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INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
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REPUBLIC OF ALBANIA

COUNTRY STRATEGIC OPPORTUNITIES PAPER

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CURRENCY EQUIVALENTS

Currency unit	=	Albanian lek (ALL)
USD 1.00	=	ALL 97
ALL 1.00	=	USD 0.01

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m ²)	=	10.76 square feet (ft ²)
1 acre (ac)	=	0.405 ha
1 hectare (ha)	=	2.47 ac

ABBREVIATIONS AND ACRONYMS

COSOP	country strategic opportunities paper
DFID	Department for International Development (United Kingdom)
EU	European Union
MADA	Mountain Areas Development Agency
MADP	Mountain Areas Development Programme
MAFF	Mountain Areas Finance Fund
NSSED	National Strategy for Socio-Economic Development
PBAS	Performance-Based Allocation System
SIP	strategic investment plan
SME	small and medium-sized enterprise
USAID	United States Agency for International Development

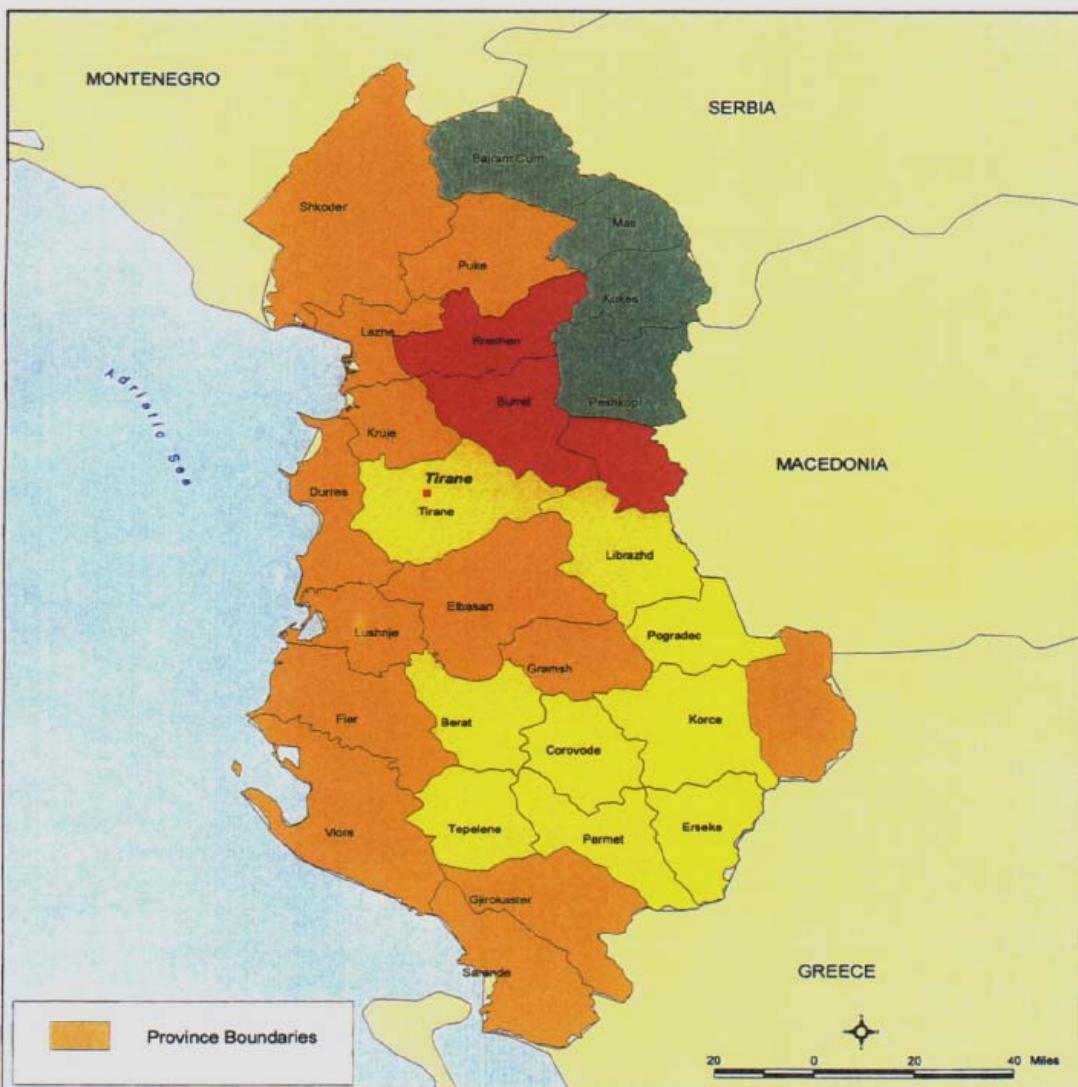
GOVERNMENT OF THE REPUBLIC OF ALBANIA

Fiscal Year
1 January-31 December

COUNTRY MAP: LOCATION OF IFAD-FUNDED OPERATIONS



ALBANIA



IFAD Supported Projects



347-AL



372-AL



526-AL

The designations employed, boundaries and presentation on this map do not imply on the part of IFAD any judgment on the legal status of any territory.

Source: IFAD.

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.



IFAD PORTFOLIO OVERVIEW

Project Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effect.	Current Closing Date	Loan/Grant Acronym	Denominated Currency	Approved Loan/Grant Amount	Disbursement (as % of approved amount)
North-Eastern Districts Rural Development Project	IFAD	UNOPS	HC	02 Dec 93	19 Apr 94	30 Jun 03	L - I - 347 - AL	SDR	8 350 000	96%
Small-Scale Irrigation Rehabilitation Project	IFAD	UNOPS	HC	06 Dec 94	08 Aug 95	01 Jul 03	G - I - 130 - ILCUF	USD	75 000	100%
Small-Scale Irrigation Rehabilitation Project	IFAD	UNOPS	HC	06 Dec 94	08 Aug 95	01 Jul 03	L - I - 372 - AL	SDR	6 100 000	100%
Mountain Areas Development Programme	IFAD	UNOPS	HC	09 Dec 99	20 Jul 01	31 Mar 08	G - I - 465 - AL	SDR	320 000	100%
Mountain Areas Development Programme	IFAD	UNOPS	HC	09 Dec 99	20 Jul 01	31 Mar 08	G - I - 80 - AL	USD	40 000	56%
Mountain Areas Development Programme	IFAD	UNOPS	HC	09 Dec 99	20 Jul 01	31 Mar 08	L - I - 526 - AL	SDR	9 600 000	74%

UNOPS = United Nations Office for Project Services. HC = highly concessional.

EXECUTIVE SUMMARY

1. Albania's transition towards a democratic society and market-based economy has proved to be very challenging. Output in 1992 reached a low of half the 1989 level; inflation went to triple digits, and the current account deficit rose to two thirds of GDP. Subsequent growth was interrupted by the collapse of pyramid investment schemes in 1997, which resulted in the loss of some USD 1.2 billion in people's savings and triggered a crisis that brought the country to the brink of civil war. Since 1998, macroeconomic indicators have gradually improved. Real GDP growth is now expected to be sustained at its present level of about 6% over the short term, and inflation, which has mainly remained below 4% in recent years, is currently running at 3%. However, poverty levels are still high, and Albania's per capita GDP is one of the lowest in Europe. While the perception of the business environment has improved, legitimate private enterprise is being adversely affected by unfair competition from the informal economy, as well as by illegal trading and administrative practices among registered companies. Weak corporate governance and a widespread lack of management skills, together with an underdeveloped banking system, are further impediments to enterprise development and foreign direct investment. The economy is also vulnerable to the effects of low quality infrastructure, including in utility services and transport facilities. Despite these substantial barriers, the improved macroeconomic stability is gradually raising business confidence not least among commercial banks, and new opportunities and mechanisms for diversifying the economy are emerging.

2. An important consequence of Albania's troubled political and economic history has been the substantial level of both legal and illegal emigration. An estimated 15% of the population, including a high proportion of the intellectual elite, emigrated in the decade up to 2000, mainly to Greece and Italy. Simultaneously, there has been substantial internal migration from rural areas to urban and peri-urban areas. The main positive outcome of emigration has been the significant amounts of remittances being sent into Albania in support of impoverished relatives, estimated by the Bank of Albania to be in excess of the equivalent of USD 600 million per year.

3. A key national goal is the fullest possible integration of Albania into the economic and political mainstream of Europe. Albania is considered a potential candidate country for European Union membership, and the country is beginning to benefit from pre-accession funding arrangements. A closer association with Europe has widespread popular support, although this is not matched by a thorough understanding of what convergence might entail and the effort needed to achieve it. The legal and regulatory framework in Albania are becoming more consistent with European Union and international standards. Measures continue to be put in place that will enable Albania to meet obligations under the trade agreements recently concluded with countries in the region and the World Trade Organization.

4. Agriculture remains important to the national economy, although its contribution to GDP has been decreasing in favour of construction, as well transport and other services. The agrarian structure was transformed because of the collapse of the command economy and the associated closure of cooperative and state farms. Land was redistributed through private ownership in a process that created 470 000 small family farms, with an average land ownership of around 0.72 ha, typically fragmented into smaller units. In some hill and mountain areas that together account for half of all agricultural land, land parcels are even smaller, at around 0.2 ha. The agricultural sector has been a major focus for external technical and financial aid. However, with the principal exception of IFAD sponsored investments in mountain areas, aid has been directed towards the coastal and lowland agricultural areas because of their greater potential to generate rapid economic growth. Although there is an emerging trend towards more market-oriented production, mainly in the higher potential coastal plains and lowlands rather than in mountain areas, most farms still operate on the basis of low-input, low-output production systems. The small size of individual farms and the unwillingness of farmers to enter into collaborative arrangements continue to limit opportunities for generating economies of

scale and, subsequently, the capacity to satisfy domestic- or export-market demands. Poverty rates are 66% higher in rural and mountainous areas than they are in the capital, Tirana.

5. IFAD's strategy in the context of the transition of Albania has been to provide a foundation for promoting sustainable increases in economic activity in disadvantaged mountain areas and encouraging the closer integration of these areas into the national economy. The North-Eastern Districts Rural Development Project and the Small-Scale Irrigation Rehabilitation Project, initiated in 1993 and 1994, respectively, were geared to broadbased poverty reduction in selected poorer mountain districts. Both projects were implemented through management offices that were essentially extensions of the responsibility of the Ministry of Agriculture during what were, in effect, conflict and post-conflict situations. Following a return to more normal conditions in 1998, a country strategic opportunities paper (COSOP) was prepared in 1999. The COSOP sought to maintain IFAD's focus on mountain areas under a programmatic approach rather than a time-bound project approach with predetermined targets. It recommended the establishment of two specialized, autonomous institutions to deal with broader aspects of mountain area development in parallel with the provision of improved access to rural financial services, thereby counterbalancing the continued concentration of development partners on higher potential areas. IFAD and the Government subsequently began financing the Mountain Areas Development Programme (MADP), which is ongoing, but will be completed in 2006. Activities under MADP are organized through the Mountain Areas Development Agency (MADA) and the Mountain Areas Finance Fund (MAFF).

6. Because of substantial technical support and supervision, the orientation of the MADP is becoming more consistent with the original design concept and with the strategic framework for IFAD operations, more specifically the IFAD subregional strategy for Central and Eastern Europe, especially in terms of:

- (a) adopting a programmatic approach within a longer-term vision of development;
- (b) maintaining momentum and the focus on the reduction of poverty in particularly disadvantaged and neglected areas of the country through the catalytic role and functions of specialized institutions, namely, MADA and MAFF;
- (c) addressing the gender dimensions of poverty and creating gender responsive interventions that enhance the economic role of rural women and youth;
- (d) building effective partnerships with others, including through: (i) contracting the necessary specialized services for implementation; (ii) leveraging additional funds from other sources; and (iii) introducing a holistic, consultative approach to improving supply chain management for farming-related and non-farm businesses, in association with expanded access to appropriate financial services and lending products;
- (e) explicitly recognizing the importance of economic diversification that supports non-farm, as well as agriculture-related aspects in boosting the rural economy and widening rural employment opportunities;
- (f) using consultative procedures for strategic planning with local stakeholders; and
- (g) strengthening local advocacy through support for the emergence of stakeholder forums.

7. An enormous task remains: to regenerate the economy of the mountain areas and integrate these areas more effectively into the national economy. However, progress in the transition process is leading to the emergence of new avenues for supporting commercial and economic development that were unthinkable in Albania even a few years ago. The Fund can now explore these avenues in the interest of the rural poor and as a means of consolidating the programmatic approach initiated under MADP and capitalizing on the experience and the gains made in directing resources specifically to mountain areas. At the same time, the absolute limits imposed by the agroecology of the mountain areas suggest that agriculture, while continuing to be important to many rural livelihoods, cannot be viewed as the sole vehicle for reviving the economy of mountain areas. Future improvements in farm production and productivity will derive from adjustments in farming practices in response to market

requirements and the consolidation of landholdings under leasing and sales agreements, leading to further intensification and mechanization, which, in turn, will lead to a further decrease in the size of the permanent agricultural workforce. In addition, however, to avoid adding to present levels of unemployment in already disadvantaged mountain areas, it will be essential also to generate employment opportunities in other sectors within a diversified rural economy, thereby reducing the reliance on primary agricultural production as the basis of rural livelihoods.

8. The importance of continuing the support for the establishment and expansion of small and medium-sized enterprises as a means of creating gainful wage employment cannot be overemphasized. This implies a need to ensure enhanced access to a range of financial instruments and sources of funding to serve a widening variety of investment requirements. MADP-sponsored operations are providing an improved platform on which to build appropriate partnerships and institutional responses to serve these requirements in the complex economic realities of mountain areas. A well-functioning MADA operating as a promotional body can be instrumental in facilitating such partnerships and mobilizing additional sources of funds in the interest of economic diversification and employment creation. MAFF, as an autonomous financial institution serving mountain areas, should be assisted in consolidating and expanding its portfolio on a sustainable basis through a gradual restructuring into a self-funding, private rural bank that offers a full range of rural financial services. MAFF, with the guidance of Rabobank, has developed a longer-term strategy and business plan for the period 2005-10 that provides a basis for future IFAD support. The development of a hybrid structure combining the characteristics of a commercial enterprise and a cooperative is an innovative construction within the Albanian context.

9. A future IFAD strategy for mountain areas must endeavour to ensure that those people who are able and interested can become engaged in economic activities that generate income. Opportunities to diversify the rural mountain area economy are emerging. They must be nurtured in a way that, first, recognizes the often interrelated, mutually supportive nature of different types and scales of investment, as well as different forms of partnership and, second, promotes the greater accrual of value-added to the rural poor, while assuring relative equity consistent with the achievement of sustained private sector growth. This perspective is based on: (i) the work of an IFAD COSOP mission to Albania in November and December 2004; (ii) the outcome of a series of consultative workshops supported by MADP and held at the district, regional and national levels in 2003 that initiated an ongoing participatory process of public engagement and stakeholder consultation for, *inter alia*, the design of the Government's Vision for Mountain Area Development; (iii) the content of the Government's National Strategy for Socio-Economic Development, including the strategy's approach to poverty reduction; (iv) the opportunities and challenges of the integration of Albania into mainstream Europe and the accession of the country to international trade agreements; and (v) the nature and scope of the substantial complementary investments being made by other development partners.

10. The performance indicators (lower scores) of the Performance-Based Allocation System (PBAS) help identify the areas of focus for IFAD in engaging in policy and institutional dialogue with the Government in support of the development of mountain areas. These areas include: (i) dialogue between grass-roots organizations and the Government; (ii) the investment climate for rural businesses; and (iii) access to extension services.

11. Given its small population and on the basis of current PBAS projections, Albania qualifies for a *base lending scenario* of only USD 7-8 million every six years. This scenario would create the challenge of developing an investment programme of interest to the Government and would imply disproportionate project development and supervision costs for IFAD. A *low case scenario*, which could be triggered by the worsening of the policy and institutional framework, would push the PBAS projection to the minimum USD 1 million per year, for a USD 6 million loan every six years. It is expected that, with further improvements in the policy and institutional framework and noting the

increasingly positive rural sector performance and the probability that there will be more resources available, a *higher case scenario* is likely. This would entail the presentation of an investment programme for sustainable development in rural mountain areas to the Executive Board in late 2005 for about USD 9-11 million. In order to strengthen the programmatic approach within a limited resource envelope, opportunities for attracting supplementary external cofinancing will be explored in line with the requirements identified during the investment design process. This would include cofinancing with the Organization of the Petroleum Exporting Countries, the Global Environment Facility, other international financial institutions involved in the rural sector and the Italian Government. In addition, grants from IFAD's core resources and supplementary funds will be sought in order to support innovative institutional development, such as a new rural bank mountain area forum and technical assistance for the development of a remittances programme.

REPUBLIC OF ALBANIA
COUNTRY STRATEGIC OPPORTUNITIES PAPER

I. INTRODUCTION¹

1. The Republic of Albania joined IFAD as a Category III member (now List C) in January 1992, after which a general identification mission in February 1993 identified three investment opportunities. The Fund subsequently approved the North-Eastern Districts Rural Development Project, the Small-Scale Irrigation Rehabilitation Project and the Mountain Areas Development Programme (MADP) for entry into its financing pipeline for Albania. Following a series of dramatic changes in Albania during the period of the first two projects, both of which have since ended, a country strategic opportunities paper (COSOP) was prepared, in February 1999, leading to the design and implementation of the ongoing MADP.
2. The present document updates the socio-economic context of IFAD-supported operations in Albania and is a guide for future IFAD investment within the framework of the Performance-Based Allocation System (PBAS). It takes into account the Fund's overall implementation experience in Albania and the implications of the current operations under MADP for future investment, as well as the operational experiences of other stakeholders in the country's development. It is also influenced by recent IFAD operations in other transitional economies, notably Armenia, Romania and the former Yugoslav Republic of Macedonia. The document offers a reflection on ongoing changes in Albania's transitional economy, notably, the emergence of: (i) greater stability in the macroeconomic framework and commercial financial sector and the implications of this for private sector development; (ii) national strategies and policies for economic growth, poverty reduction and the decentralization of public administrative authority; and (iii) the increasing importance attached by the Government to convergence with the conditions necessary to attract European Union pre-accession funding.
3. The present COSOP is informed by the outcome of a series of consultative workshops supported by MADP and held at the district, regional and national levels during 2003 and 2004. These workshops were attended by a wide range of stakeholders, including farmers, other private entrepreneurs, district council members, and representatives and parliamentarians from the mountain areas of Albania. The workshops initiated an ongoing participatory process of public engagement and stakeholder consultation. The process has included the drafting of the Vision for Mountain Area Development, conceived within the framework of the National Strategy for Socio-Economic Development (NSSED) and aimed at establishing a set of principles to guide development in mountain areas and providing a basis for stakeholders to raise the profile of mountain area concerns, lobby for change and influence resource allocations in their interest.

II. ECONOMIC, SECTORAL AND RURAL POVERTY CONTEXT

A. Country Economic Background

4. Albania is a small, mostly mountainous country lying on the western seaboard of the Balkan Peninsula. It borders Serbia and Montenegro to the north and north-east, the former Yugoslav Republic of Macedonia to the east and Greece to the south. The main geographic regions are the coastal lowlands, the intermediate hill country and the mountain ranges. Only coastal areas have a Mediterranean climate; elsewhere, the country experiences the seasonal extremes of a continental

¹ See Appendix I for additional information.

climate. The population is about 3.1 million (2001 census), of which some 0.5 million live in the capital, Tirana. An estimated 57% of the population live in rural areas, and about a third of GDP is generated in agriculture. Literacy rates are high among both sexes, at about 98%, but the quality of education is said to be declining, especially in rural areas. Social development indicators and other country data, summarized in Appendix I, suggest that the persistently high incidence of poverty is more a matter of income poverty than of human poverty.

5. Albania's transition to a democratic society and market-based economy has proved very challenging. This is due in large part to the uniquely difficult starting point that resulted from the extreme form of strict and isolationist communism during previous decades under which private trade was forbidden, internal travel was severely restricted and trade-based and other interactions with the outside world were kept to a minimum. Spurred by the transition, an estimated 15% of the population, including a high proportion of the intellectual elite, emigrated in the decade up to 2000 mainly to Greece and Italy. The continuation of illegal emigration represents a source of concern for the European Union. The major positive corollary of emigration has been the substantial level of the remittances being sent to Albania, presently estimated by the Bank of Albania to the equivalent of at least USD 500-600 million per year, or about 15% of GDP. Remittances are helping to underpin the stability of the local currency and to maintain adequate levels of foreign exchange reserves. Trafficking in humans, exacerbated by conditions of deprivation in rural and peri-urban areas, is a serious concern that is being tackled as part of regional efforts by several major donors. The support by IFAD for economic development and employment generation in the poorest areas of Albania is contributing to a solution to these problems.

6. The collapse of financial pyramid schemes in early 1997 resulted in the loss of about USD 1.2 billion in savings, triggered a crisis that brought the country to the brink of civil war, caused a collapse of institutional order and set back nascent reform processes. These problems were compounded by internal political conflict and the difficult regional situation, especially the Kosovo crisis of 1999 that provoked the flow of almost 500 000 refugees into Albania. Despite the difficulties of transition, Albania is now a parliamentary republic, and the Albanian Constitution of 1998 conforms to international democratic standards. The legal, judicial and regulatory framework is increasingly being brought into conformity with the requirements of a liberalized economy and democratic society, although considerable inadequacies remain in application and enforcement. The civil society is underdeveloped and has a limited interface with the Government.

7. Under communism, the state guaranteed employment for women as part of its effort to provide equal rights and opportunities. Although the formal legal position of women under the present Constitution is comparable to that in most European countries, violence and discrimination against women are considered serious problems. Through privatization, most economic entities were dissolved, though alternatives were not created. The resulting mass unemployment disproportionately affected women, 23% of whom have full-time wage employment compared with 45% of men.

8. According to *World Development Indicators 2004* of the World Bank, Albania, which is 73rd among 141 ranked countries, has an income per capita of USD 1 450, slightly below that of the neighbouring former Yugoslav Republic of Macedonia. The United Nations Development Programme Human Development Index ranks Albania 65th among the 174 countries listed. Income inequality is relatively low as reflected by a national Gini coefficient of 0.28. However, incomes are densely clustered around the official poverty line, indicating that large numbers of people are vulnerable to the effects of economic downturns. Well-directed pro-poor policies can thus be expected to benefit potentially large numbers of people. The dynamics of poverty are therefore arguably more important than precise poverty rates.²

² World Bank, 2002, *Albania: Poverty in Time of Growth*.

9. Beginning in 1998, the economy grew at annual rates of 7-8%, but this slowed to 4.7% in 2002 due to the energy crisis and the effects of floods on agricultural production. Real GDP growth rose to an annual rate of about 6% in 2003 and is expected to stay at this level over the short term. Inflation is presently running at about 3% and has generally remained below 4% in recent years. Sector contributions to GDP have changed substantially during the transition, although figures need to be treated with caution due to adjustments in the method of calculation. A marked drop in the contribution of industry starting in 1992 was accompanied by an increase in the agricultural contribution from about 42 to 55% following privatization and liberalization. Agriculture is still important, but its contribution to the economy is decreasing, representing 33% of GDP in 2002 and 28% in 2003. There are major and growing contributions from construction (11%), as well as transport and other services (43%). The private sector accounts for about 75% of GDP and 80% of employment.³ Although employment in the non-agricultural private sector is rising, over half the labour force is still employed in low income, labour intensive agriculture. The perception of the business environment in Albania has improved since 1999,⁴ although private businesses, particularly small and medium-sized enterprises (SMEs), still face many obstacles. Legitimate enterprises are being adversely affected by unfair competition from the informal economy, as well as illegal trading and illegal administrative practices among registered companies. Weak corporate governance and a widespread lack of management skills, together with an underdeveloped banking system, are also impediments to enterprise expansion and foreign direct investment.

10. A key national goal is the fullest possible integration of Albania into the economic and political mainstream of Europe. This is achievable in part through the Stabilization and Association Process of the European Union (EU), which was launched in May 1999 and encompasses ongoing political dialogue, the liberalization of trade and cooperation with the EU on aspects of justice and home affairs. The EU can decide to negotiate a Stabilization and Association Agreement with each country covered by the Stabilization and Association Process as a precursor to providing funds under Community Assistance to Reconstruction, Development and Stabilization Regulations. Albania currently benefits under such a programme for the period 2002-06. Albania is viewed as a potential candidate for EU membership. While there is widespread popular support for closer association with Europe, this is not matched by a thorough understanding of what convergence might entail and the effort needed to achieve it. Albania became a member of the World Trade Organization in September 2000. Some delays have occurred in carrying out commitments to liberalize trade during the period up to 2007. The maximum tariff rate remains at 15%, although the trade in many industrial products is already liberalized or is subject to very low tariff (2%). The most protected sector continues to be agriculture. Albania has also concluded free trade agreements with neighbouring Balkan countries. To achieve its trade obligations and to benefit from the advantages of free trade agreements in the longer term will require that Albanian exports become much more competitive. Albania presently has limited export capacity, mainly due to scarce industrial and agricultural production, insufficient product quality, poor distribution networks and inadequate consumer protection, including in the application of food hygiene and safety standards.

11. There are now 16 banks operating in the market; all but two of these are foreign owned. The low level and limited geographic coverage of the financial intermediaries is an important impediment to private sector development. Although their lending policies are conservative, bankers appear to be cautiously optimistic and are beginning to broaden their range of financial products, as well as expanding their outreach. Associated challenges are to: (i) increase cash-flow-based lending skills in local banks; (ii) strengthen property rights and facilitate the use of property as collateral through improvements in land registers and cadastres; (iii) educate potential borrowers on aspects of banking; (iv) improve the enforcement of contractual obligations; (v) broaden the availability of creditor information; and (vi) lower the administrative barriers and the costs to transfer remittances to the

³ European Bank for Reconstruction and Development, Transition Report 2003.

⁴ Business Environment and Enterprise Performance Survey, 2002.

Albanian banking system. The promotion of new financial instruments (e.g. leasing) and raising efficiency and market standards in the insurance sector are also seen as key to the development of non-banking financial institutions.

B. Agricultural Sector

12. Arable land constitutes 26% (700 000 ha) of Albania's land area, pasture 16% (425 000 ha) and forest about 36% (1 million ha). Of the arable land, 44% lies along the coast, predominantly in plains, and the remaining 37% and 19% in hill and mountainous areas, respectively. Less than a third of the 417 000 ha equipped for irrigation under the former command economy is now operational, but much of the balance cannot be rehabilitated in a cost effective way under open market conditions.

13. After the collapse of the command economy, the structure of the agrarian sector was transformed by the closure of cooperative and state farms and the redistribution of land through private ownership. The process created about 470 000 small family farms, with an average landholding of around 0.72 ha, typically fragmented into smaller units. In hill and mountain areas, which account for more than half of all agricultural land, some land parcels are even smaller, at around 0.2 ha. Farmers initially adopted a subsistence orientation, adjusting the production patterns of the former state to reflect their own consumption requirements. In areas of higher productive potential, which happen to lay closer to major urban centres, farmers have gradually become more market oriented. This trend is not as marked in mountain areas, where marketing opportunities are fewer and produce is generally less competitive. Farmers are highly individualistic and reluctant to cooperate with others even in the effective management of irrigation or the marketing of produce. The agricultural sector has been a major focus for external technical and financial aid. Despite these efforts, Albania is highly dependent on food imports for covering urban demand for food and agricultural products.

14. Agribusinesses in Albania have either closed down, or are obsolete, unviable and unable to compete with European industry due to shortages in and high prices of raw materials and the generally low quality of locally processed products. Smaller scale private enterprises in agriculture have been slow to emerge due to difficulties in gaining access to loan finance and the adverse conditions for establishing competitive, legitimate marketing systems. Nevertheless, the private sector has gradually prevailed and now dominates the marketing of agricultural outputs and inputs. Overall, the agricultural sector provides direct and associated employment for about 60% of the national labour force. Partly due to the small scale of their operations, many producers individually lack the means to access market outlets for their produce. Their problems are compounded by a scarcity of marketing information, lack of compliance with standards, inadequacies in packaging and labelling and continuing mistrust of the potential benefit of more formalized collaboration in business, for example through specialized, member-run marketing and trading associations. Unless processing industries can be stimulated to act as a catalyst in supply networks, opportunities open to Albanian farmers, including those in mountain areas, will remain underexploited and commercially oriented farming will remain a sporadic and unorganized activity.

15. The removal of the artificially imposed agricultural production patterns of the communist era has led to a resurgence in the importance of livestock, especially of small ruminants in mountain areas. Livestock production is now a major component of Albanian agriculture and accounts for roughly 50% of total sector output. The sale of small ruminants and related products often represents the most important source of cash income for rural households. However, fresh and processed animal products are typically marketed under poor hygienic conditions with little awareness of or respect for food safety standards or the use of veterinary controls. Despite the numerous associated difficulties and shortcomings, the marketing of livestock products, together with a range of fruit and vegetable products and viticulture, nonetheless offers some of the best opportunities for rural poverty reduction in mountain areas.

16. The agricultural workforce is heavily underemployed. However, there are only limited prospects for increasing direct employment in a competitive agricultural sector. Of necessity, notions of rural development are changing, including in the public sector, and the Government is aiming at the development of the institutional capacity to compile and implement agricultural policies within the perspective of European and regional integration, while simultaneously focusing attention on the wider, non-farming aspects of rural economic growth.

C. Rural Poverty

17. In purchasing-power-parity terms, Albania has a USD 2 per day poverty rate, which represents a position that is similar to some countries in the Caucasus, but trailing countries in the next wave of EU accession (Bulgaria and Romania). Despite the relatively strong economic growth in recent years, poverty levels remain high, and Albania's per capita GDP is one of the lowest in Europe. The 2003 Living Standards Measurement Study survey on Albania reveals that a quarter of the Albanian population lives in poverty, although less than 5% lives in extreme poverty and are unable to meet basic food requirements. Demographically, poverty is heavily skewed towards the young, with almost half the poor in Albania below 21 years of age. Larger families are disproportionately represented among the poor, with poverty rates of over 50% among households with seven or more members. Woman headed households are typically less well off than those with men as breadwinners. Poverty also has a marked spatial and regional dimension. According to all indicators of poverty, incidence rates are consistently higher in rural, northern and mountainous areas. Poverty is 66% higher in rural areas than in Tirana and 50% higher in rural areas relative to other urban areas. In the north-eastern districts of Kukes and Dibra, about 45% of the population falls below the poverty line, and 80% of family income is met through social protection schemes, economic assistance and disability payments. Poverty also has a gender dimension as the transition period has had a disproportionately negative impact on women's economic and political status. A particular change can be seen in rural areas, where wage earning jobs, many of which were formerly occupied by women, were terminated because of the closure of state farming and industrial enterprises. Women thereby became more involved in household subsistence farming. Underemployment is especially widespread in rural areas, where about half the labour force works only part time. The situation reflects the structural problems of the rural and farm economy, in which the agricultural sector provides a substantial share of income for the rural poor, albeit through very small farm units.

18. Disparities in the non-income dimensions of poverty are even more pronounced than those based on income and expenditure measures. Aside from issues of service quality, the coverage of basic infrastructure and social services (water, sanitation, health and education) is more or less universal in urban areas, but much less so in poorer rural areas. While the electricity network has good coverage, the availability of power, though everywhere unreliable, is markedly so in rural areas. Primary school enrolment rates are now lower among the poor and lowest among the extreme poor. According to the Living Standards Measurement Study, the malnutrition rate among children under 5 years of age (expressed as severe and moderate stunting and moderate wasting) is generally higher in rural areas. The characteristics of rural poverty illustrate the importance of non-farm employment opportunities as potential ways out of poverty for rural Albanians. At a macro-level, the spatial and regional dimensions of poverty also have clear implications for the design of policies and programmes to reduce poverty and improve the targeting of poverty reduction and social investment measures.

D. National Strategy for Rural Poverty Reduction

19. The efforts of successive governments to reduce rural poverty stem from the need to improve rural livelihoods on humanitarian and social grounds, as well as the need to reduce migration to coastal and urban areas. The initial response to mounting rural poverty and deteriorating rural food security in 1991 was to distribute land to the rural population as a survival mechanism. Subsequently, efforts were based on a combination of social assistance programmes and development-oriented

support. During the mid-1990s, rural development focused mainly on the rehabilitation of small scale infrastructure (much of which was vengefully damaged or destroyed in the early stages of transition) rural credit delivery and veterinary prophylaxis, implemented primarily through the Government's Albanian Development Fund. Until the advent of the IFAD-financed projects, few development initiatives were directed towards the demonstrably poorer mountain areas. The investment imbalance continues, and mountain areas remain relatively neglected and underdeveloped.

20. Most recently, the explicit expression of the Government's approach to poverty reduction has involved preparation of the Growth and Poverty Reduction Strategy 2001 (the equivalent of the current NSSED), which analysed the requirements for medium term priorities in public investment and a long-term vision for national development. The NSSED is viewed as a dynamic, evolutionary process rather than a static document. Associated core documentation has already been adjusted and enriched to provide for gradual moves towards European integration following Albania's entry into the Stabilization and Association Agreement with the European Commission in 2003. The NSSED Progress Report 2003 recognizes economic growth as the "main mechanism to reduce poverty and macroeconomic stabilization as the way to create a suitable environment for sustainable growth".⁵ The strategy emphasizes the creation and maintenance of an enabling business environment and the promotion of employment opportunities for the poor, the enhancement of human capital through increased investments in education and health and the empowerment of the poor through their greater involvement in the political process. NSSED is seen also as a means of raising the profile of a series of regional development strategies being prepared with UN support that aim to focus attention on actions contributing to the achievement of Albania-relevant Millennium Development Goals.

21. In February 2001, the Government adopted the Policy Agenda for Socio-Economic Development, which was based on the Public Investment Programme 2000-03 and the Medium Term Expenditure Framework 2001-03. The latter is viewed as a valuable means to promote the pro-poor allocation of public funds in a way consistent with policies for sustainable growth. The policy agenda covers: (i) governance and institutional development, including improved public order, real decentralization to local government, anti-corruption, legal reform and enhanced judiciary capacity; (ii) human resources and social services with increased resources to education and health, improving school attendance, consolidating education in rural areas and reorganizing vocational education to meet labour market demand, as well as sustaining the social safety net; (iii) private sector development through a competitive and internationally integrated enterprise sector able to attract foreign direct investment; and (iv) public infrastructure.

III. LESSONS FROM IFAD'S EXPERIENCE IN THE COUNTRY

22. Both the North-Eastern Districts Rural Development Project and the Small-Scale Irrigation Rehabilitation Project had the typical characteristics of a time-bound project approach in which multiple, pre-specified activities were to be carried out under the overall responsibility of centralized management systems. The implementation difficulties experienced in both projects illustrate the constraints that can be imposed by inadequacies in fiscal controls and the human resources available to those public institutions charged with project oversight. Both projects also showed that, particularly in the early stages of Albania's economic transition and in poorer areas, the time perspective necessary to build capacity in public institutions and civil society was longer than had been anticipated in the project designs. The projects relied on public institutions for implementation and assumed that there would be popular enthusiasm for collaborative arrangements at the local level and that this would help achieve development impact (i.e., support for the role of water users associations and the widening of access to credit through group based lending), this at a time when people's

⁵ Republic of Albania, Council of Ministers, Tirana, April 2004, National Strategy for Socio-Economic Development: Progress Report, 2003.

confidence in and commitment to public institutions were extremely low and the population at large had adopted a highly individualistic approach to survival.⁶ There was little experience with the village credit fund and the concept of group based lending, which has proved unsustainable in the Albanian context. The projects also illustrated the difficulty of achieving significant impact on rural livelihoods through a focus on a single subsector or via a multiplicity of separately implemented initiatives that are capable individually of generating only very small gains in any one aspect of the development of marginal areas.

23. The backdrop of the early projects was one of acute political volatility. Furthermore, the semi-lawless situation that prevailed for much of the period of implementation of the projects often precluded the effective local management and supervision of investment activities, thereby contributing to the severe shortcomings observed in the quality of the work on infrastructure carried out under the projects and the level of control achieved over the associated expenditures. Nevertheless, the rehabilitation of small-scale irrigation schemes and the services made available through the projects showed that farmers could be supported in the adoption of survival-oriented diversification in cropping patterns.⁷ A significant number of village credit funds, of which some are still functioning, provided crucial initial support so that village communities could cope with the dramatic changes. In retrospect, it is clear that the projects were implemented in what, for most practical purposes, were conflict or post-conflict contexts.

24. In recognition of these earlier experiences and to take advantage of more stable operational conditions, the 1999 COSOP sought to create a cogent, coherent programme for the development of marginal areas in Albania over the medium to long term. The approach aimed at promoting sustainable increases in economic activity in disadvantaged areas and hence the integration of these areas into the national economy. This was to be achieved by: (i) maintaining a focus on the poorer, most marginalized areas; (ii) building institutional capacities at the local and national levels for the development of marginal areas; (iii) introducing a more flexible programmatic approach through the establishment of two autonomous institutions, the Mountain Areas Development Agency (MADA), which would undertake a series of investments in mountain areas, and the Mountain Areas Finance Fund (MAFF), which would cater for rural credit; and (iv) contributing to poverty reduction through the promotion of expansion in agriculture and related sectors based on the incentive of profitability and on sustainability and improved access to appropriate and timely financial services.

25. The initial tendency in MADA to view its involvement in multiple thematic areas as discrete sets of activities was reminiscent of the former project approach. The adjustments recommended by the mid-term review mission (October 2003) sought to ensure adoption of a coordinated programmatic approach. First, the adjustments introduced the concept of strategic investment plans (SIPs) as a tool for understanding interrelationships and developing a series of investment activities based on a holistic approach aimed at improving efficiency in key supply chains. The SIPs are based on specific commodities and involve producers, processors, traders and financial institutions; constraints and opportunities are defined, and a joint investment programme is subsequently

⁶ It must be emphasized that, at the time of the design of the North-Eastern Districts Rural Development Project and the Small-Scale Irrigation Rehabilitation Project, project implementation by the line agencies of central ministries was virtually a necessity. The build-up of private sector capacity and entrepreneurship was still in its infancy on a national level and largely absent in the more remote areas served by the projects. Also at that time, newly developed regulations on local government were not being applied, and local authorities had insufficient administrative and fiscal autonomy. The National Strategy for Decentralization and Local Autonomy was ratified by Parliament only in 2000. It enshrines the principle of subsidiarity, assigning public functions to the lowest level of government whenever possible. Creating the conditions under which local governments can assume their assigned responsibilities effectively and efficiently represents a major ongoing challenge.

⁷ IFAD, 2003, North-Eastern Districts Rural Development Project Completion Report and the Small-Scale Irrigation Rehabilitation Project Completion Report, Rome, December.

developed. Second, the adjustments sharpened the focus of local institution-building activities to emphasize support for the emergence of stakeholder forums and the participatory development of a vision for mountain area development. Third, the recommendations of the mid-term review highlighted the linking of new initiatives in the rehabilitation of small scale infrastructure to the requirements identified through the SIP process. MADA personnel are now putting the changes into effect, albeit with substantial technical support and guidance. The experience gained through the MADP, consistent with that in other development arenas in Albania, suggests that a cross-sectoral view of development requirements and opportunities represents an innovative concept within the Albanian context, but also a condition for long-term development. At the same time, putting in place the institutional and human resource apparatus for this to happen is a time consuming process. These elements, however, will be key requirements in the design of support for the Investment Programme for Sustainable Development in Rural Mountain Areas.

26. MADA is beginning to show that it can influence the nature and scale of development activities at the local level in a more holistic and potentially sustainable manner and has thereby raised its visibility and credibility among stakeholders in mountain area communities. Simultaneously, MAFF is demonstrating that rural lending can occur on a sustainable basis in what is considered the high-risk environment of the mountain areas and in support of individual business investments and SME expansion. The growing impact of institutions and the level of interest shown in their operations suggest that their sustained ability to function over the medium to long term would be perceived, certainly at the local level, as an advantage. MAFF loans in arrears are almost exclusively village credit fund loans and predominantly (90%) those inherited from the earlier projects. Arrears for individual and SME loans presently amount to 1.4%.⁸ The increasingly wide range of activities for which loans are being secured and the levels of loan repayment are indicative of a growing confidence in investment in business opportunities and livelihood improvement, the emergence of a new attitude towards loan repayment and a greater understanding of business management requirements.

27. Although their boards of trustees are currently composed exclusively of government representatives, MADA and MAFF were established and continue to operate as autonomous institutions with executive authority rather than as line agencies of the Government. This arrangement has undoubtedly enabled them to function with a minimum of operational interference and helped to create transparency and accountability in their respective activities.

28. IFAD, through its Gender Mainstreaming Programme in Central and Eastern Europe and the Newly Independent States, has been providing technical assistance to MADP in order to address gender inequality and increase women's participation in the activities of the project. Several measures have been introduced within project operations such as gender-sensitive needs assessment and monitoring, and staff have been trained in gender and rural development concepts. However, the gender inequality issue has not yet substantially raised the number of women project-beneficiaries. As part of the gender sensitive strategy, MADA will pilot a gender self-targeted approach by developing two SIPs in areas traditionally dominated by women. These activities will generate employment opportunities for women and empower women to become more active economic agents within their communities, thus discouraging them from emigrating and reducing the risk they will be trafficked. Within MAFF, the gender programme provides grant financing for the implementation of a knowledge generation and skills development project for rural women and youth, which improves the access of rural women and youth to information, new technologies and higher incomes.

⁸ IFAD and United Nations Office for Project Services, November 2004, Albania: MADP Supervision Mission, Aide Memoire.

IV. STRATEGIC FRAMEWORK FOR IFAD

A. IFAD's Strategic Niche and Proposed Thrusts

29. The IFAD strategy in Albania over the last 11 years has been to provide a basis for promoting sustainable increases in economic activity in disadvantaged mountainous areas and the closer integration of these areas into the national economy. Investments in the first two projects were geared towards broadbased poverty reduction. The 1999 COSOP maintained IFAD's focus on the mountain areas through a programmatic investment approach, counterbalancing the support of development partners for areas of higher potential. Inevitably, there remains a geographical imbalance in the level and scope of development opportunity in Albania. However, as noted above, recent poverty analyses have confirmed the regional dimensions of poverty and provide ample justification for IFAD to direct its attention to the special circumstances, needs and potentials of mountain areas. The experience of IFAD in project implementation in mountain areas has shown that there is real economic potential in terms of livestock, medical herbs, horticulture production, complementary agro-processing, as well as a number of non-agricultural economic activities (including agro-tourism, wood processing and stone carving). There is also a clear opportunity to consolidate and build upon the achievements of the specialized institutions established under MADP.

30. The Fund will endeavour to ensure that those who are able and interested in doing so can become engaged in economic activity that will generate income. It will seek to stimulate the broadening of opportunities for employment generation in poorer areas through continued support for SME development. This implies a need to ensure enhanced access to a range of supportive financial instruments and funding sources to serve a variety of investments. MADP-sponsored operations are providing an improved platform on which to build appropriate partnerships and institutional responses to serve these requirements in the complex economic realities of mountain areas.

31. The absolute limits imposed by the agroecology of the mountain areas suggest that agriculture, while continuing to be important for many rural livelihoods, cannot be viewed as the sole vehicle for the economic revival of the mountain areas. Future improvements in agricultural production and productivity will derive from adjustments in farming practices, the consolidation of landholdings under leasing and sales agreements leading to intensification and mechanization and, in turn, to decreases in the agricultural workforce. To avoid adding to present levels of unemployment, it will be essential to emphasize the stimulation of employment in other sectors within a diversified rural economy and thereby lessen the reliance on primary agricultural production as the basis of rural livelihoods, including in mountain areas. Additional opportunities for diversification in economic activity are emerging. These must be nurtured in a way that promotes the accrual of more value-added to the rural poor, while ensuring relative equity that is consistent with the achievement of sustained private sector growth. To meet the obvious need for economic development and diversification will involve:

- (a) adopting a programmatic approach within a longer-term vision of development;
- (b) maintaining momentum and focus on the reduction of poverty in particularly disadvantaged and neglected areas of the country through the catalytic role and functions of specialized institutions, namely MADA and MAFF;
- (c) addressing the gender dimensions of poverty and creating gender responsive interventions that enhance the economic role of rural women and youth;
- (d) building effective partnerships with others, including through: (i) contracting the necessary specialized services for implementation; (ii) leveraging additional funds from other sources; and (iii) introducing a holistic, consultative approach to improving supply chain management for farming-related and non-farming businesses, together with expanded access to appropriate financial services and lending products;

- (e) explicitly recognizing the importance of support for non-farming and agriculture-related aspects in boosting the rural economy and increasing rural employment opportunities;
- (f) using consultative procedures for strategic planning with local stakeholders;
- (g) strengthening local advocacy through support for the emergence of stakeholder forums; and
- (h) influencing government policy both in an overall sense for the mountain areas, as well as in discrete technical areas, for example the adoption of procedures for the collaborative operation and maintenance of small scale infrastructure by user groups and the evolution of national procedures for the control of animal diseases.

B. Main Opportunities for Innovations and Project Interventions

32. Officially, the loan for the MADP is scheduled to be completed in 2007. However, the current rate of disbursement and the level of remaining funds under the programme indicate a likely completion by mid-2006. Assuming that the volume of IFAD support to Albania is maintained at the present level, it will be appropriate to finance one investment programme during the period of the new COSOP (2006-12).

33. Progress in the transition process is leading to the opening up of new avenues for support for commercial and economic development – including in the mountain areas – that were unthinkable in Albania even a few years ago. The Fund can now explore these avenues in the interest of the rural poor and as a means of both consolidating the programmatic approach initiated under MADP and capitalizing on the experience and gains made in directing resources specifically to mountain areas. MADA and MAFF are positioning themselves to become main players in this development, thus contributing to the overall goal of increasing the income of mountain area households.

34. The Government's vision for mountain areas as developed within the NSSED framework calls for poverty reduction through the strengthening of the operation of the private sector within an enabling context, environmental protection measures and greater investment in social and economic infrastructure. The Fund should support MADA so that it can play an important role in the realization of the vision in terms of consolidating the programmatic approach, strengthen resource mobilization activities and as a facilitator of partnerships. Accordingly, IFAD should assist the institution in shaping its strategy and business practices. Key requirements will be for MADA to: (i) market itself as a promotional agency, capable of connecting people to sources of business and specialist advice, training opportunities, contributory grants and loan financing; (ii) become more proactive in catalysing various forms of partnerships, individual and corporate business initiatives, or community investments associated with a potentially wide range of thematic areas relevant to economic growth and sustainable resource management in mountain areas; and (iii) establish an institutional capacity to judge the relevance of investment proposals for the overall economic advancement of mountain areas and, where appropriate, gauge the eligibility of proposals for contributory grants. MADA can also become instrumental in attracting new sources of funding, for example through the EU's mountain area initiative, the Global Environment Facility and the World Heritage Fund, as well as in accessing support on behalf of its clients from other development programmes in Albania and the region.

35. The proposed broadening of perspectives in performing a promotional, catalytic role and the development of partnerships operating under a range of mechanisms such as SIPs and mountain area forums represent innovations both for the Fund and within an Albanian context. IFAD, through its investment programme, will enable Albanian institutions to adopt a programmatic approach. The external resources mobilized through the partnerships that MADA fosters may not necessarily be channelled through MADA, nor may the associated activities become subject to MADA oversight. They should simply be consistent with expanding and safeguarding the mountain area economy.

36. With technical support from Rabobank and financed by IFAD, a long-term strategy and business plan for the period 2005-10 have been developed for MAFF. These instruments provide the basis for continued IFAD engagement with that institution. Compared to the present situation, in which MAFF is offering only a series of loan products, the progressive restructuring of MAFF into a self-funding, private rural bank with cooperative characteristics providing a full package of rural financial services is an innovative development in Albania, but also a necessary element for economic diversification and growth in mountain areas. IFAD will also assist MAFF in securing equity financing from international financial institutions and private sector partners so as to ensure the institution's long-term sustainability. IFAD has substantial experience in supporting the evolution of the financial institutions in transitional economies that will be drawn upon in restructuring MAFF.

C. Outreach and Partnership Possibilities with NGOs and the Private Sector

37. There are substantial, expanding opportunities for linkage with private sector institutions, especially commercial banks and NGOs, in order to stimulate private business investment and promote greater economic activity. Several banks are widening their outreach for lending through branch networks in regional centres and rural towns serving mountain areas, notably the American Bank of Albania, Raiffeisen Bank and Procredit Bank. The innovations to be explored with the commercial banks, but most notably with MAFF, include the development of new financial instruments such as leasing and insurance, alternative collateral instruments and the consideration of adjustments to loan repayment terms and conditions according to the specific requirements of a given investment (e.g., grace periods, irregularly phased payment plans). Opportunities can also be explored for mobilizing savings and remittances. Following the establishment of MAFF as a fully fledged rural bank, support connecting that institution to Italian institutional partners will facilitate the flow of remittances.

38. The successful development and application of the process of SIP preparation and the participatory identification of different types of investment opportunities are, in effect, a form of 'due diligence' by MADA that can be a valuable adjunct to the consideration of loan applications by financial institutions. Interest in the SIPs has been expressed by several commercial banks, which, at this stage, remain relatively unfamiliar with rural areas, as well as by representatives of microcredit programmes assisted by the United States Agency for International Development (USAID). The adoption of the SIP approach is helping in the identification of potential opportunities for partnerships or formalized contractual relationships among various parties within the private sector, as well as NGOs, in aspects of business planning and business management and in specialized technical areas such as small-scale dairy development, viticulture and food processing. Such relationships will be expanded.

39. Because of the increased focus on the promotional role and functions of MADA, linkages can be envisaged with successful, well-established agencies elsewhere in Europe – including through twinning arrangements – and via interchanges between chambers of commerce and other representative bodies geared towards human resource development, investment mobilization and market development.

D. Opportunities for Linkages with Other Donors and Institutions

40. Substantial opportunities exist for strategic cooperation and linkage with the EU, the World Bank, USAID and the United Kingdom's Department for International Development (DFID) with respect to improving the business environment in Albania. Each of these donors, backed by

substantial resources,⁹ is involved in initiatives aimed at reducing the barriers to legitimate private enterprise and improving the protection of legal rights commensurate with the needs of a liberalized, market-oriented economy, the terms of the international agreements to which Albania subscribes and the requirements to be met in achieving closer integration in Europe. A particularly close linkage is envisaged with USAID's programmes in the financial sector dealing with SME development and the delivery of microcredit. These programmes are expanding the geographical areas in which they operate so as to include a number of rural towns in the mountain areas, and they can become close partners or contractors for SME-related initiatives. In the context of improved supply chain management, additional links can be envisaged also with a number of private, chiefly agriculture-related associations that USAID has encouraged and supported over a number of years, e.g. traders associations and producers associations.

41. There is considerable scope for developing operational links with the EU, DFID and USAID efforts in institutional strengthening and the improvement of governance at the national, regional and local government levels within the framework of the Government's decentralization policy. For example, MADA's institutional capacity-building work with local government authorities and the expression of views expected to emerge from the stakeholder forums can both influence and take advantage of the investment programmes of other donors in related fields.

42. As the promotional and catalytic activities under MADP expand, it will be important for the actors to become aware of and help clients take advantage of the outcomes of the programmes of the World Bank, the International Finance Corporation, the European Bank for Reconstruction and Development and the European Investment Bank dealing variously with the rehabilitation and expansion of the utilities and infrastructure that presently constrain economic activity. A particularly close linkage with the World Bank-sponsored Agricultural Services Project is also anticipated for the development of best practices and policy development in irrigation water management and in helping mountain area farmers and processors to take advantage of the construction of wholesale market facilities through the project. Similar complementary efforts can be conceived in relation to the forthcoming World Bank support for a major natural resources management project. Specifically, in the mountain areas of Albania's northern region, linkages can be anticipated with the Economic Development Programme of the German Agency for Technical Cooperation; the German agency's grant aid funds for technical assistance would complement funds available through MADP institutions.

⁹ The World Bank's Country Assistance Strategy (2002-05) earmarks about USD 97 million for programmes to improve governance and strengthen institutions, promote sustainable private sector growth and foster human development. The International Finance Corporation portfolio since 1998 has amounted to USD 90 million for the support of major privatization schemes (including in the banking sector), and the Multilateral Investment Guarantee Agency is guaranteeing major investments in Albania by regional banks. The European Bank for Reconstruction and Development has provided EUR 120.9 million to support private sector development in banking, tourism, SME growth and construction and is assisting public sector programmes in telecommunications, the reconstruction of energy supply and road rehabilitation. The European Investment Bank is assisting in road reconstruction and SME development. Under the EU Community Assistance to Reconstruction, Development and Stabilization initiative, EUR 91 million has been assigned for 2005/06 for programmes aimed at democratic stabilization, good governance and institution building, economic and social development and the opening of community programmes. Annual USAID assistance is on the order of USD 20 million in the fields of economic growth, democracy and governance, legal and judicial systems and primary health care and in a number of cross-cutting areas dealing with the trafficking in humans, the promotion of religious harmony, energy sector planning, and the monitoring of the effects of the poverty reduction strategy paper on rural people. USAID is also supporting Albania's candidacy for the Millennium Challenge Account. DFID has allocated the equivalent of about USD 15 million for Albania as part of its Western Balkans Aid Framework for the three year period 2003/04-2005/06.

43. Increasingly close links with the EU can be envisaged; the pre-accession funds can be tapped in order to support and expand MADP operations, and, similarly, through its local level operations, the MADP can improve the platform for attracting additional EU funds. Conceivably, the capacities of local governments can be strengthened to a point that communities can become eligible for EU funding on their own account under the principle of decentralization. Standards of food safety are becoming critical for more discerning and safety-conscious domestic markets, as well as for the improved penetration of export markets. In this connection, MADP-supported efforts in SME development and enhanced supply-chain management for agricultural commodities can benefit from closer operational linkages with EU programmes that focus on the improvement and regulatory aspects of food quality and food hygiene standards. Such activities have already been initiated under the Facility for Farmers' Access to Markets, which is financed by the Government of Italy. The access facility is underpinning IFAD's investments in Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, and Albania through a broad range of interventions seeking to eliminate constraints on the penetration by farmers of domestic and international markets.

E. Areas for Policy Dialogue

44. The PBAS performance indicators (lower scores) help identify the issues on which IFAD should focus in its policy and institutional dialogue with the Government in support of the development of mountain areas. These issues include: (i) dialogue between grass-roots organizations and the Government; (ii) the investment climate for rural businesses; and (iii) access to extension services.

45. A key objective in the policy dialogue (point (i) above) is to draft and obtain the Government's agreement to adopt an explicit statement of policy or a presentation of the specific constraints and the potential for economic growth in mountain area development. The NSSED – the national poverty reduction strategy paper – provides a national development policy framework, but does not, in its current form, reflect the constraints faced in the mountain areas of Albania. Significant efforts are being made through MADA to redress the situation. At a minimum, the NSSED should incorporate a confirmed set of guiding principles for the development of mountain areas that can assist in raising the profile of the areas, influence budgetary allocations and stimulate policy debate in the interests of improved mountain area livelihoods. IFAD will continue to work with the Government to ensure that the forum process is consolidated and institutionalized in favour of the mountain areas so as to enhance participatory policy development and mobilize resources through local advocacy.

46. Attracting private investment to rural areas in support of the rural poor and their productive activities requires enabling policies and institutions in the rural sector. Using the SIP process, IFAD will strive to engage in a dialogue with the Government and other relevant stakeholders to improve the business environment for SME development in mountain areas. Specifically, issues such as weak corporate governance, the widespread lack of management skills and the non-transparent regulatory environment impede the emergence of a thriving private sector.

47. In terms of policy dialogue on extension activities, the ongoing IFAD support for the brucellosis control programme in small ruminants and the monitoring of the effectiveness of the control methodology will help keep the Government informed of the requirements for policy adjustments in line with the EU *acquis communautaire*. Through MADA and in collaboration with the EU Community Assistance to Reconstruction, Development and Stabilization initiative on small ruminant health, IFAD will contribute to the required policy changes so as to improve livestock health and phytosanitary standards and thus improve the competitiveness of Albanian products.

F. Action Areas for Improving Portfolio Management

48. Gradual steps have been taken during 2004 by MADP institutions to respond to the recommendations of the mid-term review. Additional measures will be introduced during 2005 as part of a series of actions consistent with MADP's programmatic implementation approach. A progressive transformation of MAFF into a private rural bank would obviously strengthen its independence in operations. In the case of MADA, recommendations to broaden board representation to reflect the agency's role in stimulating economic activity should be adopted. It will be essential in a future phase of support to ensure that private sector interests and, more specifically, mountain area interests are represented at the board level. More effective management and technical skills must be made available within MADA subprogrammes if the agency is to take full advantage of future technical assistance inputs and to put in place the in-house skills required to help in guaranteeing MADA's longevity as a major promotional body effective in national and international arenas. The present deficiency is partly due to the institutional and political environment in Albania, which is predisposed to emphasizing concrete investments for the delivery of short term gains rather than being concerned with a longer-term view.

49. MADA is presently functioning mainly as a technical services unit, supporting the design and execution of activities under three subprogrammes that are primarily financed from MADP's own resources and controlled by MADA. Given the dearth of reliable contract service providers in Albania, it will not be appropriate for MADA to continue exponentially to expand its own capacity in order to retain control. Increasingly, there will be a need to de-emphasize reliance on control and supervision and proportionately increase the emphasis on the agency's role as a promoter of partnerships that are self-governing and built on the use of non-MADA funds. The introduction of the SIP concept into MADA's private sector development subprogramme represents an important advance in MADA's recognition of the interrelated nature of the requirements of development and the importance of stimulating complementary investments to the mutual benefit of interested parties within a given supply chain. There is scope progressively to explore mechanisms for developing SIPs and to broaden usage of the underlying planning concepts of 'supply chain management' to encompass resource networks linked to non-farming economic activities.

G. Tentative Lending Framework and Programme of Work

50. IFAD's strategic niche in Albania derives from its association with rural poverty reduction and agricultural development issues in mountain areas over an 11 year period. Throughout this time, IFAD has remained the major external source of institutional support and finance in mountain areas, which have been largely neglected by other donors in favour of stimulating more rapid economic growth in areas of higher potential. A substantial body of implementation experience has been built up that continues to inform ongoing development efforts under MADP and that can help to guide future government policy, as well as the design of a new phase of IFAD support. With close supervision and substantial levels of technical support made available through DFID and the Facility for Farmers' Access to Markets initiative of the Italian Government, progress continues to be made in building the capacity and effectiveness of the institutions established under the MADP. Together, the institutions are helping to establish a platform from which investors and communities in the mountain areas can take advantage of economic growth and the multiplicity of ongoing efforts in socio-economic development in order to increase their incomes and opportunities for employment. MADP-sponsored institutions have gone some way in shifting IFAD and governmental support from a project orientation towards a more programmatic approach. It is now feasible to introduce measures designed to emphasize the facilitating, catalytic roles of institutions operating in the interests of the poor in disadvantaged mountain areas.

51. The country's current PBAS rating is, on the whole, quite positive, in particular with respect to macroeconomic, sectoral and portfolio performance indicators. However, given its small population

and on the basis of current PBAS projections, Albania qualifies for a *base lending scenario* of only USD 7-8 million every six years. This scenario would create a serious challenge for the development of an investment programme of interest to the Government and would imply disproportionate project development and supervision costs for IFAD. A *low case scenario*, which could be triggered by the worsening of the policy and institutional framework, would push the PBAS projection to the minimum USD 1.0 million per year, for a USD 6 million loan every six years. However, this is highly unlikely, given Albania's strong performance over the past several years. On the other hand, it is expected that, with further improvements in the policy and institutional framework and because of positive rural sector performance and the probability of an increase in the available resources, a *higher case scenario* is likely. This would entail the presentation to the Executive Board in late 2005 of an investment programme for sustainable development in rural mountain areas valued at about USD 9-11 million. In order to strengthen the programmatic approach within a limited resource envelope, opportunities for attracting supplementary external cofinancing will be explored in line with the requirements identified during the investment design process. This would include cofinancing with the Organization of the Petroleum Exporting Countries, the Global Environment Facility, the Italian Government and other international financial institutions involved in the agricultural sector. In addition, grants from IFAD's core resources and supplementary funds will be sought so as to support innovative institutional development, such as the establishment of the new rural bank, mountain area forums and technical assistance for the development of a remittances programme.

APPENDIX I

COUNTRY DATA

ALBANIA

Land area (km² thousand) 2002 1/	27	GNI per capita (USD) 2002 1/	1 450
Total population (million) 2002 1/	3.15	GDP per capita growth (annual %) 2000 1/	4.1
Population density (people per km²) 2002 1/	115	Inflation, consumer prices (annual %) 2002 1/	8
Local currency	Lek (ALL)	Exchange rate: USD 1 =	ALL 97
Social Indicators			
Population (average annual population growth rate) 1996-2002 1/	0.0	Economic Indicators	
Crude birth rate (per thousand people) 2002 1/	17	GDP (USD million) 2002 1/	4 835
Crude death rate (per thousand people) 2002 1/	6	Average annual rate of growth of GDP 2/	
Infant mortality rate (per thousand live births) 2002 1/	22	1982-1992	-2.3
Life expectancy at birth (years) 2002 1/	74	1992-2002	7.7
Number of rural poor (million) (approximate) 1/	n/a	Sectoral distribution of GDP 2002 1/	
Poor as % of total rural population 1/	n/a	% agriculture	25
Total labour force (million) 2002 1/	1.59	% industry	19
Female labour force as % of total 2002 1/	42	% manufacturing	10 a/
		% services	56
Education			
School enrolment, primary (% gross) 2002 1/	107 a/	Consumption 2002 1/	
Adult illiteracy rate (% age 15 and above) 2002 1/	1 a/	General government final consumption expenditure (as % of GDP)	8
Nutrition			
Daily calorie supply per capita	n/a	Household final consumption expenditure, etc. (as % of GDP)	93
Malnutrition prevalence, height for age (% of children under 5) 2002 3/	32 a/	Gross domestic savings (as % of GDP)	-1
Malnutrition prevalence, weight for age (% of children under 5) 2002 3/	14 a/	Balance of Payments (USD million)	
Health			
Health expenditure, total (as % of GDP) 2002 1/	4 a/	Merchandise exports 2002 1/	330
Physicians (per thousand people) 2002 1/	1 a/	Merchandise imports 2002 1/	1 516
Population using improved water sources (%) 2002 3/	97 a/	Balance of merchandise trade	-1 186
Population with access to essential drugs (%) 1999 3/	50-79		
Population using adequate sanitation facilities (%) 2002 3/	91 a/	Current account balances (USD million)	
Agriculture and Food			
Food imports (% of merchandise imports) 2002 1/	20	before official transfers 2002 1/	-1 092
Fertilizer consumption (hundreds of grams per ha of arable land) 2002 1/	324 a/	after official transfers 2002 1/	-408
Food production index (1989-91=100) 2002 1/	n/a	Foreign direct investment, net 2002 1/	135
Cereal yield (kg per ha) 2002 1/	3 265		
Land Use			
Arable land as % of land area 2002 1/	21 a/	Government Finance	
Forest area as % of total land area 2002 1/	36 a/	Overall budget deficit (including grants) (as % of GDP) 2002 1/	n/a
Irrigated land as % of cropland 2002 1/	49 a/	Total expenditure (% of GDP) 2002 1/	n/a
		Total external debt (USD million) 2002 1/	1 312
		Present value of debt (as % of GNI) 2002 1/	18
		Total debt service (% of exports of goods and services) 2002 1/	3
		Lending interest rate (%) 2002 1/	15
		Deposit interest rate (%) 2002 1/	9

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* CD Rom 2004

2/ UNDP, *Human Development Report*, 2000

3/ UNDP, *Human Development Report*, 2004

Narrative Summary	Verifiable Indicators	Means of Verification	Assumptions/Risks
<p>Goal Income of households in the mountain areas of Albania increased.</p>	<ul style="list-style-type: none"> Reduction in percentage of rural poor people living on USD 2/day. Increase in ownership of household assets. Reduction in the prevalence of malnutrition for children under five (weight for age, height for age, weight for height). Number of new full-time equivalent jobs created. 	LMS and/or DHS data, disaggregated by district. Impact assessment surveys. Albanian Institute of Statistics studies.	Political stability and continued Government commitment to pro-poor macro-economic policies and institutional reforms.
<p>Purpose/Objective Increase in the public/private investments in the mountain areas based on needs defined by communities.</p>	<ul style="list-style-type: none"> USD equivalent of public/private investments made in mountain areas. 	Enterprise records. National and local budgets/tax records.	Budgetary allocations as stipulated in the NSSED and the MTEF implemented. Regulatory framework for improving corporate governance enforced.
<p>Outputs</p> <ol style="list-style-type: none"> Access to diversified rural financial services in mountain areas improved. Mountain area influence local and national policy agenda. Effective institutional mechanisms to promote private/public partnership put in place. 	<ol style="list-style-type: none"> Year on year increase in the number of people accessing RFS in mountain areas. Year on year increase in the value of RFS transactions in mountain areas. Increase in the # of service providers operating in mountain areas. <ol style="list-style-type: none"> Number and type of laws/regulations promulgated in support of mountain areas. Mountain area development issues incorporated into NSSED. <ol style="list-style-type: none"> Number of strategic investment plans (SIPs) fully funded and implemented. Share of SIPs financed by private sector. 	Rural financial service providers records. Local/national government registers. SIP plans and enterprise records.	Banking license obtained by RFS operating in mountain areas. More authority and decision-making devolved to local entities as per local government reforms.

STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS (SWOT) ANALYSIS

Organization	Strengths	Weaknesses	Opportunities	Threats
Rural population/Rural areas.	<ul style="list-style-type: none"> • Educated labour force. • Experience in advantageous horticulture and small ruminant production. • Scenic attraction and ecological diversity of mountain areas. 	<ul style="list-style-type: none"> • Loss of skills through internal migration and emigration. • Low and irregular quality of mountain area produce. • Deteriorated and/or inadequate rural infrastructure – isolation. • Deteriorated natural resource base in mountain areas. 	<ul style="list-style-type: none"> • Economic rationalization of landholdings linked with diversification of rural economy. • Scope for SME development, especially agro-processing and services. • Potential to expand internal and external markets for mountain area produce of improved quality. • Potential for agro-tourism, eco-tourism; winter sports. 	<ul style="list-style-type: none"> • Risk of inadequate business regulation discouraging private investment; adverse competition from unlawful business practices and corruption. • Insecurity.
Government of Albania.	<ul style="list-style-type: none"> • Legal and regulatory framework increasingly consistent with needs for economic growth. • NSSED in place. • Committed to pivotal role in the economy of the private sector. • MADA in place and gaining experience as specialised mountain area institution. 	<ul style="list-style-type: none"> • Inadequate capacity to ensure adherence to laws and regulations. • Lack of explicit policies for mountain area development. • Inadequate capacity in MADA. 	<ul style="list-style-type: none"> • Regional FTAs and membership of WTO. • Pre-accession funding from EU. • Substantial donor support for improved governance, democratisation and public infrastructure. • Pro-active role of MADA as a promotional agency attracting additional resources/facilitating partnerships for business development in mountain areas. 	<ul style="list-style-type: none"> • Continuing threats to political security.
Local Government.	<ul style="list-style-type: none"> • Broadened responsibilities under decentralization policy. • Access to substantial external resources for decentralization. 	<ul style="list-style-type: none"> • Limited capacity/experience in self-administration. 	<ul style="list-style-type: none"> • Improved local govt. capacity can attract further external resources to strengthen democracy, e.g. from EU, DFID, USAID. 	<ul style="list-style-type: none"> • Slow pace of devolution and reluctance to devolve responsibility to regional and local governments.

STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS (SWOT) ANALYSIS (CONTINUED)

Organization	Strengths	Weaknesses	Opportunities	Threats
Banks & financial institutions.	<ul style="list-style-type: none"> • MAFF in place and gaining experience as specialised mountain area institution. • Commercial Banks and non-banking financial institutions expanding outreach. • Evidence of improving business culture and attitudes towards credit financing and loan repayment. 	<ul style="list-style-type: none"> • Conservative bank lending policies. • Small number of banks/financial institutions serving rural areas. • Inappropriateness of available financial products for many rural clients. 	<ul style="list-style-type: none"> • Substantial liquidity in banking sector including from high level of remittances. • Increasing interest among banks/financial institutions in broadening range of available financial products and broadening client base, including in rural areas. • Potential for restructuring MAFF to improve likelihood of longevity in interests of mountain area clientele. 	<ul style="list-style-type: none"> • Stability of conducive macro-economic environment.
Client Organizations and Civil Society.	<ul style="list-style-type: none"> • Small number of specialised producer/trader associations now operational – mainly established with strong donor support. 	<ul style="list-style-type: none"> • Deep suspicion of collaborative arrangements in business (including farming) – legacy of extreme form of communism in pre-transition era. • NGOs not widely respected in public sector – little interface with the public sector which retains a major role in development. 	<ul style="list-style-type: none"> • Scope for supporting the emergence of representative organizations/strengthening nascent organizations through local level investments tackling local issues of concern in an holistic manner. 	<ul style="list-style-type: none"> • Pace and level of commitment to processes of democratisation. • Continuing strong Albanian preference in business for reliance on personal rather than institutional relationships.

ACTIVITIES OF OTHER PARTNERS IN DEVELOPMENT – ONGOING AND PLANNED

Donor/Agency	Nature Of Project/Programme	Project/Programme Coverage	Status	Complementarity/ Synergy Potential
World Bank	<ul style="list-style-type: none"> • Country Assistance Strategy earmarks major sums to improve governance, strengthen institutions, promote private sector growth and foster human development. • Agricultural Services Project. • Irrigation Rehabilitation Project. • Natural Resources Management Project. 	<ul style="list-style-type: none"> • Direct investment in higher potential areas. • Coastal plains and lowlands. • National coverage anticipated. 	<ul style="list-style-type: none"> • Ongoing. • Ongoing. • Under preparation. 	<ul style="list-style-type: none"> • New CAS likely also to place substantial emphasis on energy and transport sectors as well as more holistic approach to NRM. • Project deals with land consolidation; wholesale agricultural market infrastructure including in locations with mountain area hinterland; seeds and germplasm component, competitive grant facility for farmer groups/associations (IFAD clientele). • Irrigation rehabilitation and water management; potential partner in terms of influencing policy in these aspects throughout agricultural areas. • Scope for collaboration in context of holistic approach under MADP to improved supply chain management, water management efficiency, agro/eco-tourism development.
USAID	<ul style="list-style-type: none"> • Country strategy focuses on fostering economic growth, democracy and governance, legal and judicial systems, primary health care and cross-cutting issues associated with human rights, promotion of religious harmony, energy sector planning and monitoring effects of PRSP on rural people. • Small Business Credit and Assistance Project. • Albanian Partnership in Microcredit. • Dairy Improvement Campaign. 	<ul style="list-style-type: none"> • Principally coastal and lowland areas but in process of expanding. • Rural areas and expanding network coverage into mountain areas. • Primarily higher potential agricultural areas. 	<ul style="list-style-type: none"> • Ongoing to at least 2007 • Ongoing to at least 2007. • Ongoing. 	<ul style="list-style-type: none"> • Considerable potential for collaboration in support of business/SME development in mountain areas (through partnership arrangement or contractual relationship.) • Considerable potential for collaboration in support of business/SME development in mountain areas (partnership arrangement or contractual relationship). • Contracted support via Land O'Lakes; build up of local skills in dairy development and especially processing/marketing of livestock products of major importance in mountain areas.

ACTIVITIES OF OTHER PARTNERS IN DEVELOPMENT – ONGOING AND PLANNED (CONTINUED)

Donor/Agency	Nature Of Project/Programme	Project/Programme Coverage	Status	Complementarity/ Synergy Potential
EBRD	<ul style="list-style-type: none"> Country Programme focusing on private sector development in banking, tourism, SME growth and construction; major public sector investments in telecommunications, energy supply reconstruction and road rehabilitation. 	<ul style="list-style-type: none"> National programme. 	<ul style="list-style-type: none"> Ongoing. 	<ul style="list-style-type: none"> Widening scope for rural regeneration in rural and mountain areas through improved investment environment.
EU	<ul style="list-style-type: none"> CARDS Programme providing major funding for improving governance at national, regional and local levels; justice and home affairs; agriculture and environmental issues as part of EU convergence processes; political dialogue and further liberalization of trade. 	<ul style="list-style-type: none"> Preliminary stages in pre-accession funding on a national basis; further stages anticipated with Albania viewed as potential candidate country for EU membership. 	<ul style="list-style-type: none"> Ongoing – 2006; further tranches of pre-accession funding anticipated. 	<ul style="list-style-type: none"> Increases scope for working effectively at local level with local institutions/associations and in improving the business environment for economic growth in mountain areas. Possibility of (i) MADP/MADA accessing resources under future funding initiatives and (ii) local authorities strengthened with IFAD support to point of qualifying for EU direct funding in their own right.
EIB	<ul style="list-style-type: none"> Road reconstruction and SME development. 	<ul style="list-style-type: none"> National programme. 	<ul style="list-style-type: none"> Ongoing. 	<ul style="list-style-type: none"> Widening scope for expanding economic activity.
DFID	<ul style="list-style-type: none"> Country Programme focusing on improving business investment environment; strengthening legal and judicial capacity; support for democratisation and decentralization of government; regional trade liberalization. 	<ul style="list-style-type: none"> West Balkans Aid Framework. 	<ul style="list-style-type: none"> 2003-2006 	<ul style="list-style-type: none"> DFID investment widens scope for complementary encouragement under IFAD-sponsored programme to Stakeholder Fora, support for associations/interest groups involved in supply chains/networks.
GTZ Raiffeisen Bank; American Bank of Albania; ProCredit Bank	<ul style="list-style-type: none"> Economic Development Programme. Fully operational commercial banks with an ongoing and expanding interest in business/SME establishment/expansion, including increasingly in rural and mountain areas. 	<ul style="list-style-type: none"> Northern region of Albania. Raiffeisen 82 branches (expanding to 90) following recent privatisation of former Savings Bank. ABA and ProCredit Banks with expanding branch networks including urban administrative centres serving some rural areas (including mountain areas) in northern, central and southern Albania. 	<ul style="list-style-type: none"> Ongoing. 	<ul style="list-style-type: none"> Potential for complementary financing of technical assistance requirements in economic development initiatives in poorest part of the country. Expressed interest in collaboration in context of financing business development opportunities, including those identified through Strategic Investment Planning approach being adopted by MADA.

