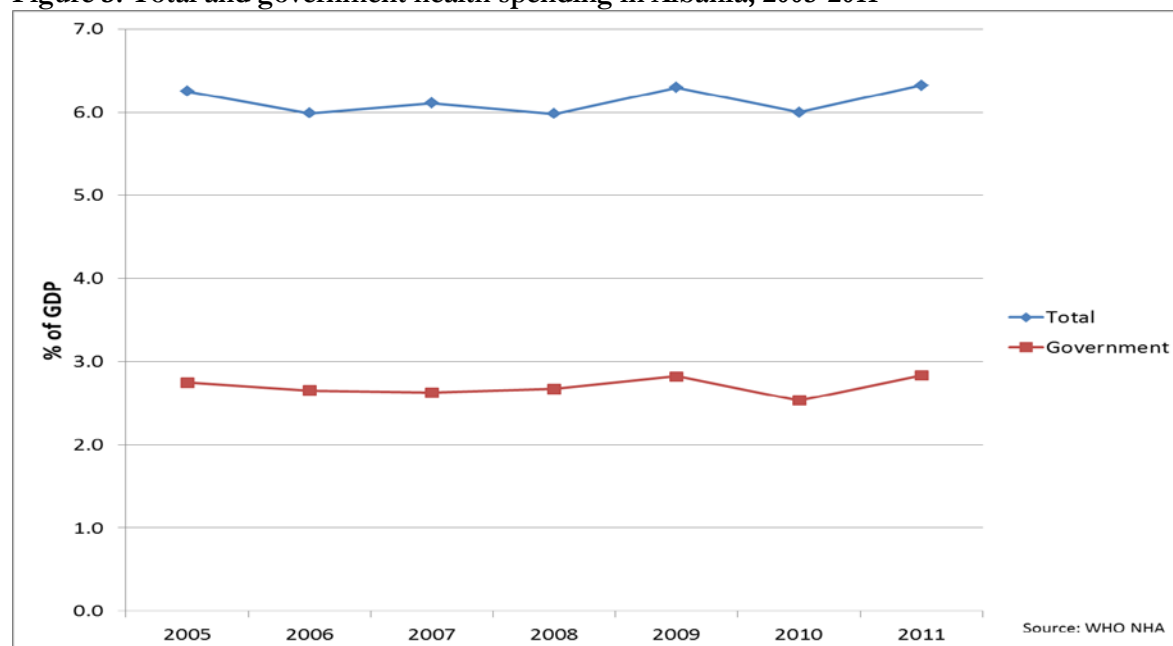
The first is revenue mobilization, or how the funds for health are collected (e.g., the level and method of taxation, reliance on out-of-pocket spending, etc.). The second aspect is how those resources are pooled (e.g., a single common insurance pool, multiple pools by the Ministry of Health or other agencies, etc.). The third aspect is purchasing, or the method by which providers are paid (salary, capitation, fee-for-service, diagnosis-related groups, etc.). Each is discussed briefly here.

Revenue mobilization in Albania is relatively weak, with government health spending quite stable over the past several years at just below 3 percent of GDP. This is low by regional standards, and in fact is less than half of total health spending, which is just over 6 percent of GDP (Figure 3). The level of total health spending, however, is similar to other countries at Albania’s level of income – it is the public-private mix (and especially the high reliance on OOP) that makes Albania unusual.

The major revenue mobilization and pooling agency in Albania’s health sector is the Health Insurance Institute (HII). This agency relies on a payroll tax of 3.4 percent, divided equally between employer and employee contributions, to fund primary health care and certain pharmaceutical expenditures. More recently, HII has also started to pay for hospital care.

¹ Gjeci, Florentina. “Albania: The Health Insurance Institute and pharmaceutical reimbursements”. EuroHealth Volume 13, Number 1.

Figure 3: Total and government health spending in Albania, 2005-2011



Both payroll tax-financed and general tax-funded health sectors are common among European countries. The fundamental difference between a social health insurance (SHI) model and general tax-financed systems is that SHI systems raise revenues mainly from earnings-related contributions levied primarily on formal sector workers, while tax-financed systems collect revenues from more broadly-based government tax and nontax sources. While the dedicated revenue stream for health embodied by the SHI model is often welcome by policy-makers within the sector, there are other challenges posed by this **A transition from a primarily payroll tax-funded system to a general tax-financed system has been undertaken by several European countries over the past fifty years, with broadly positive results.** These include Denmark, Greece, Iceland, Italy, Norway, Portugal, Spain, and Sweden. (Four Central European countries have made the opposite transition, from general taxes to payroll: the Czech Republic, Hungary, Poland, and Slovakia.)² A

² Wagstaff, Adam (2009). Social Health Insurance vs. Tax-financed Health Systems: Evidence from the OECD. Policy Research Working Paper No. 4821. World Bank: Washington DC.

system. First, the taxation of labor can discourage formal work, contributing to a large informal sector and thus foregone revenues for the government. Second, this approach runs the risk of creating a two-tier health system – a “better” system for those who work and a “worse” system for those who do not, since Ministry of Health transfers for the latter are often inadequate. These issues are compounded in Albania by the significant under-performance of HII with regard to revenue collection.

recent research effort to establish the impact of these transitions has concluded that payroll-funded health systems have higher levels of health spending, without achieving better health outcomes (and in the case of certain preventive health services, potentially worse health outcomes), and that they have done so at the expense of lower levels of employment (Wagstaff 2009). In brief, the international experience has been broadly favorable if Albania opts to move towards a general tax-financed health system.

Replacing the payroll tax with alternative funding sources will introduce a new set of challenges, however. Incomes tax rates (or tax

rates for other general revenue collection mechanisms, such as the value-added tax) would have to be increased to replace the payroll revenues. The implications of any such increases – for example, on efficiency and equity grounds – should be closely studied.

Regardless of the health financing model it chooses, Albania will need additional resources for health once the fiscal environment allows for higher revenues. The current level of government spending for health is low by regional standards, as noted above. Either a payroll-tax funded health insurance agency or a general tax-funded Ministry of Health would imply a structure consistent with those existing in many advanced, European health systems. But changing the institutional structure without significantly increasing the revenue stream for health would be unlikely to remedy the fundamental challenges currently faced by the sector. In other words, the *level* of revenue-raising

and pooling is arguably more important than the exact institutional arrangements for doing so. A new agency that similarly struggles to adequately raise revenues will not represent a significant improvement over the status quo.

Lastly, the purchasing function in Albania's health system still relies significantly on input-based approaches. These include largely historical, line-item budgeting for hospitals; and capitation for primary care. In order to improve efficiency and quality, a move towards more output-based payment methods (e.g., DRGs for hospitals, and possibly some modest fee-for-service for primary care) should attract serious consideration. Among other things, these payment methods can help to generate a flow of information about provider performance at the individual level, which in turn can be used to help promote continuous improvement in **service delivery**.

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Albania: Educational Reforms

July 2013

Policy Brief

Recent Achievements in Education

The role of education for improving individual lives as well as enhancing national economic development is well recognized in Albania. To maintain growth, narrow regional disparities, and fulfill its aspiration to join the EU, Albania aims to strengthen its education sector so that it produces school graduates who can function effectively in labor markets, become active citizens, and contribute to strengthening Albania's competitiveness.

Wide-ranging education reforms have been initiated in recent years, including:

- curriculum reform, to make curricula more modular and relevant, including the introduction of a modern information and communications technology (ICT) curriculum in basic and secondary schools, equipping all schools with computer labs and Internet access, and providing basic and secondary schools with new science labs;
- improved teacher training, so that teaching methods focus more on creativity and discussion rather than the uncritical transmission of knowledge;
- more equitable distribution of resources across regions;
- improved learning conditions, with less crowded classrooms and less need for multiple shifts in schools;
- increased average teacher salaries by 67 percent (or 49 percent in real terms) between 2005 and 2009; and
- renewed content and administration of the Matura examination upon leaving secondary school to improve relevance and ensure objective results.

Major higher education reforms have also been initiated. The focus has been on the effective adoption of the Bologna process for modular education that is compatible across Europe, the expansion of the number of enrolled students in higher education, and the introduction of short-cycle, sub-degree programs in regional universities.

In higher education, there is also a focus on increasing the efficiency and accountability of higher education institutions, including by introducing a revised per student financing formula, establishing external advisory boards, setting up an accreditation system for universities, and developing university ranking procedures.

Challenges: Improving Education Quality

The average Albanian has about ten years of schooling, which is comparable to other countries in the region but significantly below the EU average. Secondary enrollment rates remain low.

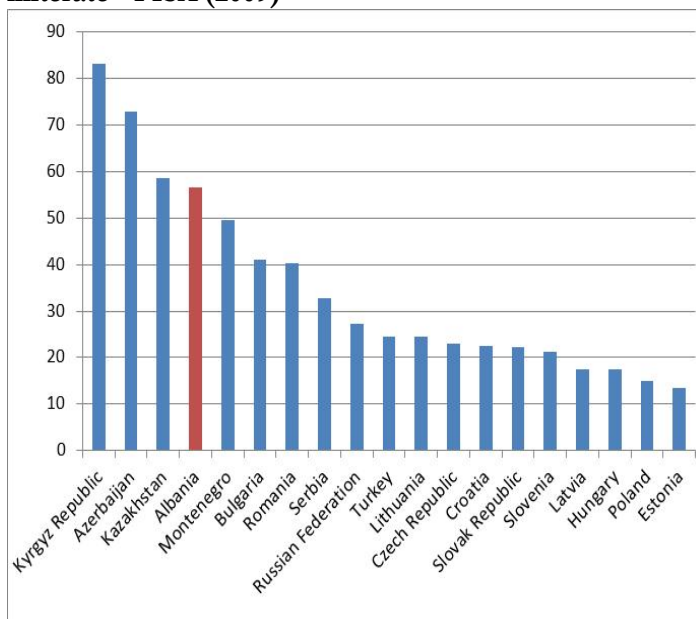
Albania's public expenditure on education, at around 3 percent of GDP, is only about half of what the other countries in the region spend on education. Only Armenia, Georgia, and Bosnia and Herzegovina spend less on education.

Despite important gains over the last decade, Albania's quality of education is still considered inadequate relative to the market needs. It has a considerable gap in educational outcomes when compared to other countries in the region, as reflected in its low ranking in the 2009 Programme for International Student Assessment (PISA) results (Figure 1).

In the 2008 Business Environment and Enterprise Performance Survey (BEEPS), more than half of the firms in Albania reported lack of skilled labor as an impediment for doing business. In the 2009 Investment Climate Survey (ICS), 51 percent of large firms, 41 percent of exporters, and 48 percent of foreign-owned firms reported skills as a major obstacle. Over 35 percent of firms that acquired new technology cited workforce education as a major constraint.

These surveys suggest the quality of education should be improved and aligned with the needs of the labor market. While increased allocation to education is warranted, improving the efficiency of current public spending in the sector is just as critical.

Figure 1: Percent of 15 year olds that are functionally illiterate - PISA (2009)



Notes: % students scoring “below level 2” on reading test.

Source: “Skills Not just Diplomas”, based on OECD Program for International Student Assessment (PISA) 2009

Education Excellence and Equity Project (EEEP)

Since 2006, the World Bank has supported a comprehensive range of reforms in the education sector in Albania through the EEEP, which is also financed by the European Investment Bank (EIB), the Council of Europe Development Bank (CEDB), and a substantial contribution from the Government. The total project amount is US\$75 million.

The objectives of the project are to support the Government of Albania’s program: (a) to improve the quality of learning conditions for students; (b) to increase the enrollment of students in general secondary education; and (c) to initiate higher education reform. The project covered basic, secondary, and higher education levels and its implementation arrangement reflected the government’s efforts to decentralize the sector.

The project has achieved the following results to date:

- Increased institutional capacity of the MoES to carry out its functions as well as to implement internationally-financed projects.
- Revision (on-going) of the basic education curriculum to ensure vertical and horizontal alignment.
- Establishment of teacher professional standards.

- Strengthened culture of student achievement exams within the education sector.
- Elimination of triple shift and reduction of double shift from 34% to 14% in basic education and from 8% to 6% in upper secondary.
- Increased equality in computer access between urban and rural areas for secondary students from 46 students per computer to 14 in urban areas, and from 143 to 13 in rural areas.
- Revision and implementation of the secondary education curriculum, and more closely alignment with European standards.
- Preparation and approval of the pre-university law.
- Development and approval of a higher education strategy.
- Provision of teaching learning equipment to 10 public universities.

The World Bank’s support for the EEEP closed on June 30, 2013 and the EIB and CEDB programs will close on December 31, 2013. Important lessons learned will be highlighted in the implementation completion report by early 2014, to inform future engagement in the sector.

Priorities Going Forward

Below is a list of key education reform “pressure points”:

1. *Improving Learning Outcomes in Early Grades*

Children who participate in quality Early Childhood development (ECD) programs have higher cognitive development and overall school readiness on primary school entry, lower repetition and dropout rates in the early grades, greater learning in school, and higher school completion rates (Camilli, 2010) (Loeb, 2007). Early childhood education (ECE) is a critical component of ECD programs and has the potential to contribute towards ensuring primary school readiness. In Albania, pre-school enrollment covers less than 60 percent of children, compared to the OECD average of approximately 84 percent (OECD, 2012).

While enhancing access to ECE programs is important, the key is assessing whether pre-school education is improving students’ ability to reap the benefits of education in subsequent years. Similarly, assessing early grade literacy, no later than at grade three, ensures that students can use their literacy as a building block for learning in upper grades.

The expansion of quality ECE and improving early grade literacy are two interventions with proven positive impact throughout a person's life, and such interventions are much more expensive to make up later. There are good examples of early childhood education student assessment instruments that have been implemented with success in Canada and Australia.

The **Systems Assessment for Better Education Results (SABER) Early Childhood Development Assessment** and technical assistance for implementing the Early Childhood Instrument (EDI) or Early Grade Reading Assessment (EGRA) could assist the government to diagnose the cross-sectoral efforts to ensure primary school readiness across five key domains (physical health and well-being; social knowledge and competence; emotional health/maturity; language and cognitive development; and general knowledge and communication skills), as well as to ensure that early literacy is mastered at this critical period.

2. *Enhancing Teacher Effectiveness*

Teacher effectiveness is the most important school-based predictor of student learning. A good teacher can get 1.5 years of learning growth in one year; a bad teacher gets as little as 0.5 years.

In most successful education systems such as in Finland, Singapore, and Korea, only the top 10-30 percent of students are hired as teachers. The most successful countries have a good balance between pre-service and in-service teacher training, and most importantly, do not only rely on certifications or years of experience to assess the quality of a teacher. Some countries deploy their best teachers to reach the most disadvantaged students, but ensure they are compensated accordingly.

It is important to understand what effective teachers do in Albania and make their behavior the norm. This is particularly important as the impact of curriculum reforms mostly depends on teachers' ability to impart those changes to the classroom. **SABER Teacher Policy Assessment** is a good first step for diagnosing the strengths and weaknesses of Albania's approach to teacher recruitment, development, deployment, and management.

3. *Strengthening the Linkage between Post-Basic Education and the Labor Market*

Although jobs creation requires strategic skills development and an enabling environment, which are often beyond the

control of the education system, education policy makers will need to take on key challenges in workforce development to support the engines for Albania's future growth.

Equipping the workforce with job-relevant skills is a continuing challenge around the world. In particular, mismatches in skills demand and supply are a persistent concern. Many school leavers and graduates are unable to find jobs commensurate with their education and training. Employers, for their part, complain of difficulty in filling their vacancies and bemoan the scarcity of "soft skills", which are considered essential for productivity in today's global economy. More broadly, skills constraints are making it difficult for companies to innovate and move into more lucrative areas of economic activity.

Curriculum reforms at the secondary level supported under the EEEP Project were a first step toward establishing a closer relationship between the skills produced within the education system and those required from the labor market. As a next step, applying the SABER Workforce Development would help Albania improve its framework for producing a dynamic and flexible workforce that meets its economic and social development needs. A comprehensive **Skills Towards Employment and Productivity Assessment**, covering early grade development to higher education, is also possible.

4. *Building on the Foundation of Higher Education Reform*

The catalytic potential of higher education reform to meet national development goals is currently underutilized in Albania. In addition to serving as a key bridge between the growing number of basic education graduates and the labor market, an enhanced higher education system is essential for improving the lower levels of education, in particular through teacher training and more generally as a preparation stepping stone for advanced opportunities.

A relevant and cost effective higher education system is a driver for workforce development, a powerful tool for addressing youth unemployment and unrest, an implementable pro-poor policy context with broad economic ramifications and critical for maintenance of on-going investments in Albania. An improved higher education system would thus contribute to the government's efforts to alleviate poverty, improve social cohesion, and reduce vulnerability to vagaries of its current fragile condition.

Building on the foundation of the EEEP, it is critical to continue implementing reforms foreseen in the Higher Education Master Plan. Such reforms seek to strengthen quality assurance mechanisms, increase autonomy and accountability of higher education institutions, and promote efficiency in the allocation of resources. As a priority, the roll out of the financial reforms, particularly the adoption of the revised funding formula for higher education institutions along with the establishment of a student loan scheme, would set the stage for further reforms in the sector, consistent with the goals of the Bologna Declaration.

The World Bank will be ready to support the Government of Albania with a range of key reforms. As a starter, the Systems Assessment for Better Education Results (SABER), a dynamic collection of tools that collects and analyzes information on system-level education policy and institutional choices, could be applied in Albania to further inform education reform. SABER offers detailed analysis of key indicators in 13 policy areas to enable comparison across countries or over time. Data have been collected and analyzed in over 100 countries so far.

As the EEEP draws to a close, the World Bank stands ready to support the Government of Albania to build upon its achievements to identify future education reform priority areas. Drawing from the lessons learned on project design and implementation arrangements, a new project is expected to continue to improve student learning outcomes in Albania

5. *Enhancing Monitoring of Learning Outcomes across Education Sector*

Human resource development is a complex process and education investments sometimes take time to show results. The Government of Albania will need to continue to monitor student learning outcomes regularly to gauge the effectiveness of its education reforms, from early childhood to post-basic education.

Albania can draw on the experiences of other countries that have implemented a variety of student learning instruments. In particular, an assessment of primary school readiness and early grade literacy would provide beneficial information on the effectiveness of investments for 3 to 9 year-olds and ensure that they are gaining the requisite skills during a critical period of cognitive and behavioral development.

While the results of the 2009 Programme for International Student Assessment (PISA) raised concerns regarding education quality in Albania, a trends analysis using the 2012 PISA results will allow the government to gauge whether more recent reform efforts are having the intended effects. A rigorous determinants analysis of the 2012 PISA results would provide the government with requisite information for further policy reform.

Recommendations / Way forward

Immediate actions

- Increase basic education spending within available fiscal space – particularly for non-wage recurrent costs to improve student learning -- and improve equity of allocation among regions.
- Undertake analysis (including using 2012 PISA) to assess progress and prioritize medium-term reforms.
- Undertake SABER assessments to diagnose priorities for sector reforms (e.g., Early Childhood Development; Teacher Policies; Workforce Development, etc.).
- Ensure successful implementation of the Education Excellence and Equity Project (EEEP), and build on lessons learned.

Medium-term actions

- Implement reforms to improve quality of teaching and learning, and to increase enrollment in primary and secondary education
- Strengthen early childhood education and development programs
- Manage expansion and quality of tertiary education, and strengthen links between post-basic education and the labor market
- Address job-specific skill gaps of youth and adults, including through:
 - More effective training
 - Better information on job prospects
 - Target disadvantaged groups
 - Develop market for adult education and training services
 - Addressing disincentives and barriers to employment

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Albania: Land Policy

July 2013

The World Bank Group



Policy Brief

Background

Land reform, security of land rights and development of the land market are key aspects for economic growth and investment, as well as social and political stability, in Albania. While Albania made rapid progress in post-1991 land reform and privatization programs, unresolved issues such as restitution/compensation and legalization remain impediments to investment, social stability, and European Union accession discussions.

Land reforms began in 1991 when the newly elected parliament reintroduced private ownership. The privatization process had four main components:

- Law 7501, dated 19.07.1991, On Land, divided agricultural lands amongst the workers and their families, effectively granting private ownership rights to two-thirds of the population.
- Law 7512, dated 10.08.1991, On Sanctioning and Protection of Private Immovable property, Free Initiative and Independent Private Activities, facilitated the sale of business sites and has subsequently been devolved to municipalities/regions that have the right to privatize certain categories of land.
- In urban areas, Law 7652, dated 23.12.1992 On Privatization of State Owned Housing, resulted in the privatization of around 440,000 apartments and houses.
- Laws 7698, dated 15.04.1993, On Restitution and Compensation of Properties to Former Owners and 7699, On Compensation of Former Owners of Agricultural land (replaced by Law 9235, dated 29.07.2004, On Restitution and Compensation of Immovable Property, as amended) is the other main component in the privatization process. In principle, restitution is possible for urban land or 'land within the yellow line'. Due to the early policy decision to privatize agricultural land to the workers of the cooperatives and

state farms under Law 7501, there is no right to restitution of agricultural land; rather former owners are to receive compensation.

Later legislation introduced the land administration framework and further land allocation/privatization programs:

- In order to secure land rights and facilitate development of the land market, Law 7843, dated 13.07.1994, On Immovable Property Registration (recently replaced by Law 33/2012) created an integrated mapping and registration system under the Immovable Property Registration Office (IPRO) with 35 district offices administering information to over 4.5 million properties.
- Law 9482, dated 3 April 2006, On Legalization, Urbanization and Integration of Illegal Constructions, as amended, was adopted in order to legalize illegal constructions that meet the defined criteria, to transfer ownership of the land on which illegal constructions are built and to develop urban plans for informal settlements.

Land Policy

Current land policy is defined in the Cross-cutting Strategy for Reform in the Field of Property Rights 2013-2020 (Strategy) and the related Action Plan (AP), approved in June, 2012. Overall the Strategy and Action Plan provide a vision and plan for reforms that are useful for both the government and the international community. The Strategy clearly outlines the problems and provides a list of policies and activities to resolve them. While there is debate as to whether all of the policies are fully defined or reasonable in the current context, the documents nevertheless provide a basis for dialogue, project planning, investments and

monitoring. Both the World Bank and European Commission use the Strategy in their current project planning processes. The Strategy and Action Plan should not be considered static documents; rather they require periodic updating and improvements as the situation changes. There are five strategic aims in the Strategy:

1. *100% completion of national systematic first registration within 2013, creation of the electronic Immovable Property Register and improved functions of Immovable Property Registration Offices IPRO.*

Reforming the IPRO and completion of First Registration and the IT system are fundamental steps to secure property rights and support the land market and investment. The IPRO is now a self-funding agency with a Steering Board to provide policy and institutional oversight. IPRO needs to operate under a modern business model and as such requires a Business Plan and Mid-term Strategy to set its priorities and allocate resources so it can provide efficient and transparent services to both public and private sector clients. Special attention needs to be given to human resource development and ensuring the highest level of professionalism for registrars and staff.

Completion of First Registration for the remaining cadastral zones requires additional policy and legal/regulatory support. Most forests/pastures have not been registered and the process requires a regulatory framework to determine administrative boundaries as well as to easily recognize the rights of users who are often from the most vulnerable groups who rely on forest products for their livelihood. First Registration also remains incomplete in the valuable Southern coastline. The European Union (EU) funded First registration activities in this area but the project closed without any registrations completed. Thus, a strategy to review the data and complete registration in the coastal zone should be a priority for this important national resource.

The IPRO IT system (called ALBSREP) was designed with the support of the World Bank and its partners. The software was developed internally by a team of local experts, advised by international consultants and independent quality assurance and control. ALBSREP uses the government data centers and is the first in Europe to comply with the 2012 official International ISO Standard 'Land Administration Domain Model' (LADM). The system is centralized and has been installed in 5 offices as of June, 2013 with the purpose of maintaining data coming from First Registration. It has modules to increase efficiency and transparency such as

document management and online application tracking systems as well as online connections for notaries and other approved institutions. Further e-services are planned and can be integrated into a wider e-government strategy. The IT system, along with the IPRO institutional reforms, will be the basis for creating the modern registry that protects property rights and supports economic development and investment.

One of the biggest challenges remains the pre-2011 registration data (data for approximately 2,300 out of 3,200 total cadastral zones). These data (maps and *kartelas*) are kept in manual form and are often of poor quality or damaged by daily use. Thus, a strategy to digitize, update and upgrade the data is urgently needed so it can be uploaded and maintained in ALBSREP. The European Commission (EC) and World Bank have a pilot activity planned for data improvement that require the full support and engagement from the government.

2. *100% completion of temporary processes at the national level: recognition of property of expropriated subjects within 2014, release (by current occupants) of houses of former-owners within 2017; legalization of informal buildings within 2013 and verification of (agricultural land) property titles within 2013.*

Overall, the institution structure for administration of property rights requires consolidation and better management. There are too many institutions responsible for allocating and managing immovable property which has led to gaps and overlaps in responsibility and weak coordination. Consolidating the 'temporary processes' into a single strategic aim is a logical step in the Strategy, although these activities require further legal, technical, policy and financial support for completion. Ultimately it would be more efficient to consolidate authority and responsibility to a single ministry or authority. There are also some fundamental policy issues that need to be addressed. Specifically,

Restitution and Compensation: The Strategy recognizes the need for improvements and restructuring of the Property Restitution and Compensation Agency (AKKP/PRCA) in order to finalize the restitution/compensation process. However, the main impediments to a final solution remain the lack of resources dedicated to the AKKP and the policy to compensate at full, current market value (see next Strategic Aim).

A second area for concern is the recent policy and legislation to evict the current occupants for former-owner housing. Although the Strategy makes reference to respecting

international standards and safeguards, the initial reports show that long-term residents have been evicted from their homes without following international standards such as receiving the promised support for the eviction (whether cash, alternative housing, loans etc.) prior to vacating their current residence.

Legalization: The completion of the legalization process requires additional effort, including improving the performance of the Agency for legalization and Urbanization of Informal Areas (ALUIZNI). While there has been progress on creating legal/technical files for legalization, there are a limited number of properties that have been legalized and officially registered in IPRO. In order to complete the process, the unresolved legal and technical issues between IPRO and ALUIZNI regarding the transfer and registration of ALUIZNI documents into the IPRO legal and mapping databases must be solved. In addition, there needs to be a clear policy and actions on what to do with illegal properties that fall outside the competence of ALUIZNI as well as the prevention of further illegal buildings. The Strategy mentions better coordination between territorial planning, approval of building permissions, enforcement by construction police and registration, but a clear plan on how to manage this complex process that involves several institutions still needs to be elaborated.

3. Creation of a unique effective compensation scheme within 2013 and beginning its implementation based on a consolidated physical and financial fund for the expropriated subjects even through reforms to the method of valuation of immovable property based on the market value and on the process of inventory of state property.

The first step that is needed to finalize the compensation scheme is to calculate the cost on the basis of the recently adopted land value maps. Cash compensation will be extremely difficult due to the unrealistic policy to compensate at current, full market value. No other country in the region adopted such a financially demanding compensation policy that diverts money that could be used for other investments. The international community has repeatedly encouraged the government to review this policy, and possible alternatives, as part of the approval of a new permanent scheme on compensation. The basis to begin that discussion is the calculation of the cost to compensate outstanding claims.

Other options such as the creation of the state fund for in-kind compensation must be supported by the inventory of

state property and approved urban/territorial plans for the areas subject to compensation in-kind.

4. Strengthening and protection of the property rights system until the phase of execution (of decisions) according to the standards of the European Court of Human Rights (ECtHR) in compliance with the Cross-Cutting Strategy of Justice in order to increase security to property acquired by law and related investments, and dynamism of the land market within 2020.

Albania's future accession to the EU will require compliance with the European Court rulings. The government needs to establish the list of final judgments or administrative decisions on compensation of former owners as per the Council of Europe/ECtHR request. Once again, the main problem with complying with the ECtHR ruling stems from the policy to compensate former owners with current, full market value which is practically impossible for the government to implement due to the high cost. The ECtHR has clearly stated that no government is required to compensate former owners at such a level. Thus, it is solely an internal political issue that needs to be addressed in order to develop a practical and sustainable solution.

5. Modernization and improvement of information, through 100% digitalization of systems that have immovable property information, including maps, according to the standards of the INSPIRE directive, in order to benefit from SDI capabilities, until year 2020.

On the European level, the INSPIRE Directive 2007/2/EC binds EU Member States to establish and provide geographic data in a standardized way. Most countries in the region are developing initiatives to widen access to and use of geospatial information. New legislation in Albania follows INSPIRE principles and now requires implementation. The work under Strategic Aim 1, completion of First Registration and the IT system (ALBSREP) are integral steps in the process. In 2012 the IPRO was assigned the responsibility for ALBPOS, the geographic positioning system that will facilitate better collection of spatial data using the national coordinate system. Land administration information is a fundamental component of the National Spatial Data Infrastructure (NSDI) and the information produced and distributed by registration/cadastre and mapping authorities represents above 85 percent of the so-called reference data (base maps) for the NSDI field.

Recommendations / Way forward

- Review and Update the *Cross-Cutting Strategy in the Field of Property Rights 2013-220*. In addition to setting reasonable deadlines for activities, there are some fundamental policy issues to address:
 - Institutional structure for administration of property rights: A successful solution will require a strong focus on ensuring effective and consistent implementation of policies and laws. It will be important for the Government to enhance coordination between IPRO, ALUIZNI, and AKKP, possibly by combining these agencies or subordinating them under a single ministry.
- Support and Oversight of IPRO
 - Develop plan for completion of First Registration, including forests/pastures and the Southern coastline. Completion of First Registration in the southern coastline should include the data from the EU funded project.
 - Complete roll out of the IT system (ALBSREP) to remaining offices and continue to develop e-services.
 - Adopt IPRO Business Plan and Mid-term Strategy as well as the regulations required under Law 33/2012.
 - Develop Data Quality Improvement Program: adopt regulations and implement the pilot programs in cooperation with the World Bank and EC; determine strategy for national roll-out
 - Develop and implement an institutional training and certification program for IPRO registrars and staff
 - Complete installation and functions of ALBPOS (Albanian Positioning System)
- Approve a final, sustainable solution for restitution/compensation.
 - Calculate and budget for the cost of the compensation process on the basis of the recently adopted land value maps
 - Review the policy related to compensation at current, full market value and make a thorough cost/benefit analysis to guide policy revision.
 - Create the state fund for in-kind compensation, ensuring that areas subject to compensation in-kind have approved territorial/urban plans.
 - Review the current Evictions process to ensure that occupants of former owner housing receive fair compensation based in international standards
- Complete the current legalisation process within realistic deadlines and with a cost policy study on the need for future interventions (i.e. a policy decision on the 100-150,000 illegal constructions not included in the actual process)
- Consolidation and consistent implementation of a national policy for territorial planning.
- Establish the list of final judgments or administrative decisions on compensation of former owners (CoE/ECtHR request).
- Support the EU INSPIRE Directive: appoint members of standards committee and approve standards for data collection, sharing, use, storage, indexing (metadata). Use IPRO data as the base layer of information and build data and services as available and needed; Improve policy implementation and operational cooperation among the different agencies by ensuring compatibility of maps and digital geographical information used.

References: Government of Albania “Cross Cutting Strategy for Reform in the Field of Property Rights” (June, 2012), Stabilisation and Association Agreement (Article 1.3 on the immovable property market) and the National Plan for the Implementation of the EU-Albania Stabilisation and Association Agreement, World Bank Issue Brief, “Governance in the Protection of Immovable Property Rights in Albania: A Continuing Challenge” (March, 2012), World Bank Land Administration and Management Project (LAMP) documents (PAD, Aide Memoires).

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Albania: Water Resources and Services

September 2013

Policy Brief

Overview: The Importance of Water Resources

Albania is endowed with substantial water resources, equivalent to an estimated 8,600 cubic meters per capita per year, of which it withdraws only 6 percent annually. However, it is also one of the country's most vulnerable to climate change impacts and how it manages this finite resource in the decades ahead is becoming increasingly important.

Albania has an annual average rainfall of 1,485 mm¹, but only about 20% falls during the summer period, making irrigation indispensable for agriculture. Agriculture contributes 21% to GDP and 58% to employment.

Water resources play a key role in the country's economy: about 95 percent of the total electricity production is generated from hydro-power plants mostly on the Drini, Mati and Bistrice rivers, and about 50 percent of cropland is irrigated producing about 80 percent of agricultural output, corresponding to 17 percent of GDP.

Adapting to Climate Change

Climate change is expected to significantly affect poverty reduction and economic growth. Analysis of recent climate data confirms that temperatures are increasing in Albania, with average warming over the next 40 years of about 1.5 °C. Changes in precipitation are more uncertain. The medium impact forecast indicates a decline in precipitation nationally of about 50 mm per year, with most of this decline occurring in the lowlands. National and annual averages are less important for agricultural production than the seasonal distribution of temperature and precipitation.

Water Resource Management

¹ Roughly equivalent to 2.12 times the average rainfall in Germany

As a result of Albania's recent rapid economic growth, increase in population and urbanization, seasonal water shortages and water abundance have magnified serious weaknesses in the management of Albania's water resources.

One of the main weaknesses in the management of water resources is the absence of a cross-sectoral framework with broad stakeholder involvement. Responsibilities are not clearly divided, and investment decisions related to water are often made on the basis of single sector considerations, leading at best to suboptimal investments, and at worst to a waste of limited public resources. In an environment of economic development and climate change, these weaknesses have become key obstacles to growth. They also constitute Albania's most important challenge in meeting the EU's accession requirements as embodied in the Water Framework Directives (WFD).

Albania will need to significantly strengthen its current policy, institutional and strategic framework as it relates to water, including a clear allocation of responsibilities, an effective and inclusive mechanism for decision making and enforcement, plans for river basin management and strengthened capacities of key stakeholders. Doing so will help Albania make sectoral investment decisions in a more rational way, while capturing multi-purpose benefits.

Irrigation and Drainage (I&D)

Irrigation is the largest user of water by far, accounting for close to 40 percent of all abstraction. Irrigation and Drainage (I&D) consume a large share of public resources to maintain, upgrade and operate canals and secure the safety of dams and flood protection systems. Since 2000, aggregate expenditure in I&D exceeds US\$ 240 million. The Bank has been the main partner of the Government of Albania in modernizing I&D system and institutions, with three consecutive projects between 1994-2009, amounting to US\$ 112.4 million.

Yet, I&D performance continues to disappoint. Out of an estimated 360,000 ha that have been equipped for irrigation, in 2009 only 80,000 ha was irrigated. The main weaknesses in the I&D sector include: (i) poor quality of I&D service delivery; (ii) poor condition of I&D schemes, with many canals and pumping stations no longer operational; (iii) safety concerns of many of the about 626 agricultural dams; and (iv) weak capacities of WUOs with poor O&M cost recovery. The Water Resources and Irrigation Project (WRIP), which has recently become effective, is designed to help address these issues and promote integrated water resources management

Water supply and sanitation (WSS)

Water and sanitation service coverage is generally good. Over 80 percent of the total population is connected to network water supply, including 91 percent in urban areas, but only 57 percent in rural areas. Despite relatively high service coverage, poor quality of service remains a key challenge, due to high non-revenue water (NRW) which is approximately 65 percent (against an EU benchmark of 20%), limited duration of supply at only 11.2 hours per day (against an EU benchmark of 24 hours/day), and poor cost recovery due to very low metering coverage (44 percent national average against an EU benchmark of 100 percent). A principal cause of this service deficit is under-investment in the water supply and sanitation systems, as well as weak operations and maintenance of the existing system. Another factor is the highly fragmented institutional arrangements (including over 50 utilities) and delivery systems in the sector, which do not benefit from economies of scale and efficiency of operations in many cases.

The National Water and Sanitation Strategy for 2010-2016, which was prepared with technical support from the World Bank, sets out to dramatically reverse this situation. The Strategy determines the following priorities: (i) expand and improve the quality of water supply and sewerage services; (ii) orient water utilities toward principles of cost control and cost recovery; (iii) improve governance and regulation in the sector; (iv) invest in enhancing the capacity of the sector work force, and (v) move toward convergence of Albanian laws and regulations with EU Water Directives.

A second major step forward was the development of a National Master Plan for capital investments in the water and sanitation sector, which was completed in 2012 and prepared

with the support of KFW. A key contribution of this plan was to help prioritize investments and ensure rural areas that don't benefit from utility services would not be overlooked in investment planning.

The World Bank provided support for a number of investment operations, dating back to 1994, to help rehabilitate and maintain existing systems, as well as to support network expansion to boost coverage of the population served. Oversight of the sector and a key strategic planning and monitoring tool of the GOA is the Performance Monitoring and Benchmarking Unit (PMBU), which was established under a World Bank-financed operation and remains until today as a good practice model of sector monitoring thanks to the effective efforts and due diligence of the team that collects the data quarterly and prepares comprehensive sector monitoring reports.

The Water Sector Investment Project (WSIP) has been prepared with a view to having a significant impact in the Durres area and on institutional arrangements and viability in the sector as a whole.

Recommendations / Way forward

It is important to lay the foundations for more rational and accountable water resources management, improve the performance and financial viability of I&D and WSS services, explore linkages between the two in a mutually reinforcing manner, and strengthen the administrative and management capacities on national and local levels.

Addressing weak governance and institutions in the water resources, irrigation and water supply sectors will help the country satisfy requirements associated with EU accession and remove some of the obstacles to growth. Doing so is urgent, as climate change will require strong sectoral and cross-sectoral governance to ensure rational allocation of limited water resources and reduce flooding, and as dam safety is threatening to undermine the sustainability of the irrigation sector.

Immediate actions could include:

- Establish database of water resources and prepare river basin management plans for key river basins
- Strengthen capacity for integrate water management
- Initiate a nationwide Water Demand Management Program with universal metering campaign for utilities
- Prioritize & Commit to Multi-Year Investment Plan to address critical infrastructure deficits, improve service standards and reduce water losses, focusing on reform in Durres
- Initiate an Institutional Reform Agenda for water utilities and focus on a cross cutting organizational structure.

Medium term actions could include:

- **Water Resource Management.** Lay the foundation for rationale and accountable water resources management, including (i) preparing a national strategy for integrated management that will be (i) supporting agricultural reform (ii) improving quality and accountability of service delivery and (iii) strengthen capacity in integrated management
- **Flood Management.** Improve dam safety to mitigate flooding and promote more efficient uses for irrigation
- **Water Utility Management:** explore different institutional models of bundling/unbundling services, including ,where appropriate, private sector participation options for water utility operations (an option in regional utility consolidation approach)

- Identify suitable irrigation PPP projects for the operation and maintenance of both the primary and secondary irrigation water supply systems. The irrigation network should preferably service commercial farmers raising high value fruit crops for sale into the European market.
- As part of PPP advisory, develop a clear and concise set of standards for both the operation and maintenance of the system by a concessionaire in a cooperative manner with the water users and the commune, which may also require the development of a framework for the collection and dispensation of water tariffs. Assist in identifying and selecting suitable operators/investors based upon a pre-agreed transaction structure.

The WSIP would devote over euro 60 million to increase the water supply capacity to Durres City and surrounding areas and to reduce the current supply deficit of 10.4 million cubic meters per year. Thus, the second largest city and prime summer tourism destination will address the persistent water supply problem which is currently approximately at only 4-6 hours per day.

The WSIP would also help address water and wastewater network losses due to dilapidated segments of the network that require urgent repair and/or replacement. Preparation of a hydrological and network model for the Durres Water Utility under WSIP would help identify critical network weaknesses and losses, as well as supply/demand mismatches in the system, pointing to ways of improving efficiency of operation and means of reducing water and energy consumption.

WSIP would also support separation of wastewater and storm water networks in critical areas around the City of Durres will mitigate the flooding and sewage overflows the city experiences during heavy rain events. Finally, the WSIP would provide technical assistance to the management and performance improvement of the Durres Water Utility (DWU); clarifying the roles of the central and local governments; promoting metering and Non-Revenue Water reduction; and addressing the current stalemate in the decentralization agenda.

The Water Resources and Irrigation Project (WRIP) and the

Water Sector Investment Project (WSIP) present two important instruments to implement the needed reforms and investments, and promote a coordinated approach to water management.

Specifically, **the WRIP** will support the measures to:

- Accelerate economic and agricultural reforms to enhance profitability of the agricultural sector
- Accelerate water sector reforms and strengthen capacities to improve the quality and accountability of public service delivery
- Improve water management by adopting a more effective and integrated framework for Integrated Water Resources Management (IWRM)
- Prepare River Basin Management Plans for the Drini-Buna and Semani river basins
- Establish a Water Resources Database
- Improve I&D by optimizing the use of irrigation water, and modernizing I&D systems, including introduction of drip irrigation and improving efficiency

References:

- Institutional Review of the Water Sector
- Ministry of Environment, Forestry and Water Management: IWRM Position Paper
- Public Expenditure and Institutional Review of Irrigation and Drainage Sector
- Ministry of Agriculture, Food and Consumer Protection: I&D Position Paper
- PPP in irrigation management
- National Water and Sanitation Strategy
- World Bank Development Indicator

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Albania: Disaster Risk Management and Adaptation to Climate Change

September 2013

Policy Brief

Overview

Albania ranks as one of the top ten countries in the world with the highest economic risk from multiple hazards: 88.5 percent of GDP generated and 86 percent of total territory is exposed to two or more disasters¹. The entire country is prone to hydro-meteorological hazards (floods, drought, heavy snow falls, and extreme temperatures) and geological hazards (earthquakes and landslides). According to EM-DAT, during the period 1974–2013, more than 60 percent of disasters had of hydro-meteorological origin. The risk is compounded by the Albania complex topography because more than 70 percent of the territory is mountainous; in addition, according to the 2011 Census, the population in urban area reached more than 50 percent of the total. In the last five years, the main disasters that hit Albania were the devastating floods in Shkodra area (2010, 2011) and the forest fires (2012) in several areas of the country. Albania is among the most vulnerably countries to climate change in Eastern Europe and Central Asia, and suffers both from high exposure to increased climate extremes, as well as a high sensitivity to climate change. Temperature increases of up to 1.7 to 2.3 C are expected by mid-century, along with a significant decrease in precipitation (up to -6.9 to -5.3 percent by 2050). Considering that close to 95 percent of Albania's electricity is derived from hydroelectric power, this will pose additional challenges to power infrastructure. Increases in the variability of precipitation, steep topography, heavily populated low lying coastal zones, and reliance on water for energy and agriculture, mean that Albania is extremely vulnerable to climate change. In addition, Albania is expected to suffer from more frequent and severe droughts, extreme weather events (floods, droughts), and increased fire risk in forest and pasture areas. Sea level rise is likely to result in a loss of wetland and coastal forest areas (Lezha coast). The risks of climate change for the agricultural

sector are a particularly immediate and important problem because the majority of the rural population depends either directly or indirectly on agriculture for their livelihoods. The rural poor will be disproportionately affected because of their greater dependence on agriculture, their relatively lower ability to adapt, and the high share of income they spend on food. Climate impacts could therefore undermine progress that has been made in poverty reduction and adversely impact food security and economic growth in vulnerable rural areas. Recent flooding events in Albania have underscored these risks – although no single weather event of this type can be directly tied to climate change, an increase in extreme temperature and rainfall events such as these are consistent with the best known science of the impacts of climate change.

While information on risk to natural hazards in Albania remains patchy, available data shows that the risk level is increasing and is comparatively higher in Albania than in neighboring countries². Albania ranks 41st in the world in terms of vulnerability to landslides, 43rd in terms of earthquakes and 58th in terms of drought risks³.

Disaster Risk Management and Adaptation to Climate Change

A national law on “Civil Emergencies” was adopted in 2001 (n. 8756) and a General Directorate for Civil Emergency Planning and Coordination (“GDCE”) was created within the Ministry of Local Government and Decentralization (currently, within the Ministry of Interior). At the national level, the Council of Ministers has the overall responsibility

² Two reports outline the level of risk to natural hazards and capacities in disaster risk management in Albania (1) Disaster risk assessment in Albania, UNDP, 2003 and (2) Disaster Risk Reduction Capacity Assessment Report for Albania, UNDP 2011

³ Global Assessment Report, UNISDR, 2013

¹ “Natural Disasters Hotspot – A Global Risk Analysis” - World Bank - 2005

for civil emergency planning and response. During emergencies, the Council of Ministers is responsible for declaring disasters and establishing an Inter-Ministerial Committee to coordinate the response at the central level. The GDCE has three main bodies: the Civil Emergency Planning and Coordination Directorate, the Directorate of Fire Rescue Services, and the National Operations Center. Although the GDCE has no authority over the work of other line Ministries, they are responsible for coordination across all Ministries. At regional level, in the 12 counties (Qarks), the Prefects are responsible for civil emergency management.

In 2004, the Council of Ministers adopted the National Civil Emergency Plan. The Plan defines the roles and duties of all relevant government institutions and civil organizations involved in all the phased on emergency management. In addition, several Ministries and institutions have different Civil Protection responsibilities and incorporate some Disaster Risk Reduction elements related to specific hazards into their plans and policies. For example, the Ministry of Agriculture, Food and Consumer Protection (MAFCP) is responsible for flood risk mitigation and protection investments in the rural areas (e.g. within the Drini Buna River Basin) along with drainage and irrigation systems. The Institute of Geosciences, Environment, Water, and Energy (IGEWE) is the official forecast and monitoring agency for hydro-meteorological and geological hazards. A new draft National Strategy and Investment Program and a new draft law have been prepared and are ready for approval.

Climate change policy is developed through National Communications to the UN Framework Convention on Climate Change (UNFCCC) that deal separately with mitigation of GHG emissions and adaptation to climate change. Under the first and second National Communication, analysis has been carried out for each economic sector, scenarios for the future have been constructed, and measures have been proposed for mitigating and adapting to expected climate change.

According to the Inter-sectorial Environment Strategy, the main focus in addressing climate change is to improve energy efficiency in all sectors in order to reduce the demand for power and the level of emissions. The strategy also requires joint programs on increasing public awareness and enforcing

the relevant standards – such as for the insulation of buildings.

The World Bank has supported the government implement the Disaster Risk Mitigation and Adaptation Project (2008-2013) which helped improve Albania's institutional capacities to reduce its vulnerability to natural and man-made hazards and to limit future losses. Key accomplishments under the project include:

- Notable impact on the institutional development of the four implementing agencies: i) General Directorate of Civil Emergencies at the Ministry of Interior, ii) Institute of Geosciences, Environment, Water and Energy (IGEWE) at the Ministry of Education and Science, iii) Ministry of Public Works and Transport, and iv) Financial Supervisory Agency;
- National Guidelines and road map to fully replace the national building codes with the Eurocodes; the project supported the integration of the Eurocode 8, seismic design of buildings, and the Govt has now added four additional Eurocodes to comply with EU standards;
- The Disaster Risk Management Strategy and prioritized Investment Program have been developed by the Government;
- The new hydromet products meet WMO standards: Real Time Data along with the digitized historical data are available on the IGEWE website; the daily bulletins of weather alerts for wild fire and flood are daily transmitted to the emergency management authorities following EU standards;
- Regional efforts on catastrophic risk insurance are on track, with Albania the first of five countries to join the Europe Re. Modules of an Interactive Consumer Awareness and Education Website have been developed and a legal and regulatory framework has been completed; the draft law on insurance has been submitted for approval; other regional efforts are in the process to be finalized targeting to launch this regional program in 2014;
- Following the floods in Shkodra District in 2010, A GFDRR TF financed study on a comprehensive flood risk management in Drini-Buna river basin has been finalized, detailing options for medium-long mitigation measures to deal with the river basin with the highest risk of floods in Albania; and,

- Establishment of a National Emergency and Command Control and Training Center to improve daily monitoring and coordination during an emergency response has been completed and it is now fully operational.

The Bank has also supported two studies⁴ namely Looking Beyond the Horizon: How Climate Change Impacts and Adaptation Responses Will Reshape Agriculture in Eastern Europe and Central Asia; and [Climate vulnerability assessments: an assessment of climate change vulnerability, risk, and adaptation in Albania's power sector](#). Both studies show that Albania is among the most vulnerable countries to climate change and the country needs to adapt to such impacts both in the agriculture and energy sectors.

Key issues

Despite the achievement so far, there are still key issues in the realm of disaster risk management and climate change in Albania, which need to be addressed:

1. Lack of capacities in risk identification, reduction, preparedness and response: while the number of people exposed to disaster-prone areas is increasing, there is important gaps in the both human and financial resources to monitor, prepare and respond to a disaster at national and at local levels;
2. Institution set up: the institution responsible for forecasting and monitoring of all hydro-meteorological and geological events, IGEWE, is a research institution under the Polytechnic of Tirana, under Ministry of Education and Sciences, hence with a weak service-oriented approach;
3. Lack of awareness, knowledge and exchange of information on disaster risk reduction and civil protection.
4. Risk communication: Albania does not have a unified emergency call system, like 112 in EU, therefore emergency services are provided with significant delays due to poor risk communication capacity and management;

5. Old building stocks: infrastructure are vulnerable to earthquake since they were built without seismic provisions following out-of-date building codes; settlements are vulnerable to hydrological events because built without a disaster-resilient urban plan;
6. More frequent hydro-meteorological disasters: the increasing number of extreme weather events, the challenging topography, and the medium-high vulnerabilities and exposures of assets and people increase the likelihood of higher frequency and magnitude of wildfires, flash floods, heat waves and landslides; and,
7. Lack of national policy and legislation related to CC adaptation and mitigation; lack of a national system for monitoring GHG to meet EU requirements.

⁴ <http://www.worldbank.org/en/news/feature/2013/04/04/looking-beyond-the-horizon>
http://www.worldbank.org/en/country/albania/research/all?qterm=climate+change+energy&lang_exact=English

Recommendations / Way forward

Approve the new draft National Strategy on Disaster Risk Management Strategy and law on Civil Protection which provides the operational framework for improved risk identification, risk reduction, financial protection strategies and resilient recovery through reconstruction. The Government needs to ensure other key new laws and by-laws, on, *inter-alia*, water management, land-use planning and communication, as well as Albania's Climate Change Adaptation National Strategy are consistent and contribute to reducing disaster risk.

Strengthen the Disaster Risk Preparedness. The Disaster Risk Preparedness pillar will support: i) the local and national civil protection departments and their operations centers in better preparing for emergencies and responding to climate and geological related-hazards, ii) the communication campaign with citizens raising awareness and train civil societies and volunteers in emergency preparedness, iii) risk identification updating and disseminating risk maps and tools, and iv) support a unified emergency call system. Particular support will also be provided to fire-fighting capacity at local and national level, enable them tackling simultaneous events or large wildfire and strengthening the linkage with the fire-prediction service run by the Hydromet service.

Modernize the Hydromet and Climate Service services. The Hydromet and Climate Service pillar will continue supporting the capacity of the Hydromet service shifting the approach in probabilistic prediction of hydro-meteorological events, including wildfires and flashfloods, and providing early warning to key decision makers and citizens. Additional tools can also be produced, such as dynamic hazard assessment, linking in almost real time forecasting and prediction to preparedness and response.

Invest in Mitigation: Resilient and Green buildings. Investing in Risk Mitigation is an opportunity: international experience shows that each dollar spent in mitigation returns an average benefit of two to four dollars. The Risk Mitigation pillar will: i) continue supporting the integration of the Eurocodes (the European Building Codes) as a national building codes and streamline capacity building programs, ii) develop tools for vulnerabilities assessment and prioritizations of retrofitting works, and iii) pilot few 'green and resilient' retrofitting works, including climate changes adaptation measures and disaster-resilient features for key critical infrastructures, such a schools, hospitals and key public buildings.

Improve energy efficiency through greater use of domestic solar water heating, improved building standards, lower-energy appliances, and alternative heating sources other than electricity. Develop policies that promote **adaptation options** that will reduce the vulnerability of the agriculture sector to climate change like new and rehabilitated drainage and irrigation, changing of crops etc.

Improve upland watershed management to build climate resilience. Supporting local communes and user associations to implement improved and more sustainable land management practices, particularly in erosion prone rural areas, will provide benefits in terms of reduced land degradation and erosion, enhanced absorptive capacity and productivity of the landscape, and improved habitats for biodiversity. This in turn will help strengthen climate resilience and offer global benefits through increased sequestration of carbon. Better upland management of water, forests and pastures can also offer broader social gains and generate income for rural farmers and local communities through the introduction of payments for the environmental services that sustainable management of upland resources (e.g. reduced erosion) provides to downstream users (e.g. increased life span of downstream water infrastructure).

Work with local communities to manage forest and pasture to reduce the incidence of human induced fires. Reducing the incidence of and the associated direct emissions from forest fires provides an opportunity to improve forest cover and increase the size of the carbon sink, thereby contributing to global efforts to mitigate climate change. Implementation of Communal Forestry and Pasture Management plans can have carbon sequestration benefits, which can attract financing from the private corporate sector. Albania already has successfully demonstrated this through several carbon offset contracts with the World Bank administered BioCarbon Fund.

Plan for unplanned expenses, such as relief and recovery operations. In addition to the national contingency budget that Albania already has, it is possible to add an additional contingency credit line for catastrophic events. One well used and utilized by several countries Bank DPL product is the Catastrophic Deferred Drawdown Option (CAT DDO), which is a contingent credit line that provides immediate liquidity to WB IBRD member countries in the aftermath of a natural disaster. The CAT-DDO is a financial instrument that offers IBRD eligible countries immediate liquidity of up to \$500 million, or 0.25% of GDP

(whichever is less) in case of a natural disaster. The instrument was designed by the World Bank to provide affected countries with bridge financing while other sources of funding are mobilized.

References:

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Albania: Environment and Waste Management

September 2013

Policy Brief

Context

Albania is distinguished for its rich biological and landscape diversity and abundant natural resources. To achieve economic growth and sustainable development, the country is striving to develop and implement efficient methods and technologies that rely on the rational use of natural resources, taking both into account their quality and quantity, and minimize the impacts of resource use on the environment. Albania's natural endowment determines tourism development as one of the key priorities for the Government. A prerequisite to realize this goal is to improve critical environmental infrastructure and municipal services, protect environment and coastal resources and enhance the stewardship of natural and cultural assets.

Albania has made notable improvements concerning environmental management and infrastructure. However, there are important issues that remain to be addressed including:

- (i) Development and implementation of more effective policy and regulatory framework for environmental sustainability;
- (ii) Putting in place more effective compliance and enforcement mechanism, including economic incentives and monitoring system to safeguard public health, environment and natural resources;
- (iii) Improve environmental quality standards concerning air, water, soil and waste management in line with EU Directives
- (iv) Foster further the national policies and proactive responses to regional challenges of climate change.

Waste management Issues

The population increase and income growth and considerable migration towards the large and coastal cities in

Albania have resulted in **increased consumer behavior** and, therefore, **increased volumes** of municipal waste. The huge transformation of the economy of the country has been accompanied by changes and an increase in the consumption of consumer goods by the population: this is shown directly by the increase in the level of packaging waste of different products. The development of the infrastructure and construction sectors in the recent years has led to an increase of **construction waste**.

Albania has started to develop waste infrastructure by constructing **sanitary landfills**. Progress towards better waste management has been made in the startup of the construction of new landfills in some regions (Shkodra, Korca and Saranda). Notwithstanding, this humble beginning waste management remains a challenge for larger cities where waste landfills or dump sites were are not properly constructed and, thus, continue to cause environmental pollution. **Landfills uncontrolled fires** and toxic emissions from burning waste (e.g. dioxin, furans etc.) present a serious problem for public health. **Polluted water sinks and untreated leachate** from landfill pose even greater risk of polluting surface waters and groundwater and getting into the food chains. Most of the waste in **rural areas** is randomly disposed, pollutes the water course that are then transported to other places.

Hazardous chemicals and waste generated by the industrial sector and municipal wastes are disposed together with urban waste. Although Albania has a national legislation regulating management of chemicals and dangerous substances, there system for the management of hazardous waste remains ineffective and with limited coverage. There is lack of institutional capacity and national structure to address the collection, safe treatment, recovery and final disposal of hazardous waste. Industries such as oil, steel, mining, metallurgy generate millions of metric tons of waste. Industrial waste generation is estimated to 170,000 tons per annum of which 3-5 percent is the hazardous waste. Past mining and oil exploration activities resulted in accumulation of large quantities of waste and contaminated lands. The list of priority hotspots sites in Albania developed with the

assistance of UNDP/Dutch Government includes 35 hotspots. Environmental Impact Assessment and remediation plans were developed for 9 High Priority Environmental Hotspots.

The World Bank jointly with the Dutch Government has supported the Cleanup of Porto Romano contaminated site as one of the first actions undertaken by the government to address the legacy of environmental hot spots. Albania can use the experience gained during this operation to launch a national program for remediation of contaminated sites to address public health concerns and protect land productivity.

Albania has approved the **National Waste Strategy and Plan 2010–25**. Two interim targets were set to reflect the short-term need to focus on management of municipal waste: to increase the amount of waste collected by local authorities that is recycled or composted at 25% by 2015; and to increase the amount of waste collected by local authorities that is recycled or composted at 55% by 2020. Six regional waste management plans have also been prepared and to be adopted by the regional authorities.

The new law on Integrated Waste Management defined norms that regulate safe hazardous waste management and its collection, transport, recovery, treatment, disposal and export. Expenditure for the implementation of waste management strategic priorities is included in the budgets of MoEFWA and MoPWT. The two ministries share functions in the area of waste management. But local authorities are also responsible for development of local waste management plans, for collecting the waste and running the waste management infrastructure financed by tariffs.

Investments for the period 2007-2013 were anticipated to cover projects for closure and rehabilitation of existing municipal dumpsites, while construction of new facilities through donor funding. Overall the level of investments, including recurrent expenditure, need to be increased fivefold in order to achieve the strategic objective of 12 new regional landfills and closure of 65 existing dumpsites by 2020, as defined in the mid-term budgetary plan (MTBP) for 2012-2014.

Protection of coastal ecosystems

Taking into account the ecological sensitivity of the Mediterranean Region and development pressure on fragile coastal and marine ecosystems, Albania may consider expanding its current efforts to strengthen environmental land use planning and protection of its coastal resources. The benefits of rational use of these resources as well as controlling the impacts of pressure factors through appropriate and effective regulation and environmental

infrastructure would have positive effect on tourist development and economic growth of coastal areas. The Coastal Zone Management and Cleanup project which will close in June 2014 supports fundamental steps in this regard, but its impacts may be limited given the increasing investment needs and EU accession process. This effort would support the implementation of Albania's climate change adaptation plans.

EU accession

For all new EU member states the investments in environmental management and infrastructure (e.g., waste management, water supply and sewage treatment) dominate. In the old EU member states recurrent cost needed to run this infrastructure is commensurate with the size of investments.

Through the support of a EU funded project on "Implementation of the National Plan for Approximation of Environmental Legislation in Albania" (INPAEL) in 2010 a legal, administrative, institutional and cost assessment (or Directive Specific Implementation Plan - DSIP) of the transposition and implementation of two directives in Albania, namely Directive 1999/31/EC of 26 April 1999 on the landfill of waste and Directive on Urban Waste Water Treatment Directive (91/271/EEC). It is expected that the overwhelming majority of the costs will be the responsibility of the local governmental units/utility services. This is based on the assumption that local government units will not only operate and maintain the sanitation and solid waste infrastructure, but also to carry out the requisite investment.

Ultimately the increased municipal costs will be recovered from the users of the services in the form of higher charges for the services. In the short- to medium-term, when these costs are rising steeply, local governments can expect to obtain support in the form of grants and soft loans from the EU, IFIs and other bilateral and multilateral aid providers.

Recommendations / Way forward

Increase the effectiveness of enforcements and monitoring mechanisms stipulated in the environmental legislation.

Improve institutional coordination and administrative capacity for management of environmental quality.

Mobilize resources to address environmental public health tissues resulting from rapid urbanization, past and current industrial development .

Enhance policies and climate related action in environmentally sensitive areas ecosystems to expand tourism development potential of Albania.

Strengthen the budget share for the environmental infrastructure, initiate cross-cutting reforms and strengthen the administrative and management capacities on national and local level.

Bridge the growing gap between adoption of new environmental legislation and the institutional capacity to implement new laws and meet accession requirements.

Prioritize the reforms and investments needed to be undertaken now versus costly and heavier investments potentially eligible for transition periods to EU accession later.

References: Environmental Cross-Cutting Strategy, Integrated Water Resources Management Position Paper, Public Expenditure and Institutional Review of Environmental Sector; OECD Environmental Performace Reviews

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Albania: Power Sector

September 2013

The World Bank Group



Policy Brief

Sector Background, an Overview

Albanian Power sector was unbundled in 2006 and is regulated by an independent regulator, Electricity Regulatory Authority (ERE). The distribution assets were divested in 2008 through an international tender. The sector is operated by Albania Power Corporation (KESH) (generation side and wholesale supplier), Transmission System Operator (OST) (transmission network, power system and market operation) CEZ Shperndarje (CEZ Sh.) (distribution and retail supplier for tariff customers) and a number of independent Power Producers (IPPs). Both KESH and OST are joint-stock companies under the Ministry of Economy, Trade and Energy (METE); 76% of CEZ Sh. is owned and operated by a Czech public company, CEZ, with METE holding the remaining 24% of the shares. . By the end of 2012, Albania had seven eligible customers with annual consumption of 600 GWh per year (14% of all electricity sales). Many private companies are licensed to supply and trade electricity on the domestic wholesale market.

IPPs operate small-medium hydro power plants with a total installed capacity 135MW. Production was GWh 323 in 2012. There are two private producers which operate Ashta HPP (50MW) and two Cascades in Mat (49MW) and Bistrica rivers (27MW), generating GWh 220 and GWh 325 respectively.

Despite major reforms, the energy sector in Albania remains in crisis. It is technically unreliable, a drain on fiscal sources, technically and commercially inefficient, unable to meet growing demand from its own resources, and highly vulnerable to weather patterns.

Albania is totally dependent on hydro resources and regional imports pending the recommissioning of the Vlore thermal plant. In 2007, a severe drought cut domestic production from an average level of 4,200 GWh per annum to 2,900 GWh. In 2010 in an extraordinary wet year, domestic hydro production increased to 7,700 GWh, resulting in exports in that year.

In 2001-2010, Albania's electricity demand grew at about 2% per year; and in 2011-2012, demand growth increased to about 4% annually. The costs of covering growing electricity demand are particularly high in dry years when additional imports are needed to offset reductions in domestic hydropower production. In the absence of sufficient imports the system may need to resume load-shedding. Load shedding was last experienced in 2007, amounting to 900 GWh, or 14% of total demand, with major adverse impact on the economy and consumer well-being.

The Albanian Electricity Market Model (AMM), approved by the Government in early 2008, holds KESH responsible for overall security of domestic supply. Under the AMM, KESH operates as a power generation company (KESH-Gen) as well as a Wholesale Public Supplier (WPS). Contrary to the EU Directives, the WPS acts as a "single buyer" and buys the electricity produced by IPPs—at regulated price agreed in Power Purchase Agreements (PPAs—as well as additional electricity on the market to the extent needed to meet the retail demand. Consequently KESH/WPS effectively operates as the "supplier of the last resort" and bears the full hydrological risk.

Historically, the sector has been characterized by high a level of distribution losses, low level of collection for the billed electricity, high levels of bad debt, and mounting arrears by budgetary and non-budgetary institutions. On the other hand, transmission losses are in line with those in developed countries.

In 2008, to turn the sector around, the GoA decided to encourage private participation in the sector. The privatization of the distribution system was concluded in March, 2009 as outlined by a Share Purchase Agreement (SPA) setting out the rights and obligations of the parties in operating the distribution assets. CEZ a.s., a Czech energy corporation, paid €102 million for 76% of shares.

These agreement/s required CEZ to control and operate these strategic assets such that:

- 1) the total distribution losses would fall to 17% by the end of 2014 from a level of 34% in 2009 as confirmed by a Loss Study prepared in 2010
- 2) the level of bad debt would be reduced by 1% yearly from level of 16.8% in 2009, as indicated by Bad Debt Study prepared in 2011, and
- 3) an investment plan and loss reduction program was implemented in a timely manner.

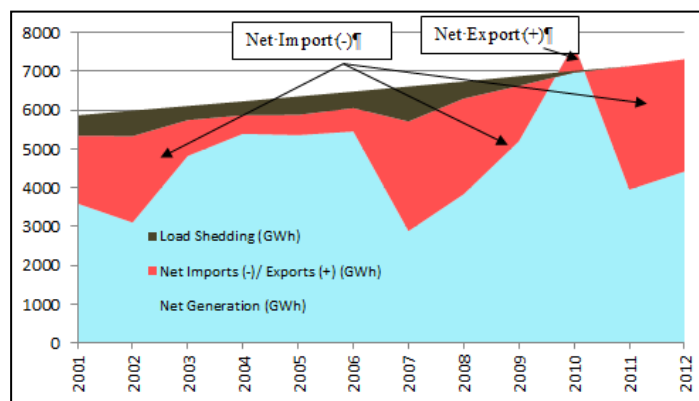
The privatization did not work out as expected. Contrary to the SPA, consensus on the level of non-technical losses and bad debts was delayed, the investment plan was deferred and adjustment of retail tariffs was not implemented as stipulated. Moreover, bill collections from budgetary and non-budgetary institutions did not improve, energy losses increased to 45% by the end 2012, and collection rates fell to 69% in 2011 before improving to 84% in 2012. By August 2012, CEZ Sh. had exhausted its resources and, without the support of its parent company, was unable to import electricity to cover its net energy losses under the SPA. KESh/WPS, as a supplier of the last resort, was forced to finance these imports and overuse its hydro reservoirs to meet retail demand. Consequently, ERE revoked CEZ Sh's operating license in January 2013 due to poor performance, and appointed a temporary state administrator to assume control of the Distribution Company and to operate the distribution assets on behalf of the State.

CEZ a.s. contested these unilateral actions and have referred counter-claims and significant damages to international arbitration as provided for under the SPA.

Sector Performance in 2007-2012

As indicated in Fig 1 below there has been no load shedding since 2010, which is a major achievement particularly in view of increasing demand and a growing supply gap.

Fig 1 Electricity Demand Vs. Generation, Imports and Load Shedding



The cost of imports to cover demand has however been growing in the recent years. It may be noted that the whole region is hydro-dependent and therefore price of imports is highly correlated to the degree of precipitation in the region.

The Albanian electricity retail tariff framework is relative modern and is supposed to pass through the cost of buying electricity at a regulated price from the WPS, the transmission tariff, distribution tariff plus a small margin to cover the Retail Public Supplier's (RPS) operating costs. Recently, however, a) WPS tariffs were usually not adjusted to reflect increased costs of imported electricity, which have been borne by KESh-WPS (as the supplier of last resort); and b) retail tariffs have not been fully cost reflective. Distribution losses impose a huge burden on the distribution operator. Since losses were not decreased as planned in 2009-2012, but increased, electricity imports have become a huge financial liability to the distribution company. In 2011 and 2012, the cost of CEZ Sh.'s imports not covered by tariff was 6.4 and 13.3 billion Lek, respectively.

As indicated before, tariff customers' collection rate remains low. The budgetary (government) and non-budgetary (water supply, hospitals, schools, etc.) public institutions have been consistently among those non-paying customers, amounting to 8.6 billion Lek at end 2012.

The result of the financial burden imposed by high losses and poor collection rates on the distribution operator is that CEZ Sh. is financially insolvent and is unable to pay its bills as they fall due. This has negatively impacted the entire sector and in reality KESh in particular is no longer financially viable due to lack of liquidity; there is very little direct public investment in the sector, absent ad hoc liquidity public support to KESh to cover its liquidity gap.

The Government can ill afford the support to the sector, which includes significant debt of budgetary and non-

budgetary public institutions, sovereign guarantees to KESH, and short-term debt to meet its obligations as supplier of last resort. For example, as of Q1 2013, KESH's overdraft was 29 billion Lek. The appointment of an interim administrator at CEZ Sh, including taking over of liabilities, will severely compound this position by the GoA's effectively assuming responsibility—at least in the short to medium-term—for the import of energy to meet energy losses, assumption of debt service by KESH of significant long-term loans undertaken by CEZ sh. at the time of the privatization, implementation of a costly loss reduction program, and potential compensatory damages claimed by CEZ a.s. under international arbitration.

Projected Sector Performance in 2013-2020: Challenges, Needs and Risks.

The potential risks for the sector arise from the following:

1) Growing supply gap and increased generation investment needs: As the economy picks up, demand is expected to reach 10,000 GWh by 2020, basically a 100% jump. If no new generation is added and assuming that distribution losses are reduced to the level of 2010 (30%) by the end of 2016, the expected electricity supply gap would increase from 3,000 GWh in 2013 to 5,000 GWh, or 50% of total expected demand, by 2020, which will put additional financial pressure on KESH-WPS. Imports are expected to increase from over 200 GWh in 2014 to almost 2,000 GWh in 2020, thus the additional costs to KESH-WPS of covering these imports would increase from Lek 2 billion in 2014 to Lek 16 billion Lek in 2020, putting upward pressure on wholesale tariffs and on the need for direct Government support to KESH. This is an unsustainable position.

This situation poses a fiscal burden, undermines the security of supply and increases the prospect of load shedding with devastating consequences to the economy and growth. Addressing this situation would require a combination of: a) an adjustment over time of the wholesale tariff to attract investments needed to expand generation capacity; b) that the 100MW Vlore thermal power plant becomes operational to diversify supply and reduce WPS's import needs, albeit at higher cost; and c) a reassessment of the existing market model, moving the hydrological risk to those better equipped to deal with, including in particular the distribution company and large consumers.

2) Governance and enforcement of Commercial Rules: While the existing market structure has been reformed, its rules are poorly implemented, energy balances go unsettled for prolonged periods and payment discipline remains poor. This, together with a poorly functional market operator, prevents a commercially based marketplace for energy from developing and sending proper price signals for efficient consumption and investment decisions.

Arrears of public budgetary and non-budgetary institutions remain an issue. As of the end of 2012, the arrears of public institutions were Lek 6.2 billion. There is no enforceable mechanism to keep them current with their electricity bills.

This poses huge risks for future development of commercial power sector, sector investment and longer-term private sector participation in the distribution assets. Capacity building of OST as a market operator, improving the management of the distribution network and enforcing payments by tariff customers—including public institutions—are the key in turning the sector around.

3) Performance of the distribution system: There is not power sector in the world that can function with a 48% level of losses. Implementing a loss reduction program with an average 4% per year losses would allow the distribution system to reach its 2010 levels by the end of 2016. Experience shows that CEZ Sh could achieve a meaningful reduction with properly targeted investments by improving metering of large tariff customers, improving network management and decreasing illicit use of electricity. It is estimated that a total of about US\$ 150 million of priority investment will be required over the next 4 years to bring power losses under control. Without significant investment, the distribution company (DSO) would continue making losses and would need to spend about Lek 25 billion to import electricity to cover its losses, of which only half would be recovered by the tariff.

4) End-user tariffs and collection rate: The costs of delivering energy to the final users will to a large extent be driven by growing imports needs, which in turn would be determined by growth in consumer demand and distribution losses. If the retail tariffs are not adjusted appropriately to reflect proper costs of electricity, the sector would continue to be loss-making, the size of which would depend not only on the difference between tariffs and actual costs incurred, but also on the collection rate. Absent any improvement there will be an annual financial gap of around Lek 17-20 billion.

Recommendations / Way forward

- **In the Short-Term: Ensuring Security of Supply and an organized transition in the Distribution Sector** through a combination of: a) optimization of water use at the Drin cascade throughout the remaining of the year, complemented as needed by imports, and taking steps to ensure proper operation of Vlore Thermal plant in the near future; b) addressing lingering legal issues surrounding CEZ Sh to properly manage the risk from contingent liabilities facing Government; and c) in parallel, agreeing to a time-bound action plan to reduce power losses in an aggressive way and improve bill collection, including in particular clearance of Government's entities arrears.
- **In the Mid-Term: Ensuring Power Market Operations on a Commercial footing**, through a combination of: a) enforcement of Commercial Market Rules and Rebalancing of Tariff levels; b) a revision and implementation of an updated Market Model to allocate the Hydrology risk among all market participants, including concessions, IPPs, KESH and consumers; c) as needed, updating of the Energy Law to reflect these changes; d) design and implementation of a Financial Restructuring Plan in the sector, aimed at clearing the balance sheet of the main public market participants; and e) introducing transparent Governance system for management, and supervision, of energy SOEs to ensure they operate under commercial practices, at arm's length of Government shareholders. These steps will pave the ground for both reduced power imports to cover losses in the future and to attract major investment in new generating capacity to cover electricity deficits into the future.
- **In the long-term, reducing Country's vulnerability, to weather patterns and emergency imports by:** i) diversification of fuel supply, including natural gas supply; ii) further Regional integration, particularly with the Kosovo thermal system and other countries in the region; and iii) attracting private capital in the future in the distribution sector for its future expansion.
- **WBG Support.** The Government is well advised to recognize the gravity of the situation and act without further delay. To address this, it has recently requested the WBG to provide, on a priority basis, substantial technical and financial support to avoiding potential supply distortions and restoring financial viability of the sector. The combination of WBG support could include: (i) an Energy Reform and Recovery Project to support the short-medium term agenda; and (ii) technical assistance; coordinated with (iii) IFC support.

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Albania: Transport Infrastructure

September 2013

Policy Brief

BACKGROUND

1. **Albania has already prepared and adopted its National Transport Plan (ANTP2 adopted in 2011) as the main instrument for decision making and strategic planning in the transport sector.** With the bulk of Investment Plan focused in the road sector, it emphasizes the importance of conservation of the new network for the road sector – with increased maintenance/rehabilitation funding until 2030 - and careful future network expansion. While there is limited progress in the rail sector – to certain extent reflecting the unsuccessful attempts of the past at privatizing parts of the network and operation - the future role of railways is a central strategic issue, which needs to be decided by the government in order to tailor the development of rail policies. On sea ports, the top priority continues to be the public-private partnership in operations and services, and privatization of the container terminal in Durres Port is one example. In the civil aviation sector, it should be noted the transformational impact of the Tirana International Airport concession in 2005, with the regulatory and safety activities now managed by the Civil Aviation Authority.

2. **A large number of investments in national roads have been carried in recent years.** Many important road corridors have started - fully, or partially, completed - mostly developed along the Albania North-South and East-West TEN (Trans European Network) corridors. These roads are aiming to provide vital connections within Albania and across the region (ME, KO, GR), to link markets to the Adriatic Port of Durres and Vlora, and to contribute to the economic growth as Albania prepares for the EU accession.

3. **With the assistance of the World Bank, the Albanian Government through the Albanian Development Fund prepared a strategy and investment program for financing about 1,500 km of rural roads mobilizing funds from many donors (about US\$ 470 million).** Allocating sufficient funds to local/rural roads is an important anti-poverty priority (half of the Albania population lives in rural areas), especially because local revenue sources are insufficient to finance rehabilitation and

reconstruction of these roads through local government budgets.

4. **Users perceive that the quality of transport infrastructure, particularly road infrastructure, has improved in recent years in Albania.** For the past three decades, the World Economic Forum's has based its analysis on the Global Competitiveness Index (GCI) - a comprehensive index which captures 12 pillars of competitiveness, including infrastructure. A comparison of Albania's rankings between the GCI for 2007-2008 and 2012-2013 indicate a perception of improvement in the quality of road infrastructure, and smaller improvements in port and airports—whereas rail infrastructure was perceived as being in better condition in 2007-2008 than road infrastructure, and the opposite is true today.

5. **The roads sub-sector consumes the largest part of the transport budget.** Expenditures on roads rose to 5.7 percent of GDP in 2008—reflecting large investments in motorways—before declining to 2.7 percent of GDP in 2010, 2.4 percent of GDP in 2011, and 1.9 percent of GDP in 2012, excluding outstanding accumulated arrears. Over the 2008-2012 period, expenditures on the national road network exceeded 95 percent of expenditures in the transport sector in all years, rising to as high as 99 percent in 2008, compared to less than 5 percent for the port sector and under half a percentage point for rail. Maritime and civil aviation have increasingly received both donor and private financing. Given the predominant use of transport budget funds for the road sector, this paper is, primarily, focused on the road sector in Albania and it will briefly present an overview of the challenges facing the rail sector, which does not benefit from private financing.

THE ROAD SUBSECTOR ISSUES/CHALLENGES

Overview

6. **Albania faces a number of challenges in the road transport sector.** Firstly, emphasis needs to be placed on conservation of new road infrastructure on a sustainable

basis, which requires rebalancing expenditures toward maintenance and rehabilitation. Secondly, there is a need to continue the necessary reform to strengthen the institutional framework, and improve allocative efficiency in the sector and the sustainability of expenditures. Thirdly, there is the need to adopt a more disciplined approach to the planning and phasing of priority investments. Finally, and most importantly, there is a need to adopt a more professional approach to the management of road assets, ensure that adequate provision is made for the maintenance of assets, and thus support the sustainability of all expenditures.

7. There are discrepancies regarding the length and classification of the road network in Albania. As per the Transport Strategy of 2008-2013, the road network in Albania is about 18,000 km long, of which 3,719 km of national roads; and the rest interurban and/or under the jurisdiction of autonomous units, enterprises or entities. However, it should be noted that there are still uncertainties regarding the total length of the road network, including the national network under the responsibility of the Albanian Road Authority (ARA), as well as its functional classification and jurisdiction. The network under the responsibility of the ARA - 1,300 km of primary importance, 1,000 to 1,500 km secondary importance, has about 42% of its length in good or very good condition. While the primary network is well defined and information on road condition is available, the same cannot be said for the secondary network, where over 45 percent is in unknown condition.

8. The emphasis on new road construction in Albania has not been always matched by the quality of works. The signs of poor quality are visible across the road network, including the premature failure of new pavement and in some cases structures, the use of different design standards on adjacent sections, poor and contradictory signage, a lack of safety, and the non-repair of electrical fixtures and fittings. There is a perception that the lack of appropriate maintenance has resulted in poor value for money from some of the capital expenditures. There is also concern at the way some projects, primarily those supported from public funds, are planned, implemented, monitored and maintained.

9. Road safety remains a major social and public health issue in Albania, despite a decline in the rate of fatalities. Annual fatalities of 7.8 per 10,000 vehicles in 2011 compares unfavorably with other countries in the region and are about six times higher than in the best performing EU countries. The number of casualties and injured has quadrupled over the last decade, rising from 616 in 2000 to

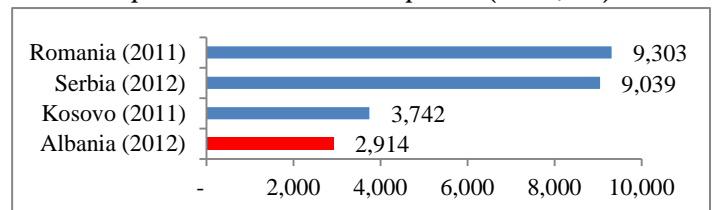
2,472 in 2011. Estimates made in 2010 suggested that the economic cost of road accidents in Albania is about Euro 130 million annually, or 1.5 percent of GDP.

Sector Expenditures

10. Road maintenance expenditures on the national road network in Albania are not sufficient, and the country has a considerable backlog. In an effort to address this issue, there were increased real annual budgetary allocations to operations and maintenance of the national road network between 2005 and 2008. However, nominal expenditures on maintenance of national roads have declined sharply - in 2012 are down 25 percent compared to 2008, while expenditures on rehabilitation have declined by 73 percent over the same period.

11. Expenditures on maintenance on a per km basis on the national network are low compared to regional comparators. Albania spent an average of 2,914 euros/km on the national road network in 2012—this is very low even compared to regional comparators who also do not spend sufficiently on maintenance.

Expenditure on Maintenance per Km (Euros/km)



12. Road user charges reached Euro 227 million in 2012, increasing by 10 percent compared to five years earlier. Recent changes include revisions to the fuel excise tax rates, the introduction of the circulation fuel tax in 2010, and the removal of the registration tax and taxes on imported vehicles—the annual tax on transport vehicles replacing the axle load and registration tax, with new vehicles not needing to pay the tax for the first three years. In 2012, actual expenditure (including new investments) on the national road network is less than the road user charges collected from all road users. It needs to be noted that these taxes accrue to the state and not directly to the Albanian Road Authority, which is dependent on budget and donor funds. The calculation of a cost recovery ratio would require allocating a defined percentage of road user charges to the national road network, on the basis of traffic count data, and from a welfare economic perspective. Road user charges are meant to cover short-term marginal costs of operating roads in order to ensure optimal use of infrastructure—the evidence suggests that revenues collected from road users in Albania are significantly above such costs.

Actual Institutional Framework

13. **The Ministry of Public Works and Transport (MPWT) has overall oversight of transport, setting sector policies, developing sub-sectoral budgetary and performing regulatory functions.** The Albanian Road Authority (ARA) - created by Law No. 10164 October 2009 - is the asset manager of the national road network, and responsible for the construction, upgrading, rehabilitation, and maintenance of the 3,740 km national road network including associated planning, budgeting, and programming. Local roads are the responsibility of 12 Regional Councils, and due to their unfunded mandate to maintain and the lack of capacity to manage their network, part of the road network rehabilitated by ADF is being transferred to ARA.

14. **The Albanian Development Fund (ADF) is a public legal entity whose mission is to encourage a sustainable, balanced and cohesive socio-economic development at local and regional level, through local and community based infrastructure projects.**

15. **The reform of GRD is a work in progress, with ARA still in the transition process toward becoming a modern and efficient road institution.** Nearly four years after the law creating ARA, the new organization is not fully operational, i.e.: (i) a Service Agreement is not yet signed; (ii) the new organizational structure has been approved, but is still not fully operational, despite substantial TA provided regarding new organizational structure in the areas of recruitment and selection, piloting of the Financial Accounting and Project Monitoring System, developing a Training Needs Assessment, among others. All these point to the slow operationalization of the ARA and thus slow progress on improving and modernizing road management practices.

Future Financing Requirements

16. **As part of ANTP2, comprehensive estimates were been made with regard to required maintenance expenditures on the national network.** Analysis of maintenance costs calculated over a 20 year period for the national roads network, where information on traffic levels and road condition is most complete suggest an annual expenditure on maintenance is about Euro 40-45 million, and with less than the vehicle operating costs and travel times will increase as road roughness levels rise. The average expenditures over 2008-2012 for the national road network

were about Euro 12 million, suggesting that what is required is over a three-fold increase. Of major concern is how the government will be able to allocate these additional funds, or at a minimum, raise road maintenance expenditures compared to current levels.

17. **Fuel taxes could be an important source of revenue for financing the transport sector.** Fuel taxation can shift the burden of indirect negative effects of transport (such as environmental pollution, noise, congestion costs, etc.) onto transport users. The analysis of ANTP2 reveals that an increase of fuel taxes by Euro 0.06/liter could finance maintenance as well as rehabilitation needs for the primary network.. However, the World Bank believes that a Euro 0.06/liter increase in the excise tax is significant, and that the financing gap is best addressed by reducing future planned investments and refocusing scarce resources on maintenance, instead of raising road user charges.

18. **One important mechanism to raise revenues for road maintenance is to rebalance expenditures in order to preserve past road investments.** The ANTP2's Investment Plan foresees Euro 1,731 million over 2016-2030, equal to Euro 302 million annually. If the plans exceed what the financial envelope under Albania's medium-term fiscal framework allows, there will be a need to prioritize network preservation over road development/expansion. The Transport Investment Plan 2010-2030 shifts the balance toward network preservation of the national road network in its second period, 2016-2030, but there is a strong case for rebalancing expenditures toward maintenance even before 2016.

19. **Earmarking revenues from road user charges through the establishment of a road fund is not considered an optimal option.**

RAILWAY SUBSECTOR ISSUES/CHALLENGES

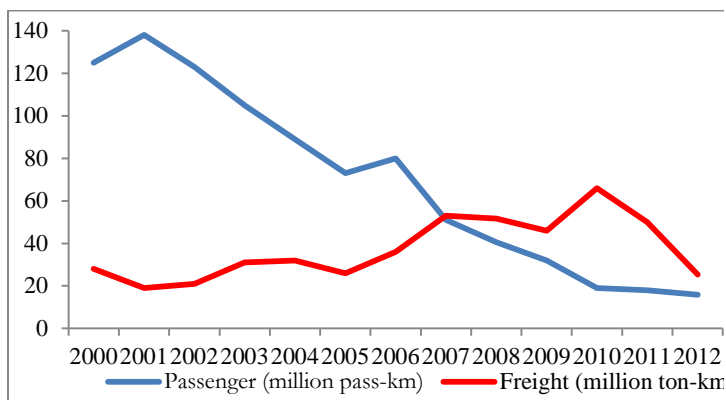
Overview

20. Albanian Railways (HSH) is the state-owned rail company and a stock holding company since 2000, with the Ministry of Economy as its owner. The rail network is small, with 399 km of single track non-electrified rail with standard gauge in operation. The core network consists of 197 km from Durres to Tirana (37km), Vlore to Shkoder (85 km), and Skhozet to Elbasan (75km). Albanian Railways has undergone a long period of under investment and maintenance work has been limited, with the result that the infrastructure is in useable but poor condition. Albanian

Railways has been reorganized into five business units—passenger, cargo, infrastructure, repairs and corporate units—in line with EU requirements.

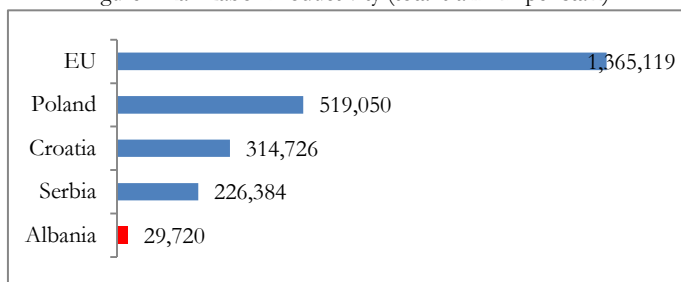
21. Rail traffic has been declining dramatically throughout the decade. Rail traffic, expressed in terms passenger-km and freight ton-km has been declining, reflecting significant under-investment in rolling stock and infrastructure, as well as the destruction of rail assets, which translates into low operational speed, poor reliability, and expensive services, at a time of significant investments in roads and increased motorization rates.

Figure Railway Traffic in Albania, 2000-2012



22. Although staffing levels have dropped in recent years, there is a need continue to with this process, especially in line with reduced passenger traffic volumes. Still, due to the sharp fall in traffic, railways labor productivity has fallen to under 30,000 traffic units per employee, which is again several folds less than the productivity of neighbors and EU.

Figure 1: Rail Labor Productivity (total train km per staff)



Financial Standing

23. Albanian Railways is loss-making, with a negative net income of Euro 2.1 million in 2012 and losses throughout 2008-2012. Contributions from the Albanian state budget to Albanian Railways are comparatively low and have been declining as a percentage of GDP over 2008-2012. from 0.06% to 0.04%,. As noted in the European

Commission’s 2012 Progress Report for Albania, “rail infrastructure maintenance is a concern and needs more resources”.

Strategic Directions

24. The strategic direction and future of the railway sector is a question that needs to be addressed. Without considerable investment in the railways—both infrastructure and rolling stock—freight and passenger traffic are likely to continue to decline or remain at current low levels. The size of the investments required and the public service obligation (PSO) subsidy suggests the need for thorough studies if further investments were to be considered. A recent review of Albania’s National Transportation Plan suggests four strategic options for the future of railways:

- (a) Option 1: Maintain the Status Quo.
- (b) Option 2: Partial or complete closure.
- (c) Option 3: Moderate infrastructure investment program.
- (d) Option 4: Major upgrading.

By default, Option 1 has been the current practice, which is not delivering a turnaround in the rail sector, , while Options 3 and 4 have relatively low economic rates of return. Concessioneing part of the network could be an option—Durres to Tirana is likely to be the most attractive—although it remains to be seen whether this could generate sufficient market interest. Other alternatives that could be considered are to dedicate rail service upgrades to freight transport exclusively and phased implementation of Option 3, only for the highest traffic rail segments which are economically viable. Since the future of Albania lies in the EU, there is a need to reorient its transport policy in line with EU policy objectives, which focus on sustainable, clean transport.

Recommendations / Way forward**In the Road Sector**

- **Rebalance road expenditures** from capital investments to maintenance and rehabilitation given the constrained financing framework; phasing planned capital investments, so that they do not come at the expense of maintenance and rehabilitation of existing assets.
- Ensure that **future spending is in line with revenues**, avoid future accumulation of arrears to contractors; no new rehabilitation and construction works unless there is adequate funding committed for planned works
- **Review the functional classification** of the road network in line with their functional requirements and the jurisdiction responsible for their preservation.
- **Establish and use a road asset management system** in ARA; with its regular update and used as a planning tool.
- Improvements in road management and ARA will only materialize when key elements in the reform process are completed, i.e.: the signature of the **Service Level Agreement** between the line ministry and the ARA
- **Modernize maintenance practices** by extending output and performance based maintenance contracts could offer significant efficiency gains.
- **Improve the design, construction, and supervision practices** and regulations for the road works.
- Focus the **future road concession program on operations and maintenance**—brown-field as opposed to green-field projects; careful review from a value for money perspective and the contingent liabilities that they may create
- **Introduce road safety audit** practices: conduct independent road safety audits for priority sections at design and construction stages and incorporate road safety standards in the bidding documents.

In the Railway sector

- **Make a strategic decision to the future direction of Albanian Railways.** Consider options of concessioning the railways in order to attract private funds to profitable freight business, withdrawing loss-making passenger services, or dedicating rail services exclusively to freight.
- If the Government remains committed to rail passenger services, there is a need to **prioritize which loss making services to support through the PSO** and analyze whether socially necessary passenger services are most cost effectively provided by rail.
- **Reduce staff levels.** A clear policy of annual staff reductions for higher staff productivity levels in the context of declining or stagnant traffic. This policy needs to be based on a prudent traffic forecast that will need regular updating.
- **Utilize multi-annual public service contracts (PSCs)** for passenger services with performance indicators. State compensation for the public service obligation defining the passenger transportation services must be allocated based on a multi-annual contract.
- Utilize **performance indicators by lines of business.** Progress must be measured based on specific indicators for each of the lines of business: infrastructure, passengers, cargo.
- **Organize customer service centers** instead of territorial structures. Many European railways have successfully implemented a business model based on profit centers that manage each major type of commodity and passenger service.

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