

**BUILDING NATIONAL COMPETITIVENESS IN
SOUTHEAST EUROPE**

**NATIONAL COMPETITIVENESS
REPORT FOR ALBANIA**

FINAL REPORT

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EXECUTIVE SUMMARY

Introduction

With the objective of supporting the competitiveness-building process in Southeast Europe, the Europe and Eurasia Bureau of USAID has asked J. E. Austin Associates (JAA), Inc., to carry out a Competitiveness Assessment to instigate a National Competitiveness Building Process in Croatia, Romania, Macedonia, and Albania. This brief summary reviews the main findings of JAA's work in Albania under USAID Task Order No. GBTI-008 of the Nathan-MSI SEGIR GBTI PCE-I-00-98-00016-00 contract.

Economic Overview

Albania started the transition process from a centrally planned economy to a market economy as the most isolated, least developed, and poorest country in the region.¹ Nevertheless, Albania's progress during the early years of transition has been impressive. While GDP fell by nearly half, and inflation rose to triple digits between 1989 and 1992,² Albania's real economic growth averaged nearly 10% during the 1993-96 period. Furthermore, inflation rates experienced an incredible reduction from 226% in 1992 to 7.8% in 1995 and 12.7% in 1996. External imbalances were also reduced sharply during that period.³

This impressive macroeconomic performance occurred in parallel with massive donor assistance during the period,⁴ as well as with Albania's early privatization of agriculture, retail trade, and small and medium-sized enterprises. However, Albania's economic performance during 1993-96 was not based on a solid foundation. The absence of strong financial institutions and good governance in Albania had led to the growth and subsequent collapse of financial pyramid schemes,⁵ causing severe civil disorder and an economic contraction of 7% in 1997.

Immediately after the crisis, strong adjustment policies were implemented to contain the fiscal deficit and tighten the country's monetary stance. The implementation of those policies led to rapid economic recovery in 1998, with GDP growth of 8%, inflation reduction from 32.1% to 20.9%, fiscal deficit improvement from 12.6% to 10.8% of GDP, and the current account imbalance narrowing substantially from 8.7% to 3.2% of GDP.⁶

¹ IMF Staff Paper Vol. 47, No.1, 2000.

² IMF Staff Paper Vol. 47, No.1, 2000; Commentary: Public Sector Deficits and Macroeconomic Stability in Developing Economies, John Flemming.

³ IMF Staff Country Report No. 00/87, July 2000: Current account deficits were reduced from 14.7% of GDP to 3.7% of GDP in 1993, 5.9% in 1994, 2.4% in 1995, and 6.2% in 1996. Trade deficits went down from 64% of GDP in 1992 to 40% of GDP in 1993, 23.2% in 1994, 19.6% in 1995, and 25.7% in 1996.

⁴ Albania Country Paper 2000-2004, January 2001, Department for International Development, the UK.

⁵ IMF Staff Paper Vol. 47, No.1, 2000: Pyramid schemes work on the principle that money paid in by later investors is used to pay artificially high returns to earlier investors. The system collapses when payments are interrupted as the interest and principal due to the old investors exceeds the money that the scheme is able to attract from new investors.

⁶ IMF Staff Country Report No. 00/87, July 2000.

The outbreak of the Kosovo crisis in March 1999 added new challenges to Albania's economic recovery. Nevertheless, Albania was able to maintain a relatively good macroeconomic performance in 2000, with an estimated GDP growth rate of 7.5%, due to strong domestic demand resulting from improved business confidence and rapid growth in private remittances.⁷ Despite the adverse impact of the Kosovo crisis, exports in 2000 increased by almost 45% over those of 1998 as a result of the resumption of activity in the chromium and steel sectors and of the renewed strength of shoe and textile exports. In 2000, Albania reaffirmed its record as a successful transition country in fighting inflation, with a deflation rate of 0.1% and a slight effect on the current account deficit, which fell from 7.3% of GDP in 1999 to an estimated 7% in 2000. The fiscal deficit was further reduced to 9.4% of GDP in 2000.⁸

Competitiveness Benchmarking

JAA has carried out a competitiveness benchmarking exercise to reflect how Albania ranks relative to the other countries in Southeast Europe,⁹ the EU accession countries, the EU countries themselves, and all countries of the world for which data were available in the areas that are generally understood to be closely correlated to competitiveness. Informed by the competitiveness theory and by the methodologies used by the World Economic Forum, Harvard University, and the Institute for Management Development, along with its own work in 100 countries in a 15-year period, JAA has selected 40 indicators linked to the following eight competitiveness-related categories: economic performance, exports, investment, financial sector, human resources, science/technology, infrastructure, and government policy.

The competitiveness benchmarking indicated that, overall, Albania's competitive position is problematic. Although there have been a few improvements in recent years, many bases that are fundamental to developing a competitive economy are lacking. Albania is particularly challenged by poor public administration that perpetuates security concerns and by an inadequate infrastructure. Despite an overall dissatisfactory competitive position, however, economic performance indicators show that Albania's economy has been performing better in the last couple of years. Investment competitiveness indicators likewise show that Albania's domestic investment has recently reached higher levels despite a poorly developed financial sector and a lack of inward foreign investment.

Albania's economy was also affected by regional political and economic problems, as well as by inadequate progress in restructuring the economy from central planning to market economics. The lack of privatization and other reforms has further hampered progress. Since the collapse in 1997, the weak financial sector has complicated business activity and driven away foreign investors, leaving Albania with practically no export sector whatever. Underlying modest results are indicators of potential for future competitiveness, such as the development of a strong and educated workforce, but to take advantage of its human resources Albania will have to aim toward achieving internal stability and a standard of living that prevents brain drain. For long-term growth, Albania needs stable and sensible governance that creates an environment favorable to

⁷ IMF Staff Country Report No. 99/69, July 1999: Private remittances are an important source of foreign exchange inflows in Albania. In 1998, it accounted for 14.4% of GDP.

⁸ Albania Letter of Intent and Supplementary Memorandum, January 2001.

⁹ Croatia, Bulgaria, Macedonia, and Albania.

foreign investment and enables Albania to implement necessary reforms and infrastructure upgrades.

Trade and Investment Competitiveness

During the Communist era, Albania recorded low levels of foreign trade as it followed a policy that anticipated exports of small volumes of raw materials to generate sufficient foreign exchange to balance essential imports. The collapse of the communist block trading system (the Council for Economic Mutual Assistance) and civil unrest at home pushed exports of goods below the existing low levels. Policies implemented recently, such as account convertibility and the abolition of import quotas, in combination with humanitarian aid, have rapidly increased imports. Although exports grew at a slightly higher rate than imports between 1993 and 1999 (14.5% and 12.5%, respectively), the increase has clearly been insufficient to improve the country's current account. Furthermore, during that period, export value oscillated between 20% and 30% of the value of imports. In 1999, exports reached US\$276.1 million; imports were about US\$1.1 billion.

Assessments performed by the International Trade Center in 1998 indicate that lumber, women's and girls' blouses, shirts and shirt-blouses, cotton T-Shirts, and men's trousers are the export product areas in which Albania has performed very well. The products were dynamic, growing at a faster rate than world trade in general, and Albania was able to outperform world market growth in those areas and increase its share of world imports. However, women's and girls' briefs and panties are a sector presenting challenges for Albania. Although the international demand has been growing at above-average rates, Albania's exports of those products have either been falling behind or have grown less dynamically than the world trade, resulting in a loss of Albania's share of the international market. Albania's share in the world import markets of plants, women's dresses, men's shirts, women's blouses and shirts, and chromium ores and concentrates grew between 1994 and 1998, even though those markets were declining or growing at below-average rates in the same period. From a strategic perspective, Albania needs to identify niche-marketing strategies to isolate the positive trade performance from the overall decline of those markets. Market shares of ferro-chromium, raw tobacco, and whole raw hides and skins of bovine and equine animal exports from Albania have declined. World imports of those products have either increased at a below-average rate or have actually declined, thus keeping export prospects for them rather bleak.

The relatively poor growth and productivity performance of Albania has been due in part to an inadequate investment climate. Investment levels in recent years have been particularly low. Albania has the lowest foreign direct investment (FDI) per-capita figure among Southeast European countries. From 1992 to 1996, an annual increase of almost 50% was registered in FDI flows. The number of foreign firms increased drastically, from 125 to 1,206, as many investors came to benefit from Albania's comparative advantages or to establish an early position in a new, growing market. However, tremendous political turmoil in 1997 reduced FDI inflows by half, from US\$97 million to US\$42 million during that year, in comparison to 1996. Furthermore, significant political uncertainties in 1998 and 1999 practically kept FDI inflows at 1997 absolute levels. By 2000, FDI had reached US\$92 million, largely due to the sale of a majority stake in Albanian Mobile Communications.

Although Albania's FDI figures seem to be on the rise recently, investors are concerned about the deterioration of important cost differentials between Albania and neighboring countries. Governance problems, lack of confidence in the judicial system, and corruption are all factors that continue to deteriorate the Albanian FDI environment. The following trends indicate that the competitiveness of the Albanian FDI environment is deteriorating:

- a) Rises in total cost of labor, including actual wage rates, taxation, and other social charges on labor costs
- b) Lack of reliable access to imported capital goods, machinery, and raw materials as a result of ineffective VAT/duty reimbursement mechanisms
- c) High transaction costs in terms of time and money because of cumbersome administrative procedures

Albania has comparative advantages in sectors such as natural resource extraction and processing, hydroelectric potential, construction materials, light manufacturing, fishing, and tourism. Albania's strategic sectors and mineral resources, including chrome, nickel, oil, coal, and copper, have the potential for export-oriented FDI. The country also has important deposits of bauxite and phosphorite, which have not yet been exploited. Additional potential for FDI exists in agriculture and tourism, based on a longer-term horizon. However, the country currently needs to focus on improving its security situation, its infrastructure, and its investment climate.

Competitiveness Constraints

Although the Albanian government has indicated its commitment to furthering economic reform and was successful in improving the country's overall economic performance for 2000, sustained political stability is uncertain. JAA's preliminary study of the Albanian economy and industry sectors indicate major constraints (summarized below) on the country's ability to improve its competitiveness and, thereby, its overall economic development. It is worth noting that many of those constraints are similar to the ones faced by other Southeast European countries, as might be expected, given the similarities in historical backgrounds and economic conditions.

General Constraints:

- The banking sector in Albania features a low level of intermediation, a high cost of capital, a severe lack of financial discipline, and poor allocation of credit. Those weaknesses clearly hamper the private sector's ability to access credit, thus seriously restricting investment.
- Though significant improvements have been made to the legislation and institutional framework, a deficient policy framework discourages both domestic and foreign investors.
- A weak governance system giving way to arbitrary interpretation and ineffective implementation of laws and regulations deters investment and erodes the competitiveness of Albania.¹⁰

¹⁰ This is particularly the case with the customs and tax authorities.

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- Corruption, non-transparent procedures, and high levels of crime deter private investment and degrade Albania's competitiveness.
 - Weak governance structures of privatized companies, inadequate credit access, and a lack of information about domestic and foreign markets contribute to the weakness of the domestic private sector, which in turn hinders the competitiveness of Albania.
 - Foreign direct investment has been limited and decreasing in Albania in past years, mainly due to uncertainty in the country's political environment, problems with policy framework and implementation, and widespread corruption.
 - Albania's deteriorated physical infrastructure – including highway, rail, power, and telephone networks – places further constraints on economic development.
 - Over-reliance on low-price and labor-intensive competition and delayed engagement in higher-technology and higher-value-added economic activities have eroded Albania's competitiveness.
 - Albania has a cheap labor force, but its businesses lack a market mentality and management systems as well as access to the information on domestic and foreign markets necessary to compete successfully in the global market.

Industry-Specific Constraints:

After consultation with key stakeholders and counterparts in Albania, three industry sectors of strategic importance to the Albanian economy were selected for in-depth analysis: tourism, information and communications technology, and export-oriented apparel and textiles sectors. A SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis and a Competitiveness Diamond analysis were completed for each sector. The constraints that hamper the competitiveness of each sector are summarized below:

a. Tourism: Albania's rich natural resources offer many opportunities for strong tourism development. To date, the sector has followed a low-end, low-price competitive strategy. Consequently, the sector suffers from a lack of quality offerings and is in need of a strategy to increase its competitiveness relative to other countries in the region. Major constraints include the following:

- Perceived image as an unsafe destination;
- Low-cost competition strategy, a consequence of severe competition from other countries in the region with lower prices;
- Delayed engagement in high-end and more sophisticated tourism products;
- Limited knowledge of outside markets and high-end product segments;
- Degraded and inadequate infrastructure facilities, including roads, hotels, telecommunications, airports, and utilities;
- Bureaucratic procedures and frequently changing requirements from the national tourism administration;
- Lack of quality market-oriented customer service;
- Lack of management and marketing skills that can increase efficiency, attract more clients, and generate high-end demands for the sector;
- Non-transparent business environment;
- Lack of strong private-sector investment; and
- Inadequate legal and regulatory framework to support the tourism sector.

b. Information and Communications Technology (ICT): Albania's ICT sector is underdeveloped. Major impediments include the following:

- Inadequate legal and regulatory framework to support the sector;
- Insufficient demand stimulation from domestic industries and individuals because of difficult economic conditions and relatively low living standards;
- Limited participation of foreign investors capable of introducing new managerial know-how and technology to the industry;
- Lack of entrepreneurship, marketing, and management skills that could bring more international exposure and experience to domestic firms;
- Ineffective protection and enforcement of intellectual property rights;
- Insufficient investment in R&D for new technologies and software;
- Lack of private-sector consultation in policy formulation as well as in R&D activities; and
- Need for more proactive policy support from the government to stimulate the growth in the industry and make it internationally competitive.

c. Apparel and Textiles for Export: Albania has thus far relied on the exploitation of a low-cost and labor-intensive strategy to compete with other countries. Over the past decade, the industry has experienced an erosion of its competitiveness. Some of the following factors have contributed to the decline:

- Declining labor-cost advantage because of increases in domestic costs and competition from other low-cost countries;
- Strong competition from illegal imports of finished products;
- Weak domestic demand;
- Delays in developing and securing strong access to foreign markets;
- Inadequate information about both domestic and foreign markets;
- Inadequate access to financing for private domestic firms;
- Lack of foreign investment and accompanying management know-how, technology transfer, and access to foreign markets;
- Lack of transportation cost advantages resulting from poor infrastructure;
- Increasing transaction costs resulting from administrative bureaucracy;
- Inadequate capitalization and restructuring efforts to infuse new technology into the industry and to establish industrial linkages that will allow Albania to engage in high-value-added activities;
- Lack of strong entrepreneurial companies to pioneer and lead technological change and upgrade processes in the industry;
- Lack of market-oriented management and marketing skills to improve efficiency in the industry, make Albanian brand names better known in world markets, and proactively find new markets for Albanian products; and
- Lack of an overall industrial strategy, as well as of the coordination and cooperation within the industry necessary to acquire new technology, share market information, and access new markets.

Recommendations for Next Steps

Building Albania's competitiveness will require a complex set of mutually reinforcing activities at the level of the firm and the industry cluster, reinforced by policy and

institutional action at the national and local government levels. A key barrier to competitiveness is the mindset of the people combined with the inability to build social capital of trust and cooperation. Learning from nations that have built prosperity quickly, and aided by the foregoing analysis, one can formulate recommendations that deal with the private sector, the public sector, and the dialogue that connects them. Also essential to that process are important roles for the institutions of civil society such as business associations, think tanks, and social enterprises.

Private Sector: Firms in the private sector are subject to very different conditions, and no one set of recommendations applies to them all. In general, competitive firms will seek direct exposure to the most demanding customers, clients, and markets, adapting their products, services, and strategies to respond to the signals those customers provide. Successful adaptation requires openness to change and the desire to innovate with products, services, and processes capable of responding to those needs.

Albanian firms that offer exportable products and services now have new opportunities to serve European markets, but they will first need to invest in learning how to take advantage of those opportunities. Firms with non-tradable products and services, and those that serve only the Albanian market, can explore trends in and learn from neighboring countries that have more experience with privatization, liberalization, and globalization. They can then selectively test the introduction of innovations in Albania. Firms that are not competitive will need to take stock of their human, capital, and organizational resources and then immigrate to other market segments or even industries.

Competitiveness also requires the ability to cooperate as a cluster, because no single firm can accomplish everything. Competitiveness depends on the ability to form good alliances and partnerships. At the industry level, business associations can participate in efforts to represent the business sector to the government. The Union of Chambers of Commerce and Industry, the Albanian Business Advisory Council, the Albanian Economic Development Agency, and industry-specific associations can all play an important role in that regard by supporting reforms that improve the environment for businesses.

However, it is important to gather as an industry cluster – that is, the entire value chain plus the related and supporting industries. The industry cluster can then benchmark the industry, develop industry strategies, and implement specific action initiatives to boost competitiveness. The approaches will vary by industry. For example, the tourism cluster should formulate specific strategies for attracting higher-spending tourists to Albania and extending the offer beyond the limited summer season. The ICT sector should explore initiatives for e-government, reducing bandwidth constraints, boosting software exports, and retaining talented professionals. The apparel and textiles sector will need to move past its focus on providing assembly labor if it is to survive beyond the expiration of quotas.

Business associations, working with the Government of Albania, can develop international trade and investment linkages to gain access to markets and technology. However, this undertaking will require greater communication and cooperation between the private and public sectors.

Industry clusters can also implement workforce development and human resource training initiatives by working with education and training providers so that the latter adapt their programs to industry needs.

Another field of activity to which the private sector should direct its attention is setting initiatives on research, development, testing, and certification. Private-sector initiatives, such as adapting standards to those of the International Standards Organization (ISO), can add value to any local industry.

Public Sector: Recommendations for the public sector on policy and institutional reform can be organized by industry cluster. For example, tourism needs to complete the privatization agenda, increase the accommodation capacity, improve tourism infrastructure, and resolve land-ownership issues. The industry itself is in the best position to design and implement initiatives to migrate from mass tourism to higher-end markets such as conference tourism, adventure tourism, ecotourism and culture tourism.

In the ICT sector, the government should promote e-government, address constraints of bandwidth availability and cost, promote the use of computers in schools, and work with universities and training providers to improve the relevance of education programs to changing needs.

Companies in apparel and textiles need to understand their competitive position and move away from business strategies that depend on cheap labor availability as their core advantage. Albania badly needs a coherent investment promotion strategy and an agency with a structure informed by best practices while taking into account Albania's specific strengths and weaknesses and the opportunities presented by preferential access to EU markets.

An "Effectiveness of Media" initiative could help the media operate more effectively; enable the poor and excluded to be heard; and ensure that government is more open, responsive, and accountable. The initiative could address the need to develop an appropriate regulatory framework and to ensure that high professional standards are maintained across the board.

Following the example of Ireland, the Government of Albania, with the help of such leading think tanks as the Albanian Center for Economic Research, should publish an annual Albanian Competitiveness Benchmarking report to provide sound data on Albania's competitiveness in areas related to investment, exports, technology, human resources, economic policy, economic performance, and infrastructure. Such a report would help inform government and industry leaders of Albania's strengths and weaknesses relative to those of other EU accession countries. It would also aid leaders in setting priorities and strategies, as well as monitor their implementation.

Albanian Competitiveness Council: This report recommends that key private-sector leaders establish the Albanian Competitiveness Council (ACC) to identify initiatives for improving Albanian businesses' competitiveness. The ACC would need to work with the Business Advisory Council in institutionalizing the dialogue between the private and public sectors. Functioning in the same way as the Business Advisory Council, the ACC

would establish priorities for reform, communicate them clearly to government, and then monitor their implementation. It would also undertake its own initiatives and help coordinate the work of various industry clusters.

The ACC would set initiatives such as:

- Encouraging the development of a world-class business school in Albania with high involvement of the private sector;
- Conducting an annual survey of SMEs and systematically removing bureaucratic constraints to business formation and entrepreneurial activity;
- Supporting the institutionalization of private-public dialogue by identifying priority concerns; and
- Cooperating with the government in negotiating better access to foreign markets

In the early months, encouragement from the Government of Albania – including the technical and perhaps even the financial support needed to jump-start such a Council – would be useful. The ACC could meet monthly, or more often if necessary, and commission specific initiatives designed to build Albania's competitiveness. The council could then review progress on those initiatives, providing leadership and vision.

If established, the ACC should work through existing business associations and research institutes rather than attempt to duplicate them. It should also build on prior research on Albanian competitiveness, policy reform, and specific industry clusters rather than conduct new and repetitive research. The focus should be on action, rather than on theory, and on building a self-reinforcing virtuous cycle of private-public cooperation to implement change.

Building Albania's competitive advantage will require much work. The recommendations above suggest some of the priorities that need to be undertaken. More important, this study recommends a mechanism in the ACC to move toward action while building the trust and private-public partnerships necessary for a strong economy and a civil society.

It is impossible in a study of four countries, with limited scope and resources, to accurately address all of the constraints or to lay out a comprehensive set of well-sequenced recommendations for such an undertaking. Nevertheless, this report is presented in the hope that it will serve as a stimulus for discussion and analysis, thereby providing Albania's leaders with the information needed to arrive at a consensus and to move forward with a preliminary action plan for strengthening Albania's global position.

CHAPTER 1 - INTRODUCTION

With the objective of supporting the competitiveness-building process in Southeast Europe to ensure that Stability Pact activities accelerate sustainable recovery from financial and political instabilities in the region, the E & E Bureau of USAID has asked J. E. Austin Associates (JAA), Inc., to carry out a "National Competitiveness Building" exercise in Albania, Croatia, Macedonia, and Romania. The objective of this report is to present the findings of the work conducted by JAA in Albania under Task Order No. GBTI-008 of the Nathan-MSI SEGIR GBTI PCE-I-00-98-00016-00 contract.

The methodology followed in this report started with a benchmarking exercise that ranked the four countries against all countries in the world for which data were available, in areas that are generally understood to be closely correlated to competitiveness, the EU, EU accession countries, and Southeast European countries. Visits were made to all four countries, and subcontractors in each country were identified to apply competitiveness tools to selected sectors. A central point was created to convene issues on competitiveness, and a regional conference was organized in Macedonia to expose the participants from public and private sectors of all countries to the concept of competitiveness and competitiveness benchmarking. As a result of that initial exercise and the demand from Croatia, an in-depth competitiveness exercise has been activated by USAID/Croatia.

The exercise had certain limitations, such as those of budget and level of effort necessary to cover all four Southeast European countries. This report should, therefore, by no means be treated as a substitute for a major study on competitiveness. Due to the limited budget available, JAA was unable to apply competitiveness tools on-site with the local counterparts that were identified in each country. Also, workshops usually performed once the leadership in a country is informed about the competitiveness concept were not utilized. As a result of elections in Albania, time delays were encountered in meeting the expected completion date for the study.

This report is composed of nine chapters. Chapter 1 introduces the report.

Chapter 2, "Recent Economic Developments," summarizes the latest economic performance of Albania to provide the reader with an understanding of the country's development efforts and their results.

Chapter 3, "National Platform for Competitiveness," reviews Albania from a political stability point of view and analyzes the micro- and macroeconomic environments in the country. The chapter ends with an analysis of the legal and institutional environment in which Albanian businesses operate.

Chapter 4, "Competitiveness Benchmarking: Albania," summarizes the findings of the competitiveness benchmarking exercise that ranks Albania relative to the EU, EU accession countries, Southeast Europe, and all other countries of the world for which data are available in areas that are generally understood to be closely correlated to competitiveness.

Chapter 5, "Trade and Investment Competitiveness," examines the areas of trade and inward and outward investment and lays out the trade and investment competitiveness of Albania based on the analyses by the International Trade Center.

Chapter 6, "Industry and Firm-Level Competitiveness," analyzes the competitiveness of three important Albanian industries: Tourism, Information and Communications Technology, and Apparel and Textiles for Export.

Chapter 7, "Competitiveness Constraints," summarizes the competitiveness constraints in Albania from general and industry-specific perspectives.

Chapter 8, "Public-Private Dialogue in Albania," reviews the status of the dialogue between the private and public sectors.

Chapter 9, "Recommendations," presents recommendations for increasing the competitiveness of Albania on three different levels: firm, industry, and government. The chapter ends with the National Competitiveness Initiative, which presents the steps that should be taken to increase the capacity and active participation of stakeholder representatives in a dialogue about developing industries in the target clusters. It also presents potential follow-on activities for USAID.

Annex 1, "Competitiveness Benchmarking," presents competitiveness benchmarking graphs and data for all selected indicators.

Annex 2 contains the Competitiveness Bibliography.

CHAPTER 2 – RECENT ECONOMIC DEVELOPMENTS

Albania started the transition process from a centrally planned economy to a market economy as the most isolated, least developed, and poorest country in the region.¹¹ Nevertheless, Albania's progress during the early years of transition has been impressive. Although GDP fell by nearly half and inflation rose to triple digits between 1989 and 1992,¹² Albania's real economic growth managed to average nearly 10% during the 1993-96 period. Furthermore, inflation experienced an incredible reduction from 226% in 1992 to 12.7% in 1996. External imbalances were also reduced sharply during the period.¹³ That impressive macroeconomic performance occurred in parallel with massive donor assistance during the period,¹⁴ as well as Albania's early privatization of agriculture, retail trade, and small and medium-sized enterprises.

However, Albania's economic performance from 1993 to 1996 was not based on a solid foundation. The absence of strong financial institutions and good governance had led to the growth and subsequent collapse of financial pyramid schemes,¹⁵ causing severe civil disorder and an economic contraction of 7% in 1997.

Immediately after the crisis, strong adjustment policies were implemented to contain the fiscal deficit and tighten the country's monetary stance. That implementation led to rapid economic recovery in 1998, with GDP growing by 8%, inflation falling from 32.1% to 20.9%, the fiscal deficit being reduced from 12.6% to 10.8% of GDP, and current account imbalance narrowing substantially from 8.7% to 3.2% of GDP.¹⁶

The outbreak of the Kosovo crisis in March 1999 added new challenges to Albania's economic recovery. Nevertheless, Albania was able to maintain a relatively good macroeconomic performance in 2000, with an estimated GDP growth rate of 7.5%, thanks to strong domestic demand resulting from improved business confidence and rapid growth in private remittances.¹⁷ Due to the resumption of activity in the chromium and steel sectors and the renewed strength of shoe and textile exports, total exports increased by almost 45% compared with those of 1998, despite the adverse impact of the Kosovo crisis. Albania experienced a deflation rate of 0.1% in 2000, reaffirming the country's record as one of the most successful in fighting inflation among transition countries. Current account deficit declined from 7.3% of GDP in 1999 to an estimated 7% in 2000. The fiscal deficit was also reduced to 9.4% of GDP in 2000.¹⁸

¹¹ IMF Staff Paper Vol. 47, No.1, 2000.

¹² IMF Staff Paper Vol. 47, No.1, 2000; Commentary: Public Sector Deficits and Macroeconomic Stability in Developing Economies, John Flemming.

¹³ IMF Staff Country Report No. 00/87, July 2000.

¹⁴ Albania Country Paper 2000-2004, January 2001, prepared by Department for International Development, the UK.

¹⁵ IMF Staff Paper Vol. 47, No.1, 2000: Pyramid schemes work on the principle that money paid in by later investors is used to pay artificially high returns to earlier investors. The system collapses when payments are interrupted as the interest and principal due to the old investors exceeds the money that the scheme is able to attract from new investors.

¹⁶ IMF Staff Country Report No. 00/87, July 2000.

¹⁷ IMF Staff Country Report No. 99/69, July 1999: Private remittances are an important source of foreign exchange inflows in Albania. In 1998, it accounted for 14.4% of GDP.

¹⁸ Albania Letter of Intent and Supplementary Memorandum, January 2001.

CHAPTER 3 – NATIONAL PLATFORM FOR COMPETITIVENESS

3.1 Political Stability

Albania is a presidential parliamentary democracy. The current government is formed by a coalition between six different parties: the Socialist Party of Albania, the Democratic Alliance, the Agrarian Party, the National Unity Party, the Party of Democratic Unity and Prosperity, and the Union for Human Rights.

As a coalition, the government faces considerable difficulties in reconciling different goals between the various political parties. In addition, frequent cabinet shuffles have contributed to rising uncertainty in the country's overall investment environment. The situation is further complicated by Albania's prevalent poor governance structure, which has led to the government's inadequate control over its own institutions, arbitrary interpretation and ineffective implementation of laws and regulations, and widespread corruption. A high crime rate is also a serious problem in Albania. Failure to address political conflicts, resolve problems in legislative implementation, combat corruption, and provide better social security negatively affects public confidence in the government and, therefore, Albania's overall stability.

The government has indicated its commitment to maintaining price stability and high economic growth rates, reducing poverty, completing privatization of state-owned enterprises, and encouraging both domestic and foreign investment through various policy reforms. Several economic indicators for 2000 suggest improvement in Albania's economic performance since the 1997 crisis. In addition, the government has started reforms in public administration, legal, and judiciary frameworks to improve the rule of law, the effectiveness of legislative implementation, and civil servants' professional ethics and standards. The government is also focusing on developing closer ties with the EU and its neighboring countries. Success in those reforming efforts, along with a continuation of the current trend of economic improvement, will increase the government's credibility and, thus, Albania's overall political stability.

3.2 Macro- and Microeconomic Environment

Fiscal Policy

Strong fiscal policies were the key to Albania's rapid recovery from the 1997 crisis. Immediately after the crisis, the government implemented measures to contain the fiscal deficit, which proved successful in bringing the overall budget deficit down from 12.6% of GDP in 1997 to 10.8% in 1998.¹⁹

On the revenue side, the government has continued to make progress in modernizing the tax system by focusing on simplification and in reducing distortions via the introduction of a lower rate and a broader-based system.²⁰ Albania's VAT system was

¹⁹ IMF Staff Country Report No. 00/87, July 2000.

²⁰ IMF Staff Country Report No. 01/29, February 2001.

reformed in 1997 to establish a more broad-based VAT, set at a rate of 20%, to cover most goods and services, with very few exemptions. The full-year effect of the reform became visible when VAT collection rose to 6.5% of GDP in 1997, from 4.5% a year earlier. Indirect taxes are now the main source of government revenue, and about half of annual indirect tax revenues come from VAT.²¹ In addition, to improve tax collection the government has implemented changes in key personnel in major customs houses, imposed better control of goods in transit, and intensified internal audit procedures. Those actions resulted in a 40% increase in tax collection by the end of March 2000,²² or an equivalent annual increase of 2.5% of GDP over that of 1999.²³

On the expenditure side, the government substantially reduced spending on personnel wages and social security contributions from 7.5% of GDP in 1997 to 6.2% of GDP in 1999, social security expenditures from 5.9% to 5.4% of GDP, and unemployment insurance payments from 0.6% to 0.3% of GDP. Meanwhile, capital expenditure increased from 4% of GDP in 1997 to 6.6% of GDP in 1999, about half of which was financed by external borrowings.²⁴

For 2001, the government announced its continued commitment to improving tax administration, reducing import duties and profit tax rates, and improving the VAT refund system, as well as improving the structure of expenditures. Capital expenditures are likely to rise in the coming years to support investment in transport infrastructure facilities and public utilities, which are considered important for Albania's long-term economic development.²⁵

Monetary and Exchange Rate Policy

Albania has been pursuing a stringent monetary policy in the context of a flexible exchange rate system, with the principal aim of maintaining price stability. Albania's exchange rate system has shown remarkable resilience to external shocks, as can be seen from the stability of the lek during the 1997 disturbances as well as during the Kosovo crisis. In addition, appropriately tight control over monetary aggregates, further supported by a significant reduction in the budget deficit and the introduction of prudential banking regulations, has contributed to Albania's position as one of the most successful of the transition countries in combating inflation. Very high inflation in the early stage of transition swiftly gave way to moderate and smoothly declining inflation rates. The increases in inflation in 1996 and 1997 as a result of the crisis proved temporary, and inflation has been virtually absent from the Albanian economy since mid-1999.

Banking Reform

In 1992, Albania transformed its centrally planned, single-tier banking system into a two-tier one, with the Bank of Albania as the central bank. Although Albania's banking system has advanced steadily since then, it remains underdeveloped and has been characterized by a low level of intermediation, limited credit availability, inadequate

²¹ IMF Staff Country Report No. 99/69, July 1999.

²² IMF Staff Country Report No. 00/74, June 2000.

²³ IMF news brief No. 01/10, January 2001.

²⁴ IMF Staff Country Report No. 00/87, July 2000.

²⁵ IMF Staff Country Report No. 01/29, February 2001.

banking regulation and supervision, and high vulnerability to credit risk.²⁶ The weakness of the formal financial sector has led to the flourishing of an informal credit market since the transition began in Albania. It was also the inadequacy of the banking system that led to the growth and subsequent collapse of the financial pyramid schemes in 1996 and 1997. The collapse of the system, in turn, caused severe civil disorder and a sharp economic downturn in 1997, as well as a massive fall in deposits and decreased public confidence in the Albanian banking system.²⁷

As a result of the crisis, major legislative changes have been made to help prevent the recurrence of similar phenomena, including the revision of the Banking System Law, adoption of the Law on the Bank of Albania, amendment of the Money Laundering Law, and improved enforcement of the Company Laws and other commercial laws.²⁸ Those legislative changes provided a better framework for the banks' operation and supervision. However, it appears that the institutional capacity and skills available at the Bank of Albania are still insufficient for effective supervision and regulation.

One important element of Albania's banking sector reform is the government's effort to restructure and privatize state-owned banks. Of the three state commercial banks, the smallest, the Rural Commercial Bank (RCB), was liquidated in March 1998; the second largest, the National Commerce Bank (NCB), was transferred to foreign investors in November 2000; and the largest, the Savings Bank, was placed under a management contract in May 1998, with preparations for its privatization under way.²⁹

In terms of private bank development, whereas the formal deposit-taking market has been dominated by state-owned banks, the market share of private banks is increasing. In the first quarter of 1999, lek deposits in private banks doubled; domestic lek credit increased sevenfold, and T-bill purchases increased fivefold.³⁰ Nevertheless, the development of private banking has been limited. Private banks provided a mere 4.2% of domestic lek credits and held 2.3% of T-bills in the first quarter of 1999.³¹ Hindered by high lending rates, persistent deficiencies in the legal system and business accounting practices, and prudential restrictions on state-owned banks,³² private-sector lending remains low and largely focuses on trade-financing and fee-generating activities.

Privatization

Albania began its privatization program in 1991. Overall the privatization program has been implemented on several different fronts, including privatization of small enterprises, large enterprises, agriculture, and housing, and has employed a variety of methods including sales to employees, auctions, and the use of vouchers.

²⁶ IMF Staff Country Reports, EIU.

²⁷ IMF Staff Paper Vol. 47, No. 1, 2000: Pyramid schemes work on the principle that money paid in by later investors is used to pay artificially high returns to earlier investors. The system collapses when payments are interrupted as the interest and principal due to the old investors exceeds the money that the scheme is able to attract from new investors.

²⁸ IMF Staff Country Report No. 99/69, July 1999.

²⁹ IMF Staff Country Reports No. 01/29, February 2001, and No. 99/69, July 1999; EIU.

³⁰ IMF Staff Country Report No. 99/69, July 1999.

³¹ IMF Staff Country Report No. 99/69, July 1999.

³² IMF Staff Country Report No. 00/74, June 2000.

The program first focused on the transfer of ownership of small establishments (such as retail trade, services, warehouses, and independent smaller units of manufacturing firms), mainly to their employees, and the privatization of agricultural cooperatives with free distribution of land to the cooperative members. Those subprograms proceeded quickly. By the beginning of 1992, more than 75% of retail trade and small service establishments had been transferred to private owners. In addition, by the end of 1993, approximately 93% of the land belonging to agricultural cooperatives had been divided among some 450,000 farming households.³³ Although the process was mainly open to insiders and regarded as having non-transparent, lengthy, and duplicating procedures, its rapid accomplishment had important effects on both economic growth and the progress of the transformation program in Albania.³⁴

Albania's privatization of housing began later, in May 1993, also proceeding with remarkable speed. By November 1993, the transfer of ownership of 97% of flats to their residents was completed, thus creating a significant wealth effect among the urban population.³⁵

The privatization of state-owned enterprises (SOEs), however, has been carried out with much more difficulty. It has been implemented in several stages with regard to small and medium-sized enterprises (SMEs), large enterprises, and strategic enterprises. As for SMEs, by 1998 nearly all of them had been sold or liquidated.³⁶ Nevertheless, although auctions were considered the main method of ownership transfer, many of the enterprises were actually sold to their employees, without any outsider interest – a result of the weak corporate governance mechanism that replaced state ownership.

The framework for the privatization of larger SOEs was not approved until May 1995. The method adopted for those enterprises was mass privatization through the use of a voucher system. Although the program did result in a large-scale diffusion of share ownership among various voucher holders, it faced corporate governance problems similar to those of privatized SMEs.

The privatization of strategic enterprises – telecommunications, mining companies, oil companies, and public utilities – has been much slower. However, some progress has been achieved recently with the sale of mobile telephone and fixed-line telecommunication providers and with preparations of the legal framework for privatization in the petroleum sector. In addition, the government has announced its commitment to further its efforts in the privatization of large enterprises and of strategic enterprises.³⁷

Import and Export Policy

After many years of isolation, Albania has made significant efforts to establish and improve relations with other countries in the region. Albania seeks eventual membership

³³ Privatization and Transition in Albania, Iraj Hashi and Lindita Xhillari, October 1997.

³⁴ Ibid.

³⁵ Ibid.

³⁶ IMF Staff Country Report No. 99/69, July 1999.

³⁷ IMF Staff Country Report No. 01/29, February 2001.

in NATO as well as in the European Union (EU). Since 1994, Albania has cooperated with and participated in many NATO activities. In September 2000, Albania became a member of the WTO. In October 2000, Albania became a full member of the Stability Pact for Southeastern Europe countries, which means that Albania is bound to undertake further economic and institutional reforms in line with EU standards.

Albania's foreign trade regime is relatively open. The new law on Customs Tariff Nomenclature, approved by the Parliament in 1999, was one step toward further reducing average tariffs and creating a simpler and more transparent tariff structure. Nevertheless, many investors continue to complain about the inconsistency in the interpretation and implementation of customs laws and procedures, including different border pricing across localities. Another problem is the prevalent smuggling and corruption in the country. Albania's new Customs Code has imposed significant fines on smuggling and related offenses and has provided the legislative basis for an anti-smuggling unit within the Customs Directorate. To fight corruption, the code also established the basis for increased internal auditing as well as for measures to apply when corruption is detected.

The following are some of the core features of the Albanian trade regime:

- No quantitative restrictions on imports and exports
- Ineffective mechanisms for VAT reimbursement on imported inputs for export-oriented production
- Substantial tariff reduction in recent years
- Simple import tariff structure
- No import surcharge
- No customs duties on exports
- Inconsistent customs valuation
- Arbitrary application of customs laws and procedures
- Prevalent smuggling and corruption at customs
- Further reforms needed to streamline customs procedures and promote stricter interpretation of regulations

Tax Policy

Albania has made considerable efforts in reforming its tax system to make the country's business environment more attractive, as well to increase tax collection and revenues. As of the end of April 1999,³⁸ Albania levied a flat corporate income tax rate of 30% on all domestic and foreign companies. However, incentives were provided to small businesses in the form of a 4% tax rate on annual turnovers between two and five million leks. Personal income tax rates ranged from 5% to 30%. VAT was charged at 20%, with exemptions on financial services, land and building leasing, and medicines. No VAT was charged on exports and supplies related to international transport as of April 1999.

Despite such efforts to improve the tax system in Albania, various problems still exist, thus placing significant constraints on businesses. Many investors have complained about Albania's ineffective tax reimbursement mechanisms, frequent harassment by

³⁸ All figures on Albanian taxes presented in this section were current as of April 1999 and based on IMF Staff Country Report No. 00/69, July 1999.

inspectors, corrupt and unprofessional tax and customs authorities, inconsistent applications of tax rules and regulations, and burdensome and constantly changing documentation requirements.

Foreign Investment Restrictions

Foreign investment in Albania is governed by the country's investment law "On Foreign Investment" No. 7764, which was adopted in November 1993. Albania Law on Foreign Investment provides a relatively liberal investment framework for foreign investors. Although foreign investors are not yet entitled to land ownership in Albania, they are treated equally as domestic investors and may invest in any sector, with the exception of certain industries related to national security. Foreign investors are allowed to repatriate their capital and income. In addition, Albania has concluded bilateral investment protection agreements with a large number of countries,³⁹ providing further evidence of Albania's commitment to enhancing the business environment for foreign direct investment (FDI).

Nevertheless, FDI flows to Albania have been limited in past years. According to the World Bank, the flows decreased from 5% of GDP in 1992 to about 1% of GDP in 1999. In addition, most foreign investment has been concentrated on small and medium-sized enterprises. Significant obstacles to foreign investment in Albania include inadequate enforcement of laws and regulations, an unprofessional and corrupt public administration (particularly in customs and tax authorities), poor infrastructure, and problems in accessing land and obtaining construction permits.

Business Start-up Procedures

The legal framework to establish a business in Albania is governed by the Law on Commercial Companies (No. 7638), adopted in 1992, and the Law on Commercial Register (No. 7667), adopted in 1993. To obtain a legal status to operate in Albania, all businesses must register with the Commercial Register and then obtain a general business license and tax identification number from the authorities. The general license is for tax purposes and must be renewed on an annual basis.

In addition to the above procedures, a commercial company may need a special license from the relevant government ministry or regulatory body responsible for supervising the business activity. Activities requiring special licensing include financial services, construction, and manufacturing. The total administrative cost for establishing a business in Albania is about 45,000 lek, or US\$320. Legal fees can vary between US\$1,500 and US\$5,000 depending on the lawyers, the type of company to be established, and the complexity of the case.⁴⁰

Many investors complain that the process of business registration and licensing in Albania is inefficient, burdensome, and bureaucratic. Investors are suffering not only from an inadequate legal framework but also from local authorities' arbitrary interpretation and implementation of rules and regulations.

³⁹ Countries include: Greece, Turkey, Romania, Bulgaria, Macedonia, Germany, Italy, France, Austria, Switzerland, Finland, Denmark, Sweden, the Netherlands, Great Britain, Slovenia, Croatia, Hungary, the Czech Republic, Poland, Russia, Israel, Tunisia, Egypt, China, Malaysia, and the United States.

⁴⁰ Studio Legale Tonucci- International lawyers, Tirana, Albania.

Unemployment and Labor Policy

Registered unemployment in Albania was 16% of the total labor force as of February 2001 – a marked improvement over rates that rose steadily from 13.1% in 1995 to 18% in 1999.⁴¹

Of its population of 3.42 million people, Albania has a relatively high proportion of people of working age. The ratio was about 64.5% in 2000 and is expected to be around 62.5% by 2050. However, Albania has a high illiteracy rate of 15%, which is behind the average for European countries. In addition, only 1% of the population pursues tertiary education,⁴² placing further constraints on Albania's ability to further its economic development and to engage in higher-technology and higher-value-added economic activities.

As for social security contributions, employer contributions accounted for about 34% of gross wages of employees as of the end of April 1999 – 32.5% for social insurance and 1.7% for health insurance.⁴³ The Government of Albania has announced its plan to review those contribution rates in the interest of increasing participation from the private sector. To strengthen revenue collection, the government also announced that it intends to amend the social security law and obligate all enterprises to file information on their payroll to the social security systems on a monthly basis.⁴⁴

3.3 Legal and Institutional Environment

Significant changes in Albania's legal and institutional framework have been made in recent years to accompany the country's transformation toward a market economy. Nevertheless, the country's economic progress has been hindered not only by its inadequate policy framework but also by a poor governance mechanism that is reflected in low institutional capacity of government agencies, arbitrary interpretation and enforcement of laws and regulations, and widespread corruption, particularly among the customs and tax authorities. Many investors complain that Albania's laws and regulations have been prepared without clear descriptions of concepts, definitions, or procedures. In addition, changes in laws are frequent and unpredictable. All those factors, in turn, create opportunities for administrative discretion in interpretation, thus hindering consistent implementation of laws and regulations in Albania.

Similar problems can be found in the judiciary system. The courts are known for their incompetence, corruption, and political bias. There is a serious absence of well-trained personnel, professional ethics, and efficient court management. In addition, court decisions remain subject to the coercive influence of political parties.

The government has announced its commitment to strengthen the judiciary system and the rule of law. As for the customs administration, the government has adopted various

⁴¹ EIU.

⁴² EIU.

⁴³ IMF Staff Country Report No. 99/69, July 1999.

⁴⁴ Albania's Letter of Intent to the IMF, January 2001.

measures to combat corruption, including the establishment of more transparent recruitment and promotion procedures, more training for customs officials, and the implementation of an anti-smuggling unit within the Customs Directorate. Nevertheless, much work needs to be done on those reforms. The weaknesses in Albania's legal and institutional frameworks remain serious problems, hindering both domestic and foreign investment in Albania.

CHAPTER 4 – COMPETITIVENESS BENCHMARKING

This chapter summarizes the findings of the competitiveness benchmarking that is presented as Annex 1 of this report.

4.1 Definition

Competitiveness can be defined as sustainable increases in productivity leading to improvements in the standards of living for the average person. Benchmarking is the ability to measure one's performance relative to a particular reference group; normally the measurement is relative to those who are doing the best job in a particular industry or area of endeavor. The Competitiveness Benchmarking for Albania, compiled by JAA, ranks Albania relative to the EU, EU accession countries, Southeast Europe, and remaining countries of the world for which data are available in areas that are generally understood to be closely correlated to competitiveness.

4.2 Objectives of Benchmarking Report

Encourages private-public dialogue. Annual competitiveness benchmarking encourages reflection and discussion on issues related to the speed and effectiveness of Albania's transition to a competitive economy. It focuses attention on strengths and weaknesses as well as on improvement and deterioration, and it helps private and public leaders set priorities.

Competitiveness Benchmarking provides objective data. Effective dialogue and policy reform require the use of good data (rather than anecdotal evidence) and the ability to relate that data to a broader context. National dialogue becomes subjective when proponents of current policies present selective data that are then interpreted as excellent performance. Critics of current policy may also present selective data and assert conclusions that allege the situation to be more pessimistic than is really the case. By presenting many sets of data, one provides a mosaic of Albania in which the true picture comes into sharper focus. By presenting the country relative to the EU, EU accession countries, and countries of Southeast Europe, one provides a basis for drawing reasonable conclusions.

For governments, Competitiveness Benchmarking serves as a powerful tool to measure progress and set priorities for policy and institutional reform. Ireland uses an annual competitiveness report to benchmark its performance against the leading countries of the world. Not content merely to measure its own progress against itself, it has for a number of years restlessly compared its rate of improvement to the best country in the world in a given area.

For economic faculties, business schools, technology institutes, and think tanks, Competitiveness Benchmarking provides a rich source of data for analysis. Those researching IT readiness, export performance, investment, economic results, human

capacity, infrastructure, and other areas will find this information a good source of data to inform their research and strengthen their ability to contribute to national dialogue.

Finally, the publication of Competitiveness Benchmarking and its use by the economic press encourages national debate on Albania's competitiveness. Such debate is useful because of the importance of the average citizen's understanding of what is at stake for Albania's future.

4.3 Methodology

Using competitiveness theory and the methodologies employed by the World Economic Forum (WEF), Harvard University, and the Institute for Management Development (IMD), along with its own work in 80 countries in a 15-year period, JAA has selected 40 indicators corresponding to eight competitiveness-related categories: economic performance, exports, investment, financial sector, human resources, science/technology, infrastructure, and government policy. Those categories are similar to the ones used by the WEF and IMD, neither of which has yet provided rankings for Albania. The rankings are based entirely on secondary sources, and efforts were made to select the most internationally qualified institution for each data set. The data were then entered into JAA databases, and rankings were made for all countries of the world for which data were available. Data for each indicator is provided for the country, along with its position relative to all other countries of the world.

For this exercise, analysis was done for Albania relative to the four countries included in the Southeast Europe Competitiveness Initiative (Romania, Albania, Macedonia, and Croatia) as well as to EU accession countries and the EU itself. The following summary of the results is meant to be *descriptive* and is not meant to propose any particular ideology or set of policy prescriptions. The authors do not intend to make judgments regarding the effectiveness or ineffectiveness of previous or current policies. Rather, the summary is intended to provide good descriptive data to stimulate and encourage debate on matters important to Albania's future.

4.4 Uses and Limitations of the Study

Most of the data are about two years old and reflect 1998 circumstances. Albania's situation is changing so quickly that these data may not accurately reflect the current situation. Unfortunately, although more recent data exist for Albania, this report contains the most recent data available for *all countries of the world*.

Nevertheless, this study allows Albania to identify its position and its achievements relative to the world's most competitive countries and to set goals and targets that are realistically based on the achievements of other countries over a sustained period of time. The study provides an objective source of data upon which to rest analysis and conclusions, and these data can be verified by going to the sources cited. This study is intended to encourage productive dialogue leading to action that supports the

improvement of Albania's living standards in the immediate as well as the long-term future.

4.5 Overview of Competitiveness Categories

Economic Performance

Albania's GDP per capita in 1998, adjusted for purchasing power parity (PPP), placed the country 104th in the world in terms of its physical standard of living, at US\$2,804 per capita. This is the lowest among the five countries of Southeast Europe and compares to US\$9,034 average GDP for EU accession countries and more than US\$21,000 for the EU itself. Growth in GDP per capita from 1990 to 1998 was 1.57% per year for Albania, compared to 3.5% in the EU and 1.1% among EU accession countries. The highest-growth country in Europe during the period was Ireland, which grew at 8.32% per year; Poland had growth of 4.15% during the same period. Economic growth in non-per-capita terms for the period was actually negative for Albania. However, GDP growth for 1998 increased to 8.00%, placing Albania 10th among 170 countries. Data on income distribution were not available for Albania.

Export Competitiveness

Albania's exports in 1998 were US\$295 million, placing it 132nd among 140 countries of the world and last among the 5 countries of Southeast Europe, even far behind Macedonia, which has a smaller population. Per-capita exports of goods were US\$62 compared to US\$1,548 for EU accession countries and US\$8,018 for countries of Europe. Non-annualized growth of exports per capita of -36.51% for 1990-1998 shows that Albania is not progressing toward developing competitive export sectors. Exports as a percentage of GDP were also only 10%, ranking Albania 125th of 129 countries. Tourism receipts per capita were a meager US\$16.2, ranking Albania 125th among 186 countries of the world.

Financial Sector

The composite ICRG country risk rating for Albania placed the country 74th of 127 countries. Domestic credit to the private sector, expressed as a percentage of GDP, was 47%, ranking average for EU accession countries, but M-2 as a percentage of GDP (an indicator of financial depth) placed Albania 50th among 146 countries. However, the average savings rate in the 1990s was -16.3% of GDP, placing Albania 118th of 121 countries.

Investment

Gross domestic investment in Albania for 1998 ranked the country in the top 16% (106th of 132 countries), and Albania had astounding growth in domestic investment from 1990 to 1998 with a rate of 22.4%, ranking it 3rd of 129 countries. Total foreign investment for 1998 was US\$45 million, ranking Albania 108th among 162 countries. Similarly, FDI per capita was only US\$13 for 1998, placing Albania 101st among 162 countries. FDI as a percentage of GDP was a mediocre 1.5%, ranking Albania 78th in the world and behind the rest of Southeast Europe for the year.

Policy

An extraordinarily high budget deficit of 12% of GDP (86th of 87 countries for which data were available) and very high inflation in 1998 damaged Albania's recent policy rankings, although more recent measurements show a reduction in the inflation rate. Trade openness, too, provided relatively low scores (108th among 126 countries). Transparency International ranked Albania 84th among 99 countries, which indicates that business people, academics, and analysts perceive the country as highly corrupt. Finally, proceeds from privatization placed Albania 53rd in the world among emerging economies.

Science and Technology

Albania ranked 93rd in the world for Internet hosts at 0.2 per 10,000 people in July 1999, well behind other Southeast European countries that are moving quickly toward connectivity. High technology exports barely totaled US\$1 million, placing Albania 86th in the world in 1998; measured as a percentage of exports, high technology exports accounted for less than 1% of total exports. Although local telecom costs are quite low, allowing for potential Internet development, international calls are very expensive in Albania.

Infrastructure

Albania ranks last in Southeast Europe in all infrastructure categories. Albania has low telephone density (98th in the world), at 31 lines per 1,000 people, and ranks 99th in the world for mobile phones per 1,000 people. In electricity consumption per capita, Albania ranks 75th in the world.

Human Resources

Albania ranked 94th in the world according to the UN Human Development Index, which ranks 174 countries. In addition, high labor force participation places Albania 52nd of 177 countries, indicating that it is utilizing most of its people that are able to contribute to building Albania's future.

4.6 Summary

Albania differentiates itself from the rest of the Southeast Europe region, displaying characteristics of a developing economy. For example, there is very little industrial production, coupled with a dominance of agriculture in the structure of the gross domestic product. In addition, Albania has a legacy of economic centralism and an underdeveloped infrastructure not comparable to the rest of Southeast Europe.

Overall, Albania's competitive position is problematic. Although there have been a few improvements in recent years, many fundamental traits of a developing, competitive economy remain absent. Albania is particularly challenged by poor public administration that perpetuates security concerns and an inadequate infrastructure. Despite that overall dissatisfactory assessment, Albania's economic performance indicators show that its economy has been improving in the past few years, and its investment competitiveness indicators reflect domestic investment that has recently reached higher levels despite a poorly developed financial sector and a lack of inward foreign investment.

Albania's economy was also affected by political and economic problems at the regional level, as well as by slow progress in its structural reforms and its transition from a centrally planned to a market economy. The weak financial sector, following the collapse in 1997, complicated business activity and drove away foreign investors, leaving Albania with virtually no export sector at all.

However, underlying modest results indicate the potential for future competitiveness in areas such as the development of a strong, educated workforce. In order to take advantage of its current human resources, Albania will have to aim toward achieving internal stability and a standard of living that prevents "brain drain."⁴⁵ For long-term growth, Albania needs stable and sensible governance to create an environment favorable to foreign investment, to implement necessary reforms, and to upgrade its infrastructure.

⁴⁵ Various surveys show that during the period 1990-1999, approximately 40% of the professors and research scientists of the universities and science institutions in Albania had emigrated. There is also a growing concern about the so-called "Canada phenomenon," as many Albanians with higher education and training have immigrated to Canada.

CHAPTER 5 – TRADE AND INVESTMENT COMPETITIVENESS

5.1 Linkages between Trade, Investment, and Growth

The relationships between exports and economic growth and between investment and economic growth, as well as the interlinkages between trade and investment, have been among the topics most debated by economists in the past 20 years.

The World Bank argues that export success had been the centerpiece of the East Asian countries' economic success, not only because exports generated income and savings and were a source of foreign exchange, but also because they contributed to the technological development of many sectors, as well as to higher productivity.⁴⁶

Inter-American Development Bank (IDB) states that because the dynamism and composition of exports may help conditions under which firms operate and alleviate the difficulties they confront, export performance of a country is a manifestation more than a measure of competitiveness.⁴⁷ IDB's calculations indicate that although some countries with successful export performances had more high-technology content goods in their portfolios, others with similar success had abundant natural resources and more low-technology content goods. Thus, one can conclude that there are many routes to success and that there is no single recipe for innovation or competitiveness.

The findings of IDB indicate that exports with a medium- and high-technology content do help speed up economic growth.⁴⁸ IDB also states that the development of exports with high- and medium-technology content and the possibilities for economic growth depend not so much on the absolute conditions of competitiveness as on the environment in which firms operate relative to the country's income level. Although world trade is shifting gradually from more basic goods toward new high-technology goods, the trend is not a sufficient reason for countries to "choose winner products," especially for small economies forced to focus on a few products to penetrate world markets.⁴⁹ Indeed, many countries that achieved successful results did so not by "choosing winning products" but by expending efforts aimed at offering financial services and compensation for tax costs, as well as by facilitating access to trade information. Small economies are at a disadvantage for fixed investments in the research, development, and technological adaptation needed to produce highly elaborated manufactures. They also lack the variety of abilities and knowledge required by more complex production processes and the economies of scales involved in marketing and international transportation.

Foreign Direct Investment (FDI) affects the economic growth of a country through the transfer of technology, as well as through its role as a stimulus to competition, innovation, savings, and capital formation in host countries. Many export-oriented activities, particularly those integrated into international production systems, are new to developing countries and involve greenfield FDI. The studies by the United Nations

⁴⁶ "The East Asian Miracle," 1993, The World Bank.

⁴⁷ "Competitiveness: The Business of Growth," 2001, John Hopkins University Press.

⁴⁸ Ibid.

⁴⁹ IDB statistical calculations.

Conference on Trade and Development (UNCTAD) on FDI indicate that FDI brings in capital and financial resources, transforms and upgrades production technologies, improves the capabilities of human resources, increases innovative activity, improves exports and foreign exchange earnings, increases gainful employment and shifts it toward higher-quality jobs, increases the host country's access to foreign markets, and helps countries exploit existing comparative advantages and build new ones.⁵⁰

While UNCTAD cites that statistical analyses show a positive link between FDI and manufactured export performance,⁵¹ the World Trade Organization (WTO) reports economic, institutional, and legal interlinkages between FDI and trade. The WTO stated that the empirical evidence points to a modestly positive relationship between FDI and home country exports and imports. The WTO also noted evidence indicating that FDI and host country exports are complementary but that FDI and host country imports may be either substitutes or complements, depending on the details of the situation – including the policies pursued by the host country (FDI attracted by low costs of production and liberal trade regimes is likely to be complementary with imports, and vice versa, for tariff-jumping FDI).

FDI and trade play a key role in firms' efforts to organize their production processes efficiently. By subdividing a production process into different phases, locating each phase in a country in which the action can be carried out efficiently, and then linking all the various phases through trade, firms can supply efficiently produced goods and services to buyers worldwide.

International trade can be a permanent source of economic growth if it functions as a channel for acquiring new knowledge and technologies and as a stimulus for continually improving productivity. It can also benefit firms that use imported capital goods or firms that produce export goods according to international standards of technology, quality, or price. Through their relations with other firms as customers, suppliers, and local competitors, firms that are not involved in international trade enjoy the continued growth generated by increasing demand of international markets, increasing global competition among firms, and improving telecommunications infrastructure (all of which are stimulated by increasing international trade).

Competitiveness is the capability to generate prosperity by producing goods and services that stand the test of the marketplace under normal conditions. To avoid an erosion of their competitiveness and to achieve a sustainable share in the world markets, developing countries should seek strategies that will help them reposition themselves over time based on increased productivity levels and increase the share of high- and medium-technology content products in their export portfolios.

⁵⁰ "World Investment Report 2000," UNCTAD.

⁵¹ Ibid.

5.2 Approach

Based on the above information on trade, investment and growth, the following approach is taken to assess Albania's trade and investment competitiveness. First, a review of Albania's trade performance, trade portfolio, and trade partners is presented in order to provide a basic understanding of whether the country has a trade surplus or not, what it trades, and with whom it trades. The trade performance review provides a quantitative picture of a country's exports and imports. Trade performance is, in part, the result of strategic decisions of firms in a given country, which occur in the context of overall business environment incentives. Last, the trade portfolio and trade partners provide a qualitative snapshot and indicate how well diversified Albania's export products and markets are overall.

When a country has only a few export markets and a few products in its portfolio, its trade balance is more vulnerable to fluctuations in those markets or products. Also, the trade competitiveness of a country is correlated to the presence of high value-added products in a country's trade portfolio. As the percentage of high value-added products in a country's trade portfolio increases and productivity levels in a country rise, its exports become more competitive.

Next, an analysis of global competitiveness of Albania's exports by the International Trade Center (ITC) is presented, which highlights how well Albanian products are competing in world markets. This analysis indicates which of the country's products performed better than the world averages (increased their share) and whether the world markets for those products were in an increase or a decline.

The FDI flows in and out of Albania are presented to provide an understanding of the country's success and ability in attracting FDI. Finally, potential opportunities for growth of Albania's exports and things the country can do to reposition itself over time on the basis of increased productivity are discussed.

5.3 Current Trade

Trade Performance. Albania has liberalized its foreign trade, with the exception of those goods that, in conformity with international rules and agreements, are deemed dangerous. The Council of Minister's Decision of September 16, 1999, "Export Import Regime of goods from and in Republic of Albania," regulates the full liberalization.

During the Communist era, Albania recorded low levels of foreign trade as it followed a policy that anticipated exports of small volumes of raw materials to generate a foreign exchange sufficient to balance essential imports. The collapse of the communist block trading system (the Council for Economic Mutual Assistance) and civil unrest at home pushed exports of goods below their existing low levels. Policies implemented recently, such as account convertibility and the abolition of import quotas, in addition to humanitarian aid, rapidly increased imports. Household demand for consumer goods that cannot be satisfied by domestic suppliers combined with equipment purchases to

retool the local industry have drawn in imports well in excess of exports. Thus, the trade imbalance of Albania is structural and is expected to remain high for some time.⁵²

Although exports grew at a slightly higher rate than did imports between 1993 and 1999 (14.5% and 12.5%, respectively), the increase has clearly been insufficient to improve the country's current account. Further, during that period, export value oscillated between 20% and 30% of the value of imports, as presented in Table 5.1. In 1999, exports reached US\$276.1 million, while imports were about US\$1.1 billion.

Table 5.1: Albania's Exports and Imports by Year (in USD Millions)

Year	Exports	Imports	Exports/Imports %
1993	122.4	571.2	21.4%
1994	143.4	601.0	23.9%
1995	204.8	713.7	28.7%
1996	226.4	923.3	24.5%
1997	147.0	632.6	23.2%
1998	206.6	838.9	24.6%
1999	276.1	1,157.0	23.9%
Compounded Annual Growth Rate (1993-1999)	14.5%	12.5%	

Source: JAA's calculations, Ministry of Economic Co-operation and Trade, INSTAT

According to a study performed by the Ministry of Economic Co-operation and Trade and the German Technical Cooperation and Assistance Program (GTZ), the main reasons for high levels of trade deficit are low levels of competitive advantages in local, regional, and international markets; low levels of economic and social infrastructure; inefficient cross-border procedures; and weak institutional organization.

An indicator of the openness of an economy – the strength of its relationship with the global economy – is its foreign trade level as a share of the economic activity in general. The following table presents that indicator for Albania from 1994 to 1999, which has remained strikingly stable throughout the transition period, at about 50%.

Table 5.2: Albania's Trade as a Percentage of GDP

Albania	1994	1995	1996	1997	1998	1999
Trade (% of GDP)	51	46	53	47	41	41

Source: World Bank Development Indicators, 2001

Evidence shows that in cases of small economies with high income levels (such as Ireland, Belgium, Netherlands), the foreign trade activity is greater than the GDP. The foreign trade/GDP indicator for the countries in Table 5.3 reflects the fact that the Albanian economy is still somewhat closed to the world. The country's trade value of 41.26% in 1999 is not even half the average for the comparison countries (118.3%) – a situation that has probably hurt Albania's growth.

⁵² EIU "Albania Country Report," 2001, p.33.

Table 5.3: Trade as a Percentage of GDP (1999)

Country	% of GDP
Bulgaria	96.03
Bosnia and Herzegovina	89.61
Macedonia, FYR	97.21
Ireland	161.38
Netherlands	116.38
Belgium	148.16
Six-Country Average	118.13
Albania	41.26

Source: World Bank Development Indicators, 2001.

Major Partners. Following the collapse of its East European markets, Albania reoriented its exports toward the European Union, which in the year 2000 took 92.5% of Albania's exports. The EU also supplied about 77.9% of the country's imports (see Tables 5.4 and 5.5). Furthermore, exports to the EU were concentrated in three countries – Italy, Greece, and Germany – which, together, bought 88.1% of the total. Imports were somewhat less concentrated, although those three countries provided 70.8% of them. Given that level of concentration, development of trade with the EU is critical for the Albanian economy.

Trade with the EU has been governed by a trade and cooperation agreement that will soon be superseded by a Stabilization and Association Agreement (SAA). Membership of the WTO (acquired in 2000) should benefit Albania's exporters as tariffs from other members start to fall. A free-trade agreement is being negotiated with Macedonia – Albania's fifth-largest export market (according to 1999 data).

In September 2000, the EU's General System of Preferences was altered for Albania and other Western Balkan States to allow many industrial products to enter the EU duty free and to ease export restrictions on the agriculture and fisheries sector. In 2001, the proportion of Albanian products entering the EU without payment of duties rose to 95%, up from 80% the year before.

Table 5.4: Albania's major export flows (2000)

Countries	Volume in Millions	Share (%)
1. Italy	49.24	71.8
2. Greece	6.93	10.1
3. Germany	4.26	6.2
4. Kosovo	2.62	3.8
5. Denmark	1.12	1.6
6. Croatia	0.72	1
7. Sweden	0.63	0.9
8. France	0.58	0.9
9. Austria	0.49	0.7
10. United States	0.39	0.6
11. Turkey	0.38	0.6
12. FYROM	0.37	0.5
13. Switzerland	0.21	0.3

Countries	Volume in Millions	Share (%)
14. Netherlands	0.1	0.1
15. Czech Republic	0.06	0.1
16. Japan	0.03	0
17. Cyprus	0.02	0
18. Bulgaria	0.02	0
19. Slovenia	0.01	0
20. Others	0.34	0.5
Total	68.53	100
European Union	63.36	92.5
East European Union	0.11	0.2

Source: Bank of Albania, June 2000.

Table 5.5: Albania's major imports (2000)

Countries	Volume in Millions	Share (%)
1. Italy	101.3	38.3
2. Greece	71.3	27.3
3. Germany	13.7	5.2
4. Turkey	13.3	5.1
5. United States	7	2.7
6. Bulgaria	5.6	2.1
7. France	5.4	2.1
8. FYROM	4.9	1.9
9. Russian Federation	4.8	1.9
10. Slovenia	3.9	1.5
11. Croatia	3.1	1.2
12. Austria	2.8	1.1
13. Switzerland	2.7	1
14. Spain	2.6	1
15. Netherlands	2.2	0.8
16. China	1.7	0.6
17. Malta	1.6	0.6
18. Hungary	1.6	0.6
19. Cyprus	1.2	0.5
20. United Kingdom	1.2	0.5
21. Others	9.2	3.5
Total	260.9	100
European Union	230.2	77.9
East European Union	17.3	6.6

Source: Bank of Albania, June 2000.

Major Products. Tables 5.6 and 5.7 below indicate the major product categories of Albanian imports and exports for 2000. Albania's exports are heavily concentrated in the textiles and footwear export group. Their value reached US\$42.7 million in 2000 and accounted for 62.2% of Albania's exports. Albanian companies often act as subcontractors for EU firms, importing raw materials from suppliers in Western Europe and working them up into finished articles for export. Such exports fell to 47% of total exports during the crisis year of 1997, when foreign partners withdrew from contracts with Albanian firms, but have since rebounded to levels above 60%. Distant second and third export groups for 2000 were metals and mineral products, with 9.0% and 7.7%, respectively. The former registered an important 8.9% increase in value.

The top import groups for 2000 were textiles and footwear (a group of commodities representing the raw materials for the active processing industry); machinery and equipment; mineral products; and food, beverage, and tobacco, with each group accounting for roughly 10% to 15% of the total. Noticeable changes occurred in mineral products; articles of stone, ceramic, and glass; plastics; and machinery and equipment. Import value rose 37.6%, 99.3%, 28.6%, and 13.2%, respectively. Finally, imports of foodstuffs, beverages, and tobacco declined about 25%.

Table 5.6: Albania's exports by group merchandise

	Volume in US\$ Millions	Share (%)	Change 1999 to 2000 (%)
Textiles and Footwear	42.7	62.2	-5.8
Base metals	6.2	9	8.9
Mineral Products	5.3	7.7	-3.2
Foodstuffs, beverages, tobacco	2.8	4.1	-17.3
Vegetable products	2.3	3.4	-5.7
Leather and articles	1.9	2.7	12.2
Wood and articles	1.6	2.3	-31.8
Machinery and equipment	0.9	1.3	-82.4
Miscellaneous manufactured articles	2.3	3.3	35.6
Others	2.6	3.9	-49.4
Total	68.5	100	-12.6

Source: Bank of Albania, 2000

Table 5.7: Albania's import groups by merchandise

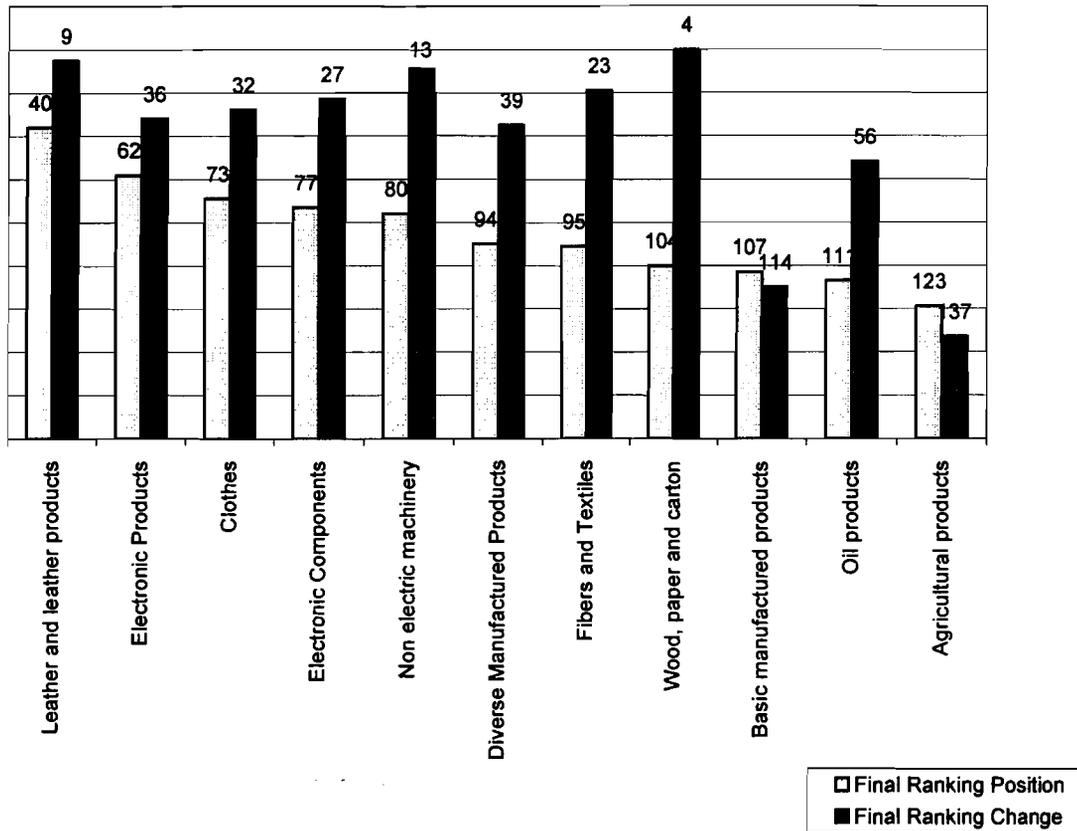
	Volume in USD Millions	Share (%)	Change 1999 to 2000 (%)
Textiles and Footwear	40.4	15.5	5.7
Machinery and Equipment	30	11.5	13.2
Mineral Products	28.1	10.8	37.6
Foodstuffs, beverages, tobacco	25.2	9.7	-25.8
Vegetable products	22.6	8.7	7.7
Transport Vehicles	21.2	8.1	21.9
Base metals	20.3	7.8	8.7
Products of chemical industry	13.7	5.3	-7.1
Articles of stone, ceramics, glass, etc	10.7	4.1	99.3
Plastics	8.4	3.2	28.6
Others	40.4	15.5	-2.1
Total	260.9	100	6.9

Source: Bank of Albania, 2000

5.4 Global Competitiveness of Albanian Exports

To understand the competitiveness of Albanian exports, it is important to benchmark the export performance, to identify new markets, and to monitor the role of competitors. The Trade Performance Index (TPI) developed by International Trade Center (ITC) assesses the multifaceted dimensions of export performance and competitiveness of countries and their principal export sectors. Using COMTRADE database of the UN Statistics Division and covering 184 countries, the TPI calculates two composite rankings – one for the *overall position* of the country and the sector under review, and one for the *change in performance*. Thus, the TPI allows comparison of the performance of a country's export sector with that of other countries as well as with the performance of other sectors of the same country, shedding light on both the competitive and the comparative advantage. As seen in Chart 5.1 below, Albania ranked between 40th and 123rd for the export sectors under review. Leather products, electronics, clothes, and electric components exports from Albania ranked within the top 80 in the world; in terms of performance, wood, paper, and carton; leather and leather products; and non-electric machinery ranked 4th, 9th, and 13th, respectively.

Chart 5.1: Trade Performance Index



Source: ITC, 2000

Likewise, the International Trade Center has developed a tool to present a country's export portfolio in terms of the dynamics of national supply and international demand. Chart 5.2 indicates the performance of Albania's top 20 leading export product groups, showing the export value of the products and comparing national export growth to growth of international demand.

REPLACE PAGE WITH CHART 5.2

Chart 5.2 also indicates the average nominal growth of total exports of Albania (6% per annum indicated by the vertical line) for the period 1994 to 1998 and the average nominal growth of world imports over the same period (6% per annum, indicated by the horizontal line). The diagonal line (the line of world constant market share) divides the chart into two parts: exports of products to the right of the line have increased their share in the world market, and the ones to the left have experienced an erosion of their world market share. The large bubbles, such as parts of footwear (excluding stiffeners); plants (used primarily in pharmacy, perfumery, insecticides, and fungicides); and men's trousers, overalls, and shorts, indicate that Albania's exports are relatively concentrated in those sectors.

Lumber (beech, >6mm); women's and girls' blouses, shirts, and shirt-blouses (cotton knitted); cotton T-Shirts; and men's trousers are the export product areas in which Albania has performed very well. They are dynamic products that grew faster than the world trade in general and for which Albania has been able to outperform world market growth by increasing its share of world imports. Exporters of those products proved their international competitiveness during the 1994-1998 period.

Women's/girls' briefs and panties (cotton knitted) is a sector that presents challenges for Albania. Although the international demand has been growing at above-average rates, Albania's exports of those products have either been falling behind or have grown less dynamically than the world trade, resulting in a loss of Albania's share of the international market. With those products, the bottleneck is on the supply side rather than the demand side. It is essential for Albania to remove the barriers that impede a more dynamic expansion of such exports.

Albania's share in the world import markets in plants (including parts, seeds, and fruit); women's dresses (woven of artificial fibers); men's shirts (woven from cotton); women's blouses and shirts (woven of man-made fibers); and chromium ores and concentrates grew between 1994 and 1998, even though those markets were declining or growing at below-average rates in the same period. From a strategic perspective, Albania must identify niche-marketing strategies to isolate the positive trade performance from the overall decline in those markets.

Market shares of ferro-chromium (more than 4% of carbon), raw tobacco, and whole raw hides and skins of bovine and equine animal exports of Albania have gone down. World imports of such products have either increased at a below-average rate or actually declined; thus, the export prospects for those products tend to be bleak.

Table 5.8 (next page) presents the exports of Albania's 30 product categories at the HS 6-digit level in 1998. Although "Trend 94-98" column shows the annual percentage growth in export value, the "Volume Trend" column shows the annual percentage growth in quantity of product. The "World Trend" column indicates annual percentage growth of world imports of the product under review in the period 1994-98. Looking at the values under that column, one can argue that Albania apparel exports are recovering at a fast pace because they're growing faster than the world trend. The table also indicates that Albania's market share in those products is between 0.1% and 2.4%. Products with a "Unit Value" above 1 suggest that the products are positioned in a market segment characterized by above-average quality and prices. The "No." column indicates the number of countries importing that particular product from Albania.

In the Communist era, chromium was Albania's largest export. However, reserve depletion and civil unrest in production areas have led to a sharp decline in metal exports. A large proportion of manufactured exports comprises labor-intensive products such as textiles/apparel products, reflecting the comparative advantage that Albania derives from low-cost labor. Agricultural commodities and other food products are potentially an important source of exports but have been held back by poor packaging and a lack of emphasis on higher-value-added products.⁵³ Likewise, Albania should become competitive in the production of early season fruits and vegetables, particularly for the EU market, now that trading restrictions have been relaxed as discussed above.

⁵³ EIU "Albania: Country Profile," 2001, p.33.

Table 5.8: World Imports from Albania

Rank value	SITC category	Product	Value 1998	Trend 94-98	Trend stability	Volume trend	World trend	Market share	Unit value	Leading Markets			
										No.	1st	2nd	3rd
		All goods (mirror sat.)	273	6	Low	30	6	0.0	n.a.				
		All goods (IMF)	255						n.a.				
2	121190	Plants, in parts, seed & fruit-in pharmacy, perfumery, insecticides, pesticides	14	14	High	10	3	1.5	0.8	19	DEU	USA	ITA
14	160416	Anchovies, prepared/ preserved, whole/ in pieces, not minced	3				-2	2.2	0.6	1	ITA		
5	240110	Tobacco (unmanufac.), not stemmed or stripped	11	22	Med	37	2	0.6	1.0	11	USA	NLD	ITA
20	261000	Chromium ores & concentrates	2	11	Low	2	-2	0.7	0.9	6	SVK	HRV	FRA
16	271000	Preparation of/non-crude petroleum oils & oil obtained from bituminous minerals	3				-20	0.1	0.7	2	ITA	YUG	
17	410110	Whole raw hides & skins of bovine/ equine animals, dry w<8kg, wet w<14kg	3	-43	Low		-14	1.0	1.3	1	ITA		
11	440792	Lumber (thickness>6mm) - Beech	5	76	Med	61	17	0.6	1.1	3	ITA	SVN	GRC
30	610462	Women's/Girls trousers, overalls & shorts - knitted -cotton	1	60	High	50	2	0.1	0.5	3	GRC	DEU	ITA
19	610610	Women's/Girls blouses, shirts & shirt-blouses - knitted - cotton	2	38	Med	51	10	0.1	0.3	3	GRC	ITA	DNK
21	610620	Women's/Girls blouses, shirts & shirt-blouses - knitted - man-made-fibers	2	77	High	59	21	0.1	0.5	5	GRC	DNK	DEU
18	610711	Men's/Boys underwear - knitted - cotton	3				11	0.2	0.9	2	ITA	GRC	
9	610821	Women's/Girls briefs/ panties - knitted - cotton	5	-24	Low		6	0.2	0.8	3	ITA	IRL	GRC
10	610910	T-shirts, singlets & other vests - knitted - cotton	5	50	High	45	9	0.1	0.4	2	ITA	GRC	
23	620113	Men's/Boys overcoats, raincoats, capes & sim. - woven - man-made-fibers	2				0	0.2	1.0	2	GRC	ITA	
3	620342	Men's/Boys trousers, overalls & shorts-woven - cotton	14	47	High	82	8	0.1	0.4	3	ITA	GRC	BEL
25	620343	Men's/Boys trousers, overalls & shorts-woven - synthetic fibers	1	28	Low	-10	9	0.1	0.5	3	BEL	ITA	GRC
15	620444	Women's/Girls' dresses - woven - artificial fibers	3	92	Med		2	0.3	0.4	8	DEU	ITA	FRA
8	620520	Men's/Boys' shirts - woven - cotton	6	81	Med	96	1	0.1	0.6	3	ITA	GRC	AUT
6	620640	Women's/Girls' blouses, shirts, shirt-blouses - woven -man-made-fibers	10	32	High	48	0	0.3	0.7	12	DEU	DNK	ITA
7	640399	Shoes, sandals & slippers - rubber/ plastic soles, leather uppers	7	105	Med	-37	6	0.0	0.8	4	USA	ITA	GRC
1	640610	Parts of footwear - uppers (excluding stiffeners)	63	-17	Low		0	2.4	0.7	2	ITA	GRC	
13	640699	Parts of footwear - others	4				6	0.4	1.2	2	ITA	BEL	
4	720241	Ferro-chromium, >4% of Carbon	14	-35	Med		3	0.9	0.9	3	ITA	SVN	RUS
22	731010	Tanks, casks, drums, boxes, & sim. Containers, cap. 50-300L, iron/steel	2	25	Low	39	6	0.4	2.2	2	GRC	ITA	
24	740311	Cathodes & sections of cathodes - unwrought refined copper	2	-5	Low		3	0.0	0.9	2	GRC	ITA	
29	740400	Copper waste & scrap	1	-26	Low	-5	-1	0.0	1.4	4	ITA	DEU	GRC
26	760120	Unwrought Aluminum - alloyed	1				7	0.0	0.7	1	ITA		
27	830160	Parts for locks/ clasps/ frames with clasps - base metal	1				16	0.1	1.0	1	ITA		
12	847330	Parts & accessories of auto. data processing machines & units thereof	4				13	0.0	1.5	3	FRA	DEU	ITA
28	853661	Electrical lamp holders - for V<=1000 volts	1				5	0.3	0.3	1	ITA		
		Transport service, credit	13	-2	Low		4	0.0					
		Travel, credit	54	-10	Low		5	0.0					
		Other services, credit	20	22	Med		7	0.0					

Source: ITC

NOTES on TABLE 5.8

1. Value figures are in US\$ million. 2. Trend and growth in percentage per annum 3. Market share figures are in percentage. 4. Unit Value - The relative average unit value serves as an indicator for the positioning of products. Values above (below) 1 suggest that the products are positioned in a market segment characterized by above-average (below-average) quality and prices.

As shown in Table 5.9, labor-intensive industries were the driving force behind Albania's exports between 1994 and 1998. Labor-intensive products were the leading category in export value and second in growth, and they had the largest share of Albania's total exports. Although they recorded a significant growth rate of 35%, the technology-intensive manufactures did not compose a large share of the country's total exports. The natural resource-intensive manufactures of Albania experienced a decline of 24% between 1994 and 1998, indicating a shift away from natural resource-based exports. The human capital-intensive manufactures did not record much growth, and they composed only 4% of the country's total exports.

Table 5.9: Indicators on Export Performance of Albania

Group of Products	Value 1998 (in US\$ million)	Growth 94-98 (% per annum)	Share in exports (%)
Primary products	57	3	21
Natural resource intensive manufactures	22	-24	8
Labor intensive manufactures	169	12	62
Technology intensive manufactures	13	35	5
Human capital intensive manufactures	10	11	4

Source: ITC

5.5 Current FDI flows to Albania

The relatively poor growth and productivity performance of Albania have been due in part to an inadequate investment climate. Investment levels in recent years have been particularly low. As seen in Table 5.10, Albania has the lowest FDI per-capita figure among Southeast European countries. From a regional perspective, the investment levels overall have been low for almost all Southeastern European (SEE) countries. With the exceptions of the Czech Republic and Albania, FDI as a percentage of GDP has been roughly 5%.

Table 5.10: FDI flows to Southeast Europe (1999)

	FDI flows in US\$ millions	FDI per capita in US\$	FDI/GDP
Albania	41	13	1%
Bulgaria	770	93	6%
Czech Republic	5,091	492	9%
Croatia	1,347	299	6%
Macedonia*	117	59	4%
Romania	961	43	4%

Source: World Development Indicators, World Bank.

* 1998 figures

Table 5.11 shows the FDI inflows into Albania for the last 7 years. From 1992 to 1996, an annual increase of almost 50% was registered. The number of foreign firms increased drastically from 125 to 1,206, as many investors came to Albania to benefit from its comparative advantages or to establish a position early in a new, growing market. Reflecting strong trade linkages and geographical proximity, the majority of FDI came from Italy, Greece, and Turkey. However, political trouble in 1997 reduced FDI inflows by half, from US\$97 million to US\$42 million during that year in comparison to

1996. Furthermore, political uncertainties in 1998 (namely, the killing of democratic leader Hajdari) and in 1999 (the Kosovo crisis) practically kept FDI inflows at 1997 absolute levels. By the year 2000, FDI had reached US\$92million, largely due to the sale of a majority stake in Albanian Mobile Communications.

Table 5.11: FDI Inflows to Albania (in USD Million)

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total	32,0	45,0	65,0	89,0	97,0	42,0	45,0	43,0	92,0

Source: OECD Strategy Paper, EIU Country Report.

According to the assessment of the Organization for Economic Co-operation and Development (OECD) on national investment strategy, Albanian legislation does apply national treatment to foreign investments, except for land ownership. Institutionally, there are many agencies with the main task of promoting FDI through the dissemination of a new image for Albania and through the promotion of favorable investments in the country. To provide security and protection against losses arising from political risks, the World Bank has provided a loan to support a political risk guarantee facility, administered by the Albanian Guarantee Agency.

5.6 Competitiveness of Albanian FDI environment

Despite its difficult investment climate, Albania possesses several assets to offer to investors. Assets include: proximity to the EU market, low cost of relatively well-educated workers, rich natural resources and minerals, fertile and arable land, and an ideal climate and coastline for the development of tourism. However, to increase the competitiveness of its FDI environment and capitalize on its assets, Albania must eliminate the major weaknesses in the current investment environment.

Although Albania's FDI figures seem to be on the rise recently, investors are concerned about the deterioration of important cost differentials between Albania and neighboring countries. The following areas indicate that the competitiveness of the Albanian FDI environment is deteriorating:

- a) Rises in total cost of labor, including actual wage rates, taxation, and other social charges on labor costs
- b) Lack of reliable access to imported capital goods, machinery, and raw materials as a result of ineffective VAT/duty reimbursement mechanisms
- c) High transaction costs in terms of time and money because of cumbersome administrative procedures

Neighboring countries have made significant progress in improving their business climates and removing disincentives, which has lowered the comparative cost of doing business in those countries. Moreover, a survey carried by Foreign Investment Advisory Services indicates that Albanian worker productivity is lower than that of neighboring countries. The bottom line is that important cost differentials between Albania and its neighbors may have a negative effect on export-oriented FDI in certain industry sectors.

The amount of FDI that Albania attracts is low when compared to the other Balkan countries. Albania ranks among the lowest recipients of FDI in Eastern Europe – almost on par with Macedonia, and above Bosnia and Herzegovina. The stability of economy in 2000 started to increase the competitiveness of the FDI environment and began to attract foreign investors. However, governance problems, lack of confidence in the judicial system, and corruption are factors that continue to deteriorate the Albanian FDI environment.

5.7 Opportunities

Albania has comparative advantages in sectors such as natural resource extraction and processing, hydroelectric potential, construction materials, light manufacturing, fishing, and tourism. Albania's strategic sectors and mineral resources, including chrome, nickel, oil, coal, and copper, hold significant potential for export-oriented FDI. The country also has important deposits of bauxite and phosphorite that have not yet been exploited. Unfortunately, Albania's mining industry suffers from the same problems that pervade the rest of Albania's industry: outdated technology and a lack of management expertise.

There is also long-term potential for FDI in agriculture and tourism. FDI in agriculture is obstructed by the smallness of plot sizes of land and by restrictions on land ownership by foreigners. Once the plots are consolidated to enable economies of scale, agribusiness (for exports to the EU) and food processing will be two sectors with many opportunities for foreign investors. Albania's 450 kilometers of unspoiled coastline, mild climate, and unique cultural heritage sites have the potential for tourism investors. However, the country needs to focus on improving its security situation, its infrastructure, and its investment climate.

From a strategic perspective, Albania needs to identify niche-marketing strategies for its traditional industries such as the apparel sector (women's dresses, blouses, and shirts as well as men's shirts) to isolate its trade performance from the overall decline in those markets.

CHAPTER 6 - INDUSTRY AND FIRM-LEVEL COMPETITIVENESS

6.1 Introduction

This chapter presents three industry analyses – Tourism, Information and Communications Technology, and Apparel and Textiles for Exports – from a competitiveness point of view. The three tools used in the analyses are discussed below.

Diamond Analysis

The industry analyses below utilize the competitiveness diamond, developed by Michael Porter, to demonstrate the decision-making process for firms in a particular industry in a given country. The four determinants of the diamond are factor conditions; demand conditions; related and supporting businesses; and firm strategy, structure, and rivalry. Factor conditions refer to the presence of basic and advanced factors such as labor, technical infrastructure, and other factors related to productivity. The analysis of the determinant focuses on how well the country has upgraded its natural circumstances. Demand conditions reflect the level of sophistication of the local customer base, which would ideally be anticipating global trends and preparing local producers for future upgrades. Related and supporting businesses are the local suppliers and distributors who can serve as catalysts for innovation, reinforce skills in product manufacture, process technologies, and market channels. Finally, strategy, structure, and rivalry describe firms' choices and positioning and the presence of local competition. Some innovation-driven economies present a very high degree of rivalry. Generally, strong local competition is positive preparation for firms to compete in the global marketplace.

SWOT Analysis

SWOT analysis refers to strengths, weaknesses, opportunities, and threats, and it helps firms assess the business environment in which they operate from a strategic perspective. Strengths look into the advantages faced by an industry; weaknesses cover the points that should be avoided, disadvantages, and poor characteristics of a particular sector. Opportunities represent changes in market trends, potential technical innovations, government policies, and demand trends that may positively affect the industry in question. Finally, threats cover the rival's strategy, threatening trends in technology, potential cash-flow problems, and changes in the products and job specification that may negatively affect the firm. Although strengths and weaknesses refer to an internal analysis of an industry, threats and opportunities refer to an analysis of the environment in which an industry operates.

Fairbanks 7-Opportunities

In his book *Plowing the Sea*, Michael Fairbanks identifies seven patterns of uncompetitive behavior commonly present in developing countries. The first pattern is an overreliance on basic factors of advantage, which causes exportation of natural resources at devalued exchange rates, a depletion of the exported products, and pressures to keep costs low. The remedy for that pattern is to develop more complex sources of advantage. The second damaging pattern is a poor understanding of customers. The private sector in most developing countries does not make explicit choices about customer segments, does not understand different customer needs, and

does not seek out the most attractive customers. Industries must invest in customer research to become competitive. The third pattern is ignorance of relative competitive position. That pattern reflects a high degree of vulnerability to competition in combination with the tendency to make uninformed choices and to pursue a habit of ineffective communication. To correct the pattern, businesses in developing countries should research their relative competitive position. A fourth pattern is that of a failure to forward integrate. By postponing critical decisions on strategic issues, companies cede control of their future. Studying the results of forward integration in businesses is crucial for enhancing the relative competitive position of those businesses and, consequently, the industry in which they operate. Poor interfirm cooperation is the fifth damaging pattern. The behavior of a firm is strongly affected by its rivals. Cooperation can substantially raise productivity levels; defensiveness forces companies to arrive at illogical conclusions, avoid competitive solutions, and engage in backward behavior. Finally, the seventh pattern is excessive paternalism. Heavy governmental control and protection of key sectors of the economy prevent innovation and therefore need to be eliminated.

6.2 Tourism

A. Industry Definition and Background

The tourism industry can most simply be described as the set of economic activities that supply the needs of a common market in the form of tourists traveling and staying away from home. Such economic activities include establishments engaged in providing attractions, facilities, and services for tourists. As tourists use a range of attractions, facilities, and services, they are customers of a variety of industries that significantly depend on tourists for their business, such as hotels and tour operators.

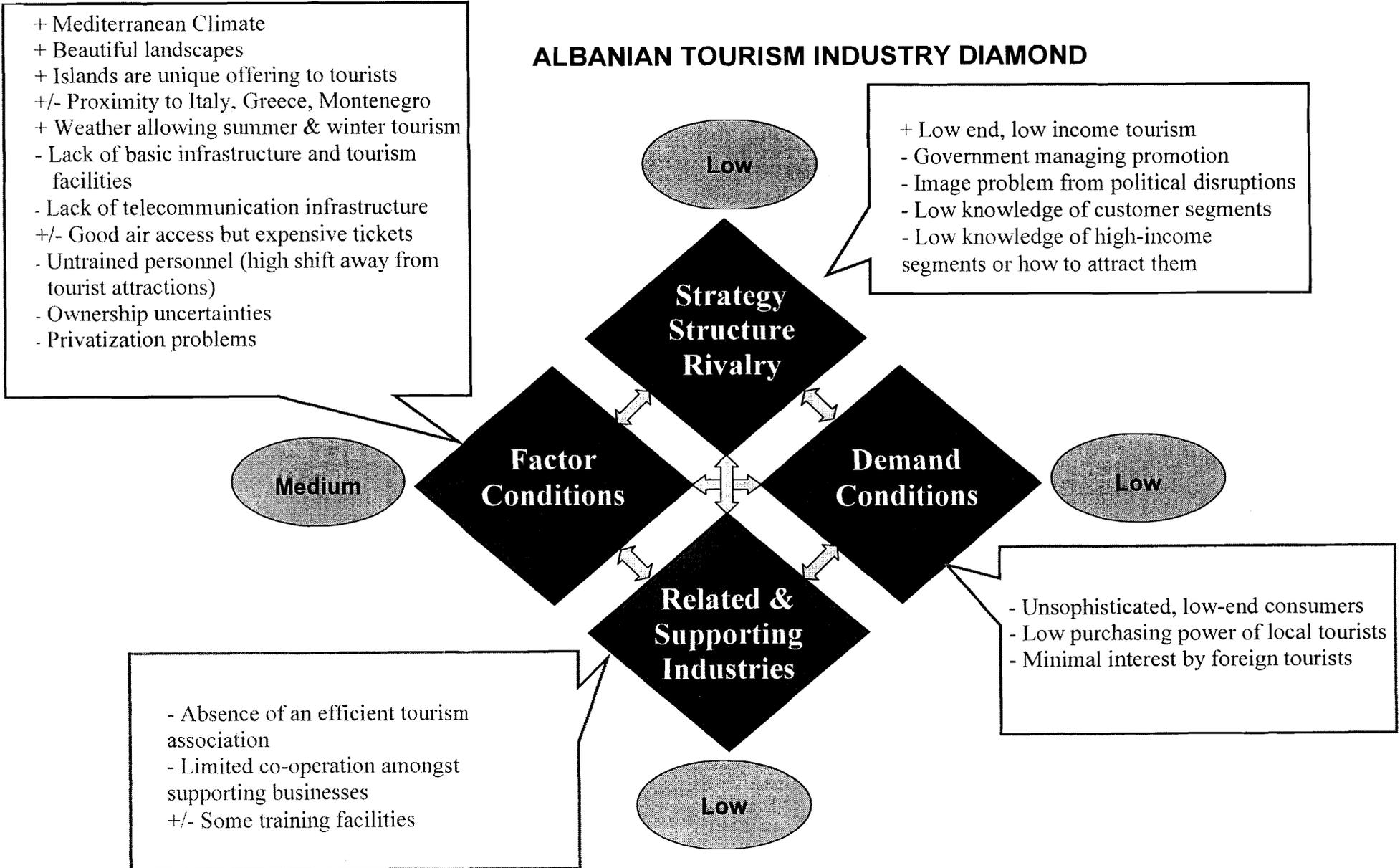
Although the state-owned hotels were mostly privatized in Albania after 1992, few of them are renovated according to Western standards. However, a private accommodation market started to flourish after 1994, mainly in Tirana, Durrës, Vlora, and Saranda. The private market offers a range of two to four star hotels, well built and furnished, all of which are local private investments. Good business hotels of international standards are built in Tirana, generally by foreign capital. Other tourist developments have been limited generally to the areas near Tirana and until now have been serving only the domestic market.

B. Diamond Analysis

Factor Conditions. Albania has favorable natural resources such as a warm Mediterranean climate, diversity of beautiful landscapes, and abundant and varied wildlife. These resources offer the possibility of building up a sound year-round tourism industry spread throughout the country.

In the meantime, basic tourist infrastructure such as hotels and other facilities, as well as general infrastructure (transportation, water supply, electricity, sewage and disposal treatment, and telecommunications) are lacking. Although there are connections from Tirana airport to the main cities of Europe, the low frequency of flights and low capacity of operating carriers result in high-priced tickets.

ALBANIAN TOURISM INDUSTRY DIAMOND



Ownership uncertainties and additional problems related to the privatization of the existing tourism infrastructure have had a negative impact on the development of tourism in Albania. Other contributing factors include a large shift away from tourist attraction areas (caused by the insurrection of 1997, the recent unpleasant economic situation, and the absence of foreign investors) and a lack of customer service training for the hospitality workforce in general. In addition, a lack of understanding of marketing techniques, market segments, and marketing strategy implementation has resulted in limited ability to capture customers.

Demand Conditions. The demand for tourism products in Albania is considerably low. Although there is a lack of statistical data on tourist arrivals, during the best period, in 1996, the majority of visitors who came to Albania were business travelers, or friends and relatives of the Albanian Diaspora, and many of them were daily visitors from Corfu. Generally, business people stay in Tirana, and tourists visit the countryside on one- to two-week cultural tours that originate from the capital. The Western travelers generally come from West European countries such as Italy, Greece, UK, and Germany.

The Albanian tourists are generally oriented toward sea and sun holidays. The most frequently visited destinations are Durres, Vlora, Saranda; the traditional villages on the Jonian Coastline; and Pogradec, by the Ohrid Lake.

Because of the lack of quality and diversity of tourism products, Albania has traditionally attracted unsophisticated, low-end consumers.

Strategy, Structure, and Rivalry. After being modified, "Strategy for Tourism Development 1993-2010," a basic strategy paper financed by the European Bank for Reconstruction and Development (EBRD) and prepared by Touch Ross & Euro-principals Limited (an international tourism consultancy) in cooperation with Albanian institutions, was approved by a Governmental Decree in 1993 to set the Albanian Tourism Development Strategy. However, very little has materialized in terms of implementation since the paper was approved.

The Albanian private sector in tourism-related activities is relatively inexperienced. Until now, such businesses have established only a single association: "Association of Travel Agents." Hoteliers are not yet organized under an association, despite the flourishing private accommodation market mainly in Tirana, Durres, Vlora, and Saranda.

Finally, there is no intense rivalry among the local players of the Albanian tourism sector.

Related and Supporting Industries. The related and supporting tourist industries such as tour operating, catering, and tourist attraction and recreational facilities are not yet well developed in Albania. They are similar to the tourism sector, which is also in the very early stages of its development. The status of the transportation sector is not supportive in terms of increasing the competitiveness of tourism-based activities. There are, however, some training institutions that offer programs to help improve the service skills of those individuals who are interested in pursuing a career in a tourism-related field.

C. Role of Government

Since 1992, the Albanian government, through the National Tourism Administration, has been enforcing the licensing of travel agencies and transportation firms. In 1993, the government enacted Law 7665 on "Priority Tourism Development Zones" (which grants special incentives to investors of those zones) and established the Committee for Tourism Development (CTD), which is responsible for approving or rejecting applications by physical or legal persons for the granting of permits to conduct tourism activities in the "priority tourism development zones." The Committee for Tourism Development (CTD) and the National Council on Tourism Planning both play an important role in the tourism sector. In 1998, the National Tourism Administration started to issue grade classification of accommodation establishments.

One of the main constraints in Albania for tourism development is the lack of qualified staff at the institutional, managerial, and support levels. The National Tourism Administration lacks a cohesive strategy on workforce development and training. The institutions responsible for educating employees for the hospitality and tourism sector are the Economics Faculty of Tirana University and, through their tourism programs, the Vlora and Korca Universities. Better coordination between the National Tourism Administration and the Ministry of Education is needed to implement a real strategy on workforce development and training in support of the Tourism Development Strategy. Meanwhile, privatization of tourism establishments, including the privatization of all activities of the Albaturist State Agency, needs to be completed.

D. SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ➤ The beauty and diversity of landscape ➤ Abundant and varied wildlife ➤ Rich cultural and historical heritage ➤ Colorful folklore and customs ➤ Pleasant Mediterranean climate ➤ Intriguing culture, tradition, and country for Western tourists ➤ Well-preserved and restored "museum cities" ➤ Very friendly and hospitable people ➤ Extensive knowledge and use of international languages ➤ Strong communication and people skills ➤ Short distance to major European cities, and easy access by boat from Italy, Montenegro and Greece ➤ Generally, a high level of education ➤ Young labor force 	<ul style="list-style-type: none"> ➤ Under-developed infrastructure (although there are ongoing improvements) ➤ Tourism is not a priority for the government ➤ Image problems due to security and inner political troubles ➤ Long bureaucratic border procedures ➤ Lack of appealing tourism products ➤ Insufficient quality of hotels ➤ Lack of effective and efficient management of tourism businesses ➤ Absence of a service-oriented culture ➤ Lack of knowledge on foreign tourists' needs ➤ Poor marketing efforts by the Government ➤ Insufficient tourism and hospitality education and training, especially for low level skilled personnel ➤ Educated and skilled labor leaving the country ➤ Absence of awareness on environmental issues among the population ➤ Illegal buildings spreading in tourism zones ➤ Frequently changing structure and staff of the national tourism administration ➤ Confusion in tourism concepts/definitions of the institutions related with tourism, including the Albanian Government

	<ul style="list-style-type: none"> ➤ Uncertainty about the model of tourism development to pursue ➤ Confusing situation about land ownership in tourism areas and rising conflicts of interest ➤ Lack of land use policies for land with tourism development potential
<p>Opportunities</p>	<p>Threats</p>
<ul style="list-style-type: none"> ➤ An image of mystery and curiosity as a relatively unknown country amongst travelers ➤ Preservation of the natural resources through development of environmentally sound tourism ➤ A coastline with many opportunities to develop yachting and other nautical tourism activities ➤ Development of annual national and international events based on local culture and customs ➤ Special interest tours based on archaeological sites, folklore, culture, literature, bird watching, and wildlife ➤ Business tourism based initially on existing convention and exhibition facilities in Tirana ➤ Develop alternative forms of tourism and offer a range of tourist products to diversify into niche markets, thus placing Albania on the Mediterranean tourism map as a desirable destination for high spending tourists ➤ Opportunities to attract tourists visiting Corfu and the northern part of Greece, Croatia, and Montenegro ➤ Solicit cruise ship excursions which will be a valuable and consistent source of foreign currency ➤ Development of a bed and breakfast accommodation scheme 	<ul style="list-style-type: none"> ➤ Possible conflicts in an unstable region may continue to deter tourists and investors ➤ Unstable internal political environment and insufficient order to ensure security and safety for tourists ➤ Absence of a fully functioning legal system which protects property rights and promotes a sound investment climate ➤ Competition from other Mediterranean environmentally-sound tourist destinations ➤ Development of cheap seaside tourism with no differentiating factors, which can be easily substituted by other countries ➤ Increasing corruption, making investing in tourism difficult ➤ Risk of brain drain; specialized people leaving the country

E. Looking Ahead

There are different actions the tourism sector may take to achieve an increase in productivity levels. Those actions can be effective only if some basic issues such as internal political stability, security and safety in the country, regional stability, development of basic infrastructure, and land ownership in tourism are resolved.

Proactive cooperation between travel agents and hoteliers, organized in the form of associations, could create a positive environment for the development of a diverse range of tourism products. Likewise, understanding customer needs and improving customer service through training courses can help tourism-related industries develop new tourism products.

Albania cannot presently compete with already-established mass tourism destinations such as Italy, Croatia, Greece, and Turkey. However, by developing alternative forms of tourism (based on natural and cultural potential resources), Albania can develop a

diverse range of tourist products for niche tourism markets that will differentiate Albania as a new destination and will attract the higher-spending tourists, extend the season, and promote tourism development in rural areas. Developing existing local airports as well as improving the road network would facilitate the movement of tourists.

The Albanian government has to react to problems created by the privatization of the hotel portfolio. It has to create new incentives for the new owners to invest in modernizing the facilities and improving management. The incentives granted by Law No. 7665 are not sufficient to entice the sector.

Development projects along the coast, in the lake areas, and in the inner country are examples of places where incentives such as low-interest loans from small tourism activities would be appropriate. Improving the law controlling land, improving legislation that relates to the reinstatement of property, and giving the former landowners more opportunities to take part as developers on the priority tourism areas should be priorities for the government.

Based on its unspoiled coastal scenery, cultural heritage, and friendly people, Albania can build a sound tourism industry by uniquely positioning itself in the international tourism market. Whether generating foreign exchange earnings, increasing employment opportunities, distributing direct or indirect economic benefits, or supporting the integration of Albania to Europe, tourism will be able to play an important role in the development of the country.

Albania should learn from the many examples of policies and types of tourism development that exist in other countries. In particular, Albania should take into consideration that in many developing countries, poverty and pressures for fast economic development have led to overexploitation and extraction of natural resources, which has not always benefited local populations. Ecotourism, or "green tourism," is one of the best and most sustainable alternatives for Albania to use in protecting and improving the quality of the environment, biological diversity, and the landscape. At the same time, such an approach would help secure a sustainable income base for Albanians working in that sector.

F. Fairbanks 7-Opportunities

Opportunity Category	Potential Opportunity	Suggested Action
1. Improve Customer Learning	Increasing knowledge of customers, utilizing the potentials of the Tourism Program of the Economics Department in Tirana University, Tourism Programs in Vlora and Korca Universities will help businesses in tourism identify opportunities.	Integrate courses that increase knowledge about the nature and needs of customers into the Tourism programs in Universities. Stimulate the development of training courses on customer learning for travel agencies, operators,

		<p>tour-guides, and hospitality sector workforce.</p> <p>Include courses on the service sector in the educational programs of the secondary and high schools.</p>
2. Explore Forward Integration	<p>Promoting the development of private tourism-related businesses, organizing them in associations and improving partnership with public sector will help to identify opportunities.</p>	<p>Improve and institutionalize the coordination of activities between the hotel sector and the travel agencies (tour operators).</p> <p>Improve the effectiveness of promotion by bringing together all the components of tourism products with special emphasis on three core resources: the natural, cultural and human resources.</p>
3. Innovate	<p>Innovation of new tourism products will increase business.</p> <p>Building of basic infrastructure will help increase revenues from tourism sector.</p>	<p>Widen scope of tourist products offered throughout the country.</p> <p>Construct basic transportation and telecommunications infrastructure.</p>
4. Cooperate with Cluster	<p>Increasing efficiency of the Travel Agents' Association and its membership base would yield benefits to the tourism cluster.</p> <p>Establishing a Hoteliers' Association will help businesses to join forces and benefit from economies of scale.</p>	<p>Stimulate the establishment of Hoteliers' Association, which will serve as a platform to exchange and share ideas, collaborate in education, training and promotion, and will disseminate information to potential consumers.</p>

<p>5. Understand Competitive Position</p>	<p>Assessing Albania's competitive position in the tourism sector will indicate possible opportunities for niche markets, and reveal what Albania needs to accomplish to maximize its tourism potential.</p>	<p>The Government should secure and allocate funds to assess the competitive position of the Albanian Tourism industry jointly with the private sector.</p> <p>Increase awareness of the parties in tourism industry of the importance of a tourism product diversity for successfully building Albania's image as a tourist destination.</p>
<p>6. Avoid Over-Reliance on Basic Factors</p>	<p>Building a strategy based on advanced factors rather than one that relies only on basic ones will open more doors for the success of the Albanian tourism sector.</p>	<p>Establish a dynamic product development and marketing strategy based on a mix of basic and advanced factors; and implement pilot projects.</p>
<p>7. Avoid Government Paternalism</p>	<p>If the Government of Albania avoids over-protection of the tourism sector and successfully carries out the privatization of the tourism infrastructure and hotels, opportunities for new businesses may emerge.</p>	<p>Effective measures have to be taken by the Government, such as applying low interest loans to stimulate the new owners of hotels undertaking modernization of the facilities, and offering incentives to create training centers to improve the managerial skills of the workforce.</p> <p>The Government should improve policies over the use of land for possible tourism development projects.</p>

6.3 Information and Communications Technology (ICT)

A. Industry Definition and Background

For the purposes of this study, ICT is defined as writing and providing specific software, importing parts for and assembling personal computers (PCs) and other hardware, providing and distributing internet connections, using Web authoring to service non-governmental and governmental institutions, and developing e-business and e-commerce.

With the assistance of the United Nations Development Program (UNDP) in 1985, the first access point of Internet Service Provider (ISP), which was mainly used by research institutions, was created in Albania. The system was abolished in 1993 and reactivated under the name FreeNet in 1995. FreeNet provided e-mail access to NGOs, some government agencies, and academic institutions; however, legislative constraints made its further expansion impossible.

Further developments in 1997 brought Soros Open Society Foundation to support the second access point of Internet called OiC, which was able to create Ardianet, the kernel of the academic backbone in Albania. The technology used by Ardianet includes two satellite links with 64 kbps, UNIX and NT servers, wireless modems, cable links, and dial-up. Its services include:

- 1) DNS for the following websites: org.al, edu.al, gov.al, and com.al
- 2) E-mail services
- 3) Access to the "World Wide Web"
- 4) Web proxy service
- 5) FTP

Ardianet's main users are the Albanian government, some faculties at Tirana University, a number of NGOs, and the National Library, as well as some R&D institutions that use dial-up connection.

B. Diamond Analysis

Factor Conditions. The factor conditions rank medium for the Albanian ICT sector. Although the language skills of the population and the low cost of domestic telecommunications are pluses, the business expansion constraints and low quality of the telecommunications infrastructure are minuses for the ICT sector. Many Albanian residents are bilingual in either Italian or English. A number of good universities produce graduates who are sought by the market. However, the penetration of computers in schools is not high in Albania, thus limiting exposure of students to computers and computer software. Although it is improving, Internet usage is poor in Albania. The country does have skilled computer engineers and software engineers, but a recent trend has been toward relocation from Albania to higher-income countries.

Demand Conditions. The demand conditions rank from low to medium. There is a low but growing local demand in Albania for ICT services. The banking sector presents ICT companies with opportunities. However, the amount of business they would represent is not sizable enough to attract large multinational software houses into the country. The domestic market has very little exposure to the world market, as there are only a few multinational firms currently active. Those firms are being serviced by ICT firms from their countries of origin.

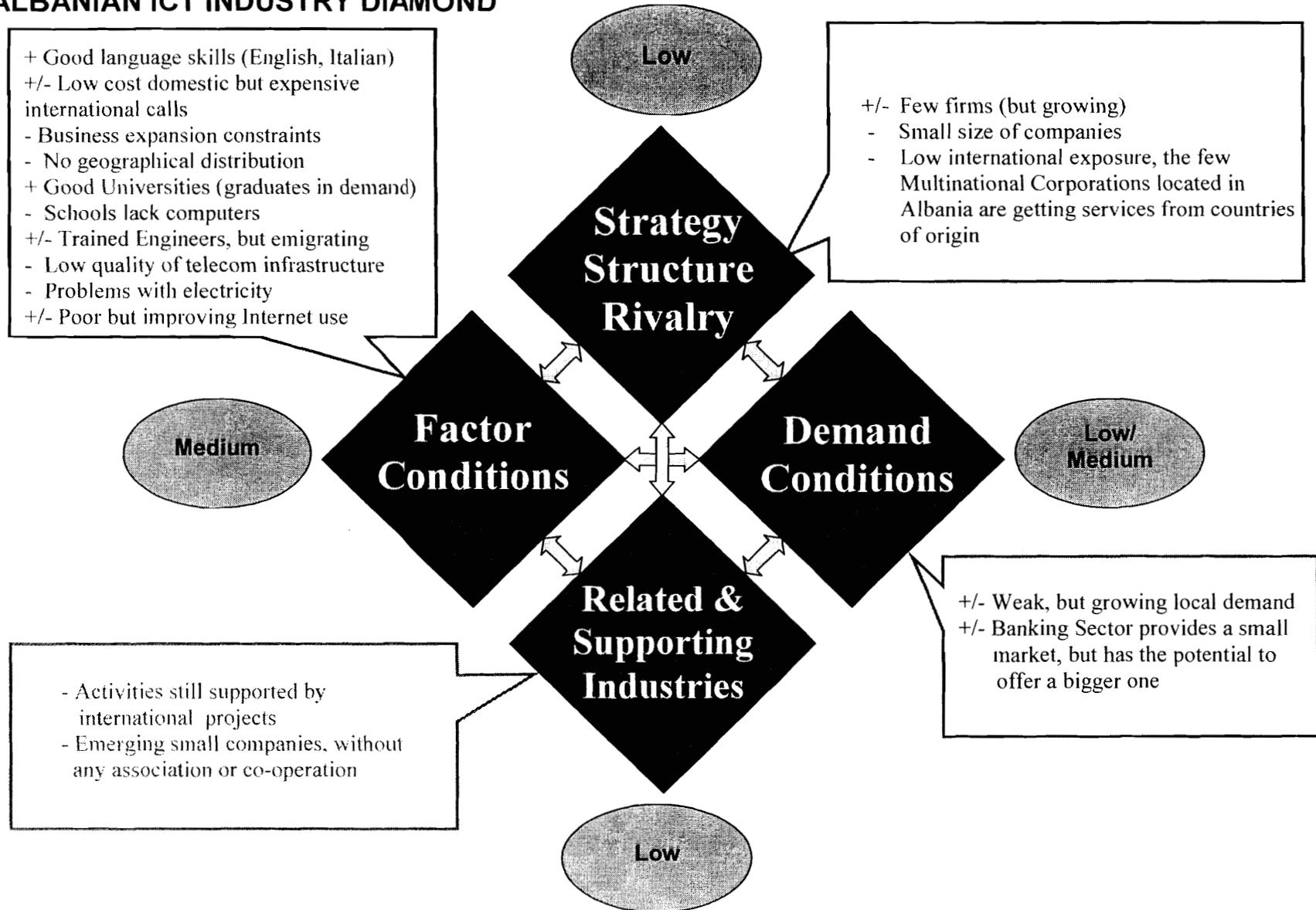
Strategy, Structure, Rivalry. The number of firms in the ICT sector in Albania is few but growing. Most of those firms are computer and service companies (building LAN and providing maintenance) that are small in size, employing only a few people. Since ICT is an infant sector for Albania, there is not much rivalry. Internet is also new in Albania and is mostly used by production companies as a communication infrastructure for both data and voice.

There are 11 commercial ISPs and 2 non-commercial ISPs authorized by the National Regulatory Agency (ERT). Two of the commercial ISPs have been authorized to provide regional services, and six ISPs provide services on a local basis – only one of which fulfills the conditions for national services. One of the remaining two provides POP services, and the other provides backbone services. Meanwhile, an application for a national ISP is currently under consideration.

Although the government has taken steps in the direction of e-government, they are considered to be relatively minimal.

Related and Supporting Industries. Most of the ICT-related activities are still being supported by the donor community in Albania. Even though a number of companies are emerging in the ICT sector, they are not organized in any format such as a business association. The current condition of the Albanian telecommunications sector is not supportive in terms of increasing the competitiveness of the Albanian ICT sector, but recent developments in the telecommunications field are positive indications of development. Obtaining terminal hardware for Internet service or network providers in Albania is easy, as personal computers are locally available and easy to import. However, terminal software is not developed in Albania, and only limited possibilities exist for buying terminal software. Software in the Albanian language is not available, and the current Albanian legislation does not help mitigate software piracy or protect intellectual property.

ALBANIAN ICT INDUSTRY DIAMOND



C. Role of Government

In 1998, the Albanian government started to regulate the ICT sector by adopting Law No. 8287, which amended Law No. 8038 (1995) on telecommunications. As foreseen in Law No. 8287, the National Regulatory Agency (ERT) was created in August 1998 as an independent institution, authorized to issue licenses to Internet Service Providers (ISPs) and telecom operators. As mentioned earlier, since its establishment, the ERT has authorized 11 commercial ISPs and 2 non-commercial ISPs.

The government should adopt the European standards for third-generation wireless communication (UMTS), promote e-government, address constraints of bandwidth availability and cost, promote the use of computers in schools, and work with universities and training providers to improve the relevance of education programs to changing needs.

D. SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ➤ Good language skills (English, Italian) ➤ Computer and software engineers with some expertise ➤ Low labor cost 	<ul style="list-style-type: none"> ➤ Inadequate telecommunications and power infrastructure ➤ Insufficient management skills ➤ Insufficient marketing skills ➤ Lack of information structures and services (information about modern technologies, procedures to do a business, custom procedures, foreign market opportunities, licensing regulations) ➤ Insufficient information of legal framework ➤ No adequate financial facilities for industry development ➤ Lack of public order, political instability ➤ Incapacity to compete with imported products ➤ Low labor and capital productivity ➤ Lack of Export Promotion Agency ➤ Lack of export services companies
Opportunities	Threats
<ul style="list-style-type: none"> ➤ Banking sector offers some opportunities for the domestic IT firms and foreign firms who might be interested in joint ventures ➤ Increasing internet penetration rates are offering opportunities for internet-based application businesses ➤ Low cost of labor offers good potential for foreign companies wishing to contract local firms 	<ul style="list-style-type: none"> ➤ Attractive overseas salaries for qualified IT engineers and staff create "brain drain." ➤ World-famous companies with their IT services pose a threat for small sized Albanian firms ➤ Slow development of infrastructure ➤ Slow development of other sectors offering potential business for this industry

E. Looking Ahead

The prospect of Albania's becoming an ICT powerhouse seems to be distant due to the limitations of infrastructure and human resources. However, that situation does not preclude Albania's becoming a serious player in certain niche markets.

As the fixed investment in the country rises, purchases of capital goods by companies are most likely to be dynamic in the next two to three years. Privatized company buyers have already started to place substantial orders with telecommunications giants like Nokia for network infrastructure, mobile phone switching centers, and high-capacity base stations.

The Albanian Government must join forces with the private sector and lead efforts to establish a strategy for the Albanian ICT sector for the next decade. Initial efforts by the private sector to establish an ICT association should be supported, and the ICT companies should try to enjoy the benefits of acting as a cluster.

Investments into the infrastructure and human resource development programs will be crucial to further developing the Albanian ICT sector in the years to come.

F. Fairbanks 7-Opportunities

Opportunity Category	Potential Opportunity	Suggested Action
1. Improve Customer Learning	Learning about the customer needs and requirements will open new business opportunities for the Albanian ICT sector.	Increase knowledge on customers; thereby fully understanding how to serve the Albanian market. Invest in young Albanians to create a larger pool of available labor with highly sought skills sets.
2. Explore Forward Integration	Improve and institutionalize the coordination of activities between banking and finance sector and the ICT companies as a starter.	Promote the development and expansion of private ICT related businesses, organizing them in associations while improving partnership with public sector.

3. Innovate	Increase software development skills and increase R&D.	Either working jointly with large Western companies or by themselves, Albanian ICT companies should make innovation a priority – to be in a position to rank among the best in the world.
4. Cooperate with Cluster	Establish an ICT Association which will help ICT businesses join forces and benefit from economies of scale.	Stimulate the establishment of a national ICT Association, which will serve as a platform to exchange and share ideas, collaborate in education, training and promotion, and will disseminate information to potential consumers. Invite Western ICT experts to join the Association in order to promote interest in the Albanian ICT market.
5. Understand Competitive Position	Assess Albania's competitive position in the ICT sector to identify possible opportunities for niche markets, and what Albania will need to carve out a niche for itself.	The Government should secure and allocate funds to assess the competitive position of the Albanian ICT industry jointly with the private sector.
6. Avoid Over-Reliance on Basic Factors	Building a strategy based on advanced factors will open more doors for the success of Albanian ICT sector, rather than relying only on basic factors such as low cost human resources	Establish a dynamic product development and marketing strategy based on a mix of basic and advanced factors; and implement pilot projects.
7. Avoid Government Paternalism	In avoiding government defensiveness and paternalistic approaches, the ICT sector will be open to new opportunities as it tries to increase the quality of its products and offerings.	The Government of Albania does not have any protection of the Albanian ICT sector. However, it should assume a more responsible role to regulate it.

6.4 Apparel and Textiles

A. Industry Definition and Background

Apparel and textiles for exports is defined as production of ready-wear apparel and textiles materials for export purposes and includes products such as women's/girls' blouses and shirts; men's/boys' trousers, shorts, overalls, T-shirts, and other vests; women's/girls' panties; and briefs.

The textiles, apparel, and shoe industries have traditionally been the main exporters of Albania, accounting for 60% of the country's exports. They have benefited from modern management and production techniques implemented by foreign investors in the late 1990s. Because the Textile Agreements provide Albania with generous quotas, the country had been exporting successfully to EU markets. However, following the turmoil of 1997, many foreign companies that had contracts with Albanian firms decided to pull out.

As mentioned above, apparel, textiles, and footwear accounted for a large share of the total manufactured goods exports of Albania. Most of the work done in apparel by Albanian factories is under subcontracting agreements to foreign firms. Clothes or shoes come in half prepared, and the labor-intensive parts of the production process take place in Albania. The finished product is then repatriated to the countries of origin, mainly the EU.

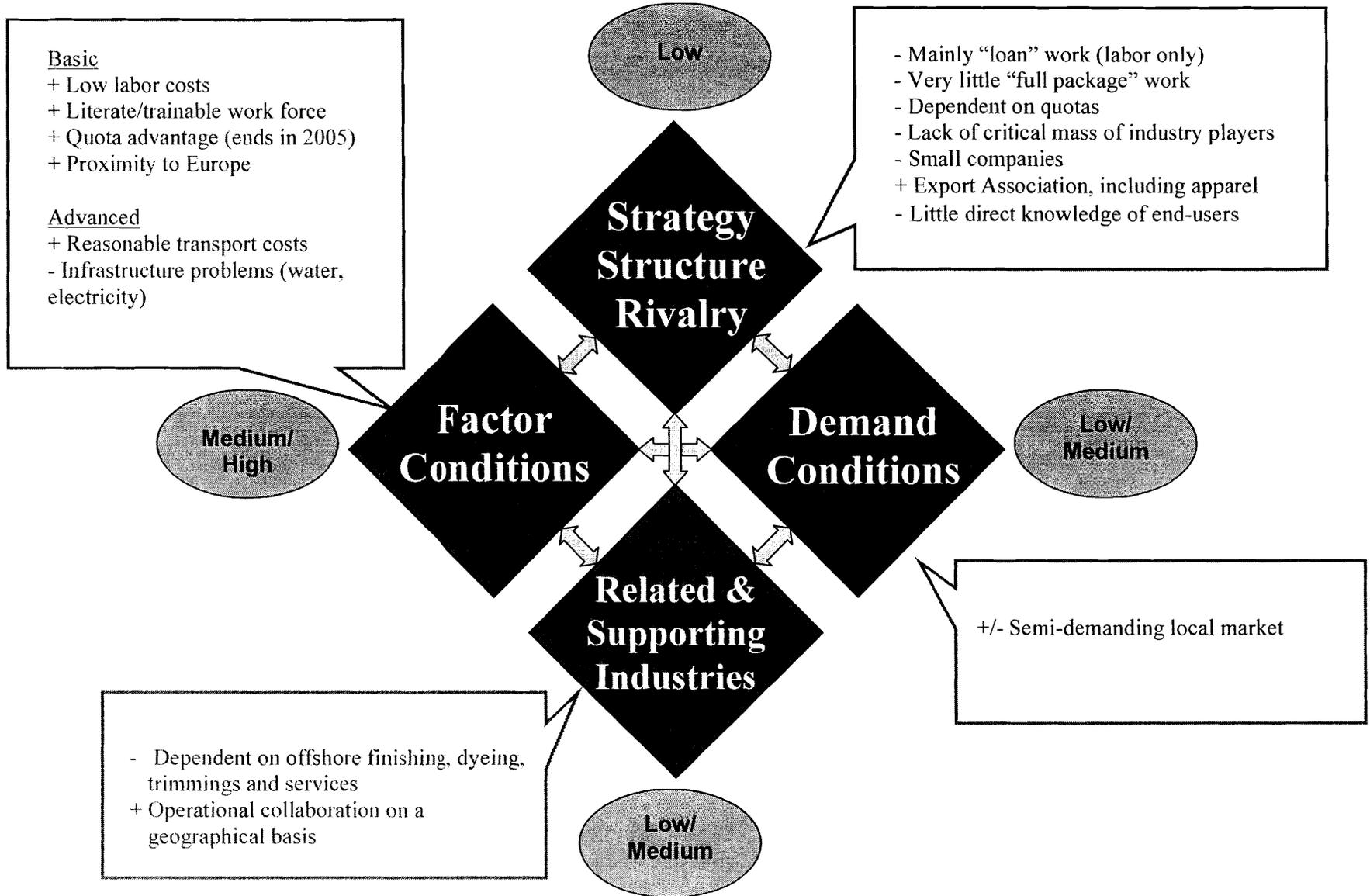
B. Diamond Analysis

Factor conditions. The comparative advantage of Albania, based on low-cost labor, has been degrading; labor costs have not been as low as they used to be in comparison to other countries of the region. The most obvious assets Albania offers the apparel and textiles business are its proximity to the EU market and the availability of low-cost but relatively well-skilled workers.

Labor at low cost for apparel and textiles businesses is available in large numbers in Albania. Unemployment and underemployment are high and are estimated to be roughly 40% of the labor force. Albania has a location advantage over many of its Balkan neighbors in that it has direct access to the Mediterranean Sea and is very close to the Italian and Greek markets. The proximity to their home markets and the low-cost and productive labor force tempted businesses from those countries to locate in Albania despite the high political risk and poor infrastructure.

Poor infrastructure is another characteristic of Albania that hurts the apparel and textiles sector. The lack of reliable and high-quality power, unpredictable availability of water, and difficulties in transportation result in higher production costs.

ALBANIAN APPAREL AND TEXTILES INDUSTRY DIAMOND



Most of the factories built before the transition are sprawling facilities built on large parcels of land. The physical plants are in most cases rundown. Additionally, the factories and the grounds are filthy. Existing equipment is of Russian or Chinese origin and, although it is often well maintained and still operational, its output generally does not meet EU standards and is therefore not exportable.

Most Albanian managers do not know modern management techniques for competitive businesses. They lack the marketing skills to make Albania part of the global market economy. Albanian entrepreneurs must realize that to be competitive, they need to invest in modern technology. Additionally, there is a very strong need to encourage further development of business associations and chambers of commerce and industry.

Demand Conditions. The only firms that are currently in production are those with new foreign equipment installed and manufacturing for export. Factories producing for the local market have little or no output. Their personnel have been reduced to a core staff, and their managers are hoping for a foreign investor to show some interest in their firm. However, firms that are fully or partly owned by foreigners export 100% of their production.

Three factors threaten the continuance of the firms that are targeting the local market: weak local demand, cheap imports, and rising production costs as certain domestic suppliers start to close down. One example is the case of carpet producers who must now import their wool yarn at nearly twice the price of locally produced wool yarn.

Since 1989, there has been an increase in competition from imports to Albania. The textiles manufacturers are among those most affected by the imported goods; manufacturers of other products such as shoes, underwear, wood furniture, and electrodes were not affected as much because their prices are usually lower than those of imports. With the elevated price sensitivity of Albanian consumers, the demand for the cheapest and most durable products increased. The producers of shoes and underwear identified their target market as rural households. No import can match the durability of their products at their low prices.

Strategy, Structure, and Rivalry. The apparel and textiles sector lacks long-term strategy, a problem shared by other industrial sectors in Albania. There is a very strong need to develop a sector strategy to identify the opportunities that will generate export-oriented production. The industrial system used in the past consisted of a few large enterprises and some small-scale, but still state-controlled, enterprises. Now, the vast majority of new private enterprises in Albania are micro-enterprises. The number of enterprises that can be classified as small and medium are very limited. Thus, the competition among Albanian firms is not fierce.

Related and Supporting Industries. Currently, the related and supporting industries for the apparel and textiles sector are not providing an advantageous situation for the industry. Raw materials and accessories are not of high quality, and transportation problems prevent timely delivery of apparel products for exports. The packaging sector is not well developed, and the quality standards do not meet the expectations of the export markets. To be competitive, the apparel and textiles sector will have to overcome the absence of the following supporting businesses:

- Export management companies specialized in markets or products to provide quick and easy access to international markets
- Export trade companies to stimulate exports of apparel
- Skilled and experienced export agents to stimulate product sales
- Product distribution channels
- International transportation companies that can provide assistance in cost and price calculation and in affixing labels to products according to international standards, for example

C. Role of Government

In its economic development program, the Albanian government intends to include an extended strategy with concrete projects to promote export-oriented production and to attract FDI to manufacturing. Therefore, the government has to develop a legal and regulatory environment that allows export-oriented production to flourish, provides policy leadership, provides guidance on strategy and sustained commitment to mobilizing necessary resources to achieve strategic goals, and promotes competitiveness of Albanian industry.

Moreover, the government has to improve the quality, quantity, and dissemination of information; continue privatization; and strengthen links between governmental and non-governmental institutions involved in export activities. Government has to work closely with the banking sector to create credit facilities for export-oriented businesses as well as to create financial mechanisms for Albanian export guarantees.

The network of the Chambers of Commerce and Industry (CCI) is broad, with 35 Chambers of Commerce and Industry across the country. However, they lack the quality and quantity of services necessary to meet the needs of their members. They provide information on markets, technology and products, trade fairs, and exhibitions.

The Union of CCIs also has cooperation agreements with other chambers in Europe. That arrangement results in the exchange of trade directories and other practical information as well as in regional cooperation (e.g., with the Balkan Chambers) related to markets, investments, and joint ventures.

Finally, encouraging the establishment of companies to provide business services such as marketing, accounting, and strategy consulting is necessary. In addition, standardization and quality control institutions have to be put in place.

D. SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ➤ Low labor cost ➤ Use of domestic resources ➤ Good reputation as business partner in special sectors such as clothing ➤ Tradition and artisan spirit ➤ Relatively well educated people with technical skills 	<ul style="list-style-type: none"> ➤ Lack of Albanian export promotion strategy ➤ Lack of Export Promotion Agency ➤ Unsuitable and partially old technology ➤ Second-hand equipments ➤ Insufficient management skills ➤ Insufficient marketing skills ➤ Lack of quality control ➤ Lack of information structures and services (information about modern technologies, procedures to do a business, custom procedures, foreign market opportunities, and licensing regulations) ➤ Inadequate legal framework ➤ Inadequate financial facilities for industry development ➤ Inadequate physical infrastructure ➤ Lack of public order, political instability ➤ Incapacity to compete with imported products ➤ Low labor and capital productivity ➤ Lack of export services companies
Opportunities	Threats
<ul style="list-style-type: none"> ➤ Opportunities to expand production and fill the quotas to EU with no duties ➤ New business opportunities may arise and new markets may open if better technology were to be utilized ➤ Direct export of labor intensive goods, offers good potential for growth ➤ Generous quotas for apparel exports in EU markets ➤ Proximity to the EU market offering opportunities for transfer of technology, joint ventures, FDI and exports 	<ul style="list-style-type: none"> ➤ Unfair competition regarding both quality and prices ➤ Slow development of infrastructure ➤ Slow development of related and supporting sectors offering raw materials for this industry

E. Looking Ahead

The Albanian apparel and textiles sector needs to assess its current competitiveness and focus its efforts on identifying areas that can help improve the overall efficiency of the sector. In that regard, the apparel and textiles businesses need to identify niche markets in which they can compete in quality as well as in price.

The apparel and textiles sector will definitely benefit from the establishment of an Export Promotion Agency, which could:

- a. Increase facilitation with different ministries, customs, banks, transport, and logistics companies
- b. Assist in developing new markets via connections with Albanian economic and commercial attachés abroad, foreign export promotion agencies, foreign donors, fairs and exhibition organizers, and consulting firms

The Albanian apparel and textiles sector should also notice the benefits of acting as a cluster and help increase the development of the competitive skills of packaging companies and accessories manufacturers while supporting standardization and quality control institutions and encouraging close cooperation with scientific research institutes and universities.

F. Fairbanks 7-Opportunities

Opportunity Category	Potential Opportunity	Suggested Action
1. Improve Customer Learning	If Albanian apparel and textiles manufacturers increase their knowledge of their customers by electronic networking, which can be used for such purposes as information dissemination, discussion, and collaboration, then they can better serve their clients.	Apparel and textiles manufacturers should increase their knowledge of the potential and existing customer base, as well as explore alternatives to improve their communication with the clients. They could also focus on equipment and training needs to serve their clients better.
2. Explore Forward Integration	There are potential opportunities for those apparel and textiles firms who are willing to forward integrate their businesses by delivering the total package to the clients rather than working on a contract basis and assembling parts of an item or a line.	Identify the niches and areas that will enable businesses to be far more profitable.
3. Innovate	Albanian apparel assemblers need to move away from "contract only" business toward creating their own brand names.	Invest more in research and development of new products and focus on creating and developing brands.

4. Cooperate with Cluster	When Albanian apparel, textiles, accessories, and packaging manufacturers act together to market their businesses, they achieve better opportunities as a result of economies of scale.	Optimize economies of scale through collaboration with one another. Increase level of coordination with institutions such as Chambers of Commerce and Industry in organization of trade fairs, exhibitions, and trade missions.
5. Understand Competitive Position	By understanding their competitive positions, Albanian apparel and textiles companies will be in a better position to evaluate what they are lacking in terms of production, marketing, and distribution.	Study how competitive the business is and identify how and where to focus it to increase value.
6. Avoid Over-Reliance on Basic Factors	Do not rely solely on basic advantages such as cheap labor and production costs. Integrate advanced factors such as dependable infrastructure or transportation.	Government should focus on setting the following priorities to create a conducive environment for business: <ul style="list-style-type: none"> • Improve Infrastructure • Attract FDI • Develop SMEs • Accelerate Privatization • Implement fiscal reform • Focus on anti-corruption measures • Introduce Competition law and policies • Introduce Accounting regimes/practices.
7. Avoid Government Paternalism	By staying away from paternalistic relations with government and defensiveness and building partnerships with the government, businesses succeed in improving their competitive positions and creating more opportunities.	During its transition to a market economy, the Albanian government should stay away from paternalistic approaches.

CHAPTER 7 – COMPETITIVENESS CONSTRAINTS IN ALBANIA

Over the last ten years, Albania has made considerable progress in its transition to a market economy. Albania has been extremely successful in fighting inflation. It has also been able to recover from the 1997 crisis and achieve a relatively good macroeconomic performance in 2000. However, there are certain weaknesses in its political and economic environment that can hamper its ability to achieve higher levels of competitiveness and improve its overall economic development. Major constraints, based on JAA's review of the Albanian economy and industry clusters, are summarized below in two subsections: (1) general competitiveness constraints and (2) industry-specific constraints. It is worth noting that many of those constraints are similar to those confronted by other transitional economies in Southeastern Europe.

7.1 General Competitiveness Constraints

Although the government has indicated its commitment to furthering economic reform and was successful in improving the country's overall economic performance in 2000, sustained political stability in Albania is uncertain. Challenges in reconciling different goals between the member parties in the coalitions, frequent cabinet shuffles, and a weak governance mechanism all contribute to increasing uncertainty in Albania's investment environment. In addition, such challenges negatively affect public confidence in the government's credibility.

Although Albania has emerged from the 1997 crisis, as indicated by its improved economic performance in 2000, a slide back into weak and unsustainable economic growth would undoubtedly be detrimental to investment. Poor economic growth can generate neither sufficient domestic demand nor enough national savings to stimulate investment in various industries and thus constrains development.

Reform has been carried out in the banking sector, but the system is still weak and has a low level of intermediation, a high cost of capital, a severe lack of financial discipline, and poor allocation of credit.⁵⁴ That situation clearly hampers the private sector's ability to access credit and seriously restricts investment in the economy.

Though significant improvements have been made to the legislation and institutional framework, a deficient policy framework discourages both domestic and foreign investors. For example, registration procedures for business start-ups remain time-consuming. Albania needs to simplify administrative processes to make them easier for investors.

A weak governance system deters investment. A poor governance structure gives way to arbitrary interpretation and ineffective implementation of laws and regulations, as well as to widespread corruption at different levels, which is seen as a serious obstacle to

⁵⁴ IMF Staff Country Report No. 00/74, June 2000.

investment in Albania. Corruption, non-transparent procedures, and high levels of crime deter private investment as well.⁵⁵

The quality of law enforcement is also seen as an area of serious concern. Investors complain about inadequate enforcement as well as arbitrary interpretation of laws, particularly with the customs and tax authorities. In addition, the judicial system is known for incompetence, corruption, and political bias in its decision making.

Strong private investment in the Albanian economy has been lacking. Although Albania has achieved considerable progress in its privatization progress, its domestic private sector remains weak. Various factors contributing to this underdevelopment include weak governance structures in privatized companies, inadequate credit access, lack of information about domestic and foreign markets, a deficient legal framework, and widespread corruption.

Foreign direct investment has not only been limited but has decreased in Albania in past years, mainly due to uncertainty in the country's political environment, problems with policy framework and implementation, and widespread corruption. FDI is seen as an important source of capital to help reconstruct Albania's economy, as well as a source of up-to-date management expertise, market access, and critical knowledge transfer – all crucial to a country's economic transition. However, those potential benefits from FDI have not yet been fully captured in Albania. The country, therefore, needs to make greater efforts to improve its policy and institutional environment to become more attractive to both domestic and foreign investors.

Another constraint on Albania's economic development is its poor physical infrastructure. Albania's highway and rail networks have deteriorated substantially. In fact, they are far below the standards of other European countries. Also, Albania's telephone network is one of the least developed in Southeastern Europe. Frequent power cuts in recent years have added further constraints to the operation of businesses in the country.

Delayed engagement in higher-technology and higher-value-added economic activities can cause an erosion of Albania's competitiveness. In the last few years, Albania has become over-reliant on low-price and labor-intensive competition. The comparative advantage of such a strategy has been declining over time, largely due to competition from other low-cost countries. In 1998, Albania's high-tech export was only 1% of total manufactured exports, making it among the lowest in both SEE and the world.⁵⁶

A lack of focus on international markets, combined with a small domestic market, undermines Albania's competitiveness. Albania is not endowed with the inherent advantages of a huge domestic market and a large population. For that reason, Albania needs to focus more on the demand from outside markets to generate more domestic products and increase exports out of the country.

⁵⁵ According to the Transparency International, which publishes "Corruption Perception Index," Albania ranked 84th of 99 countries in 1999.

⁵⁶ The World Development Indicators, The World Bank, 2000.

Albania has a cheap labor force but lacks a market mentality, a management system, and access to the information about both domestic and foreign markets that is necessary to compete successfully in a new global market context. Also absent are strong marketing and management skills, as well as entrepreneurial spirit. Such qualities are essential not only for new business development but also for renewal in existing companies in any sector, from tourism to apparel and textiles to ICT, as illustrated in the following subsection.

In general, the government's policy-making approach lacks private-sector consultation, although the government has made certain efforts to involve the private sector in the policy formulation process. Also missing is a mechanism by which the private sector can collectively present its own feedback on government policies, as well as one to ensure proper and timely follow-ups to policy recommendations.

7.2 Industry-Specific Constraints

The following paragraphs offer a brief analysis of the constraints that Albania faces in the development of three illustrative industry clusters – Tourism, ICT, and Apparel and Textiles for exports – which JAA reviewed in its Competitiveness Exercise in Albania. Those industry-specific constraints reflect the general issues discussed in subsection 7.1 of this report and are similar in many ways to those constraints facing industries in other transitional economies in Southeastern Europe.

Tourism: Albania's rich natural resources offer many opportunities for a strong tourism development. To date, the sector has been following a low-end, low-price, competitive strategy. Consequently, the sector suffers from a lack of quality offerings and is in need of a strategy that could increase its competitiveness relative to other countries in the region. Major constraints on the tourism industry in Albania include the following:

- Perceived image of Albania as an unsafe destination;
- Erosion of competitiveness in the low-cost competition strategy due to price competition from other countries in the region;
- Delayed engagement in high-end and more sophisticated tourism products;
- Limited knowledge of outside markets and high-end product segments;
- Degrading and inadequate infrastructure facilities, including roads, hotels, telecommunications, airports, and utilities;
- Bureaucratic procedures and frequently changing requirements from the national tourism administration;
- Lack of quality market-oriented customer service;
- Lack of management and marketing skills to increase efficiency, attract more clients, and generate high-end demands for the sector;
- Non-transparent investment environment for the private sector;
- Lack of strong private-sector investment in the sector; and
- Inadequate legal and regulatory framework to support the sector.

Information and Communications Technology (ICT): Albania's ICT sector is underdeveloped. Major impediments include the following:

- Inadequate legal and regulatory framework to support the sector;

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- Insufficient demand stimulation from domestic industries and individuals because of difficult economic conditions and relatively low living standards;
 - Limited participation of foreign investors capable of introducing new managerial know-how and technology to the industry;
 - Lack of entrepreneurship, marketing, and management skills that could bring more international exposure and experience to domestic firms;
 - Ineffective protection and enforcement of intellectual property rights;
 - Insufficient investment in R&D for new technologies and software;
 - Lack of private-sector consultation in policy formulation to support the industry as well as in R&D activities; and
 - Need for more proactive policy support from the government to stimulate the growth in the industry and make the country internationally competitive.

Apparel and Textiles for exports: Albania has thus far relied on the exploitation of a low-cost and labor-intensive strategy to compete with other countries. Over the past decade, the industry has experienced an erosion of its competitiveness. Some of the following factors have contributed to the decline:

- Declining labor-cost advantage, due to increases in domestic costs and competition from other low-cost countries;
- Strong competition from illegal imports of finished products;
- Weak domestic demand;
- Delays in developing and securing strong access to foreign markets;
- Inadequate information about both domestic and external markets;
- Inadequate access to financing for domestic private firms;
- Lack of foreign investment in the sector, and the accompanying management know-how, technology transfer, and access to foreign markets;
- Lack of transportation-cost advantages, due to Albania's poor infrastructure condition;
- Increasing transaction costs due to administrative bureaucracy;
- Inadequate capitalization and restructuring efforts to infuse new technology into the industry and to establish industrial linkages to help Albania engage in high-value-added activities;
- Lack of strong entrepreneurial companies to pioneer and lead the technological change and to upgrade processes in the industry;
- Lack of market-oriented management and marketing skills that can improve efficiency in the industry, make Albanian brand names better known in the world markets, and proactively find new markets for Albanian products; and
- Lack of an overall industrial strategy and of the coordination and cooperation within the industry necessary to acquire new technology, share market information, and access new markets.

CHAPTER 8: PRIVATE-PUBLIC DIALOGUE IN ALBANIA

The concept of *private-public dialogue* in Albania is in its very early stages of development. As a result, institutional mechanisms for the promotion of such dialogue are either nonexistent or in their initial phases of progression as well.

8.1 Institutional Landscape

The key stakeholder ministries and governmental agencies in Albania that play an important role in the private-public sector dialogue include:

- Ministry of Finance
- Ministry of Economy
- Ministry of Economic Cooperation and Trade
- Ministry of Transport
- Ministry of Agriculture and Food
- Ministry of Foreign Affairs
- Ministry of Public Economy And Privatization
- Ministry of Public Works
- Committee for Tourism Development
- National Telecommunication Regulatory Entity
- National Free Trade Zone Entity
- Albanian Guarantee Agency

On the private-sector side of the dialogue, key organizations include:

- Business Advisory Council
- Albanian Business Union
- Albanian Economic Development Agency (AEDA)
- Union of Chambers of Commerce and Industry
- Union of Industrialists and Investors
- Italian Entrepreneurs Association
- Agro-Business Association
- Albtelecom
- Regional Development Agencies (RDAs)

A third group of players with an important role in the public-private dialogue comprise academia, think tanks, and civil society organizations:

- Faculty of Economics, Tirana University
- Albanian Center for Economic Research
- Institute of Contemporary Studies
- Center for Economic and Social Institute of Legal and Public Policies
- Albanian Initiative Center
- NGOs Forum
- Universities

The last group includes the media, because of their coverage of business and economic development issues:

- Economic Journalist Association
- Media Institute
- Audiovisual Journalist Association
- Albanian Radio Television Station (RTSH)
- TVA (Arberia)⁵⁷
- “Ekonomia dhe Tranzicioni” Quarterly Magazine, a publication of the Albanian Center for Economic Research, which publishes research and studies in the fields of economic development and finance, as well as in other issues relating to transition economies.
- “Monitor” Magazine, which covers business, trade, and economic issues from the investors’ point of view.

Although the Albanian media operate free of government influence, the quality of information varies widely. And though a media code of ethics does exist, it is not widely observed. There are no mechanisms for monitoring and regulating media standards or for enforcing a code of ethics among media players. That framework must be developed to achieve the high standards necessary to produce quality journalism.

Also, because many journalists are allied with political parties and have a tendency to report in line with political allegiance, very little independent investigative journalism exists.

Recently created bodies include the National Commission for Television and Radio, which grants broadcasting licenses, and the Parliamentary Commission on the Media, which deals largely with the preparation of legislation and regulatory procedures.

8.2 Overview of Legislation Change Process in Albania

According to the Constitution of the Republic of Albania, the right to propose new legislation and amendments to existing legislation belongs to the Parliament Members, the Council of Ministers, and the voters. The business associations also have the right to propose changes to legislation. A request from any interested party for an amendment is directed to the public institutions responsible for drafting legislation. Once a proposal for new legislation or a proposal to amend the existing legislation is made, the Parliament holds parliamentary sessions that are open for public hearings.

The practice of having joint meetings and discussions among all interested parties on changes to the legislation during the drafting period is taking place in Albania with increased regularity. However, such practices are not always exercised because of time pressures in drafting and adopting legislation.

If any proposed change has potential financial repercussions or if a request comes from a high level – the Parliament or its representatives, for example – then a prior

⁵⁷ Mass media including TV, daily journals, etc., cover the economic development and business issues.

adjustment to an already-approved budget is required. Normally, parliamentary sessions are held in which parties introducing any changes elaborate on the reasons behind the changes.

8.3 Recent Experiences

The Business Advisory Council was established based on Prime Minister's Order No. 55, dated February 17, 2000, with the main objective of providing continuous dialogue between the government and the business community regarding legislation and its implementation. The council is chaired by the Minister of Economic Cooperation and Trade and functions as an advisory body for that ministry. The main purpose of establishing a solid public-private dialogue was to ensure that any proposed changes toward improving the business environment would be subject to input from all parties involved.

A recent example of public-private dialogue pertains to the approval process of the fiscal package. All tariff and taxation rate changes that were part of the fiscal package were discussed at all stages with the private sector. Institutions such as the Business Advisory Council, the Consultative Committee on Business Issues, and the Ministry of Finance were consulted prior to negotiations with the International Monetary Fund. The Parliamentary Commission on Economic and Financial Issues and the Parliamentary Commission on Stability Pact and Economic Integration were established as a result of the dialogue.

One of the objectives of discussions on the fiscal package was to ensure consideration of the integration of Albania at the regional and international levels while simultaneously respecting all obligations under the IMF and other international donor agreements. The process took more than six months, and the outcome was the approval by the Parliament by the end of 2000 of the fiscal package that was to take effect January 1, 2001.

CHAPTER 9 - RECOMMENDATIONS

Building Albania's competitiveness requires a complex set of mutually reinforcing activities at the level of the firm and the industry cluster, reinforced by policy and institutional action at the national and local government levels. A key barrier to competitiveness is the mindset of people and their resistance to change combined with their inability to comprehend the open-market economy.

Learning from nations that have built prosperity quickly, and aided by the foregoing analysis, one can formulate recommendations that deal with the private sector, the public sector, and the dialogue that connects them. Integral to that process is also an important role for civil society institutions such as business associations, think tanks, and social enterprises.

Recommendations for Private Sector

Firms in the private sector are subject to very different conditions, and no one set of recommendations applies to them all. In general, competitive firms will seek direct exposure to the most demanding customers, clients, and markets – and thereby adapt their products, services, and strategies to respond to the signals those demanding customers are providing. Such adaptation requires openness to change and the desire to innovate with products, services, and processes that respond to those needs.

Albanian firms with exportable products and services now have new opportunities to serve European markets, but those firms will need to invest in learning how to take advantage of those opportunities. Firms that have non-tradable products and services and that serve the Albanian market can explore trends only in neighboring countries that have more experience with privatization, liberalization, and globalization and selectively test the introduction of innovations in Albania. Firms that are not competitive will need to take stock of their human, capital, and organizational resources and then immigrate to other market segments or industries.

Competitiveness also requires the ability to cooperate as a cluster to be able to achieve better results, because no one firm can accomplish everything. Competitiveness depends on the ability to form good alliances and partnerships. At the industry level, business associations can participate in efforts representing the business sector to the government. The Union of Chambers of Commerce, the Albanian Business Advisory Council, the Albanian Economic Development Agency, and industry-specific associations can play an important role in that regard and can support reforms that improve the environment for businesses.

However, it is important to gather as an industry cluster – that is, the entire value chain plus the related and supporting industries. The industry cluster can then benchmark the industry, develop industry strategies, and implement specific action initiatives to boost competitiveness. Those items will vary by industry. For example, the tourism cluster should formulate specific strategies for attracting higher-spending tourists to Albania and for extending tourism beyond the limited summer season. The ICT sector should explore initiatives for implementing e-government, reducing bandwidth constraints, boosting software exports, and retaining talented professionals. The apparel and textiles sector

will need to move beyond its focus on providing assembly labor if it is to survive beyond the expiration of quotas in 2005.

Working with the Government of Albania, business associations can develop international trade and investment linkages to gain access to markets and technology. However, this undertaking requires greater communication and cooperation between the private and public sectors.

Industry clusters can also implement workforce development, human resources, and training initiatives by working with education and training providers so that the latter adapt their programs to industry needs.

Research, development, testing, and certification initiatives can also add value to the industry while adapting to ISO and similar standards.

Recommendations for the Public Sector

With regard to policy and institutional reform, the public sector can be analyzed on an industry cluster basis. For example, in tourism, the privatization agenda needs to be completed, the accommodation capacity needs to be increased, the tourism infrastructure needs to be improved, and the outstanding land-ownership issues need to be resolved. The industry itself is in the best position to design and implement initiatives to migrate from mass tourism to higher-end markets such as conference tourism, adventure tourism, ecotourism, and culture tourism.

In the ICT sector, the government should adopt the European standards for third-generation wireless communication (UMTS), promote e-government, address constraints of bandwidth availability and cost, promote the use of computers in schools, and work with universities and training providers to improve the relevance of education programs to changing needs. The introduction of e-governance systems will contribute to transparency and reduce corruption by making information and services available on the World Wide Web.

In the apparel and textiles sector, companies need to understand their competitive position and move away from business strategies depending on the availability of cheap labor as their core advantage.

Albania needs a coherent investment promotion strategy and an agency with a structure that is informed by best practices while taking into account Albania's specific strengths and weaknesses, particularly the opportunities presented by access to EU markets. Albania can learn from best practices approaches in Europe from countries such as Ireland, Scotland, the Netherlands, Hungary, and the Czech Republic.

Another initiative should focus on helping the media operate more effectively, thereby enabling the poor and excluded to be heard while simultaneously ensuring that the government remains more open, responsive, and accountable. The initiative can address the development of an appropriate regulatory framework and make certain that high professional standards are maintained across the board.

Following the example of Ireland, the Government of Albania, with the help of such leading think tanks as the Albanian Center for Economic Research, should publish an annual Albanian Competitiveness Benchmarking report providing sound data on Albania's competitiveness in areas related to investment, exports, technology, human resources, economic policy, economic performance, and infrastructure. Such a report would help inform government and industry leaders of Albania's strengths and weaknesses relative to other EU accession countries. It would also help inform efforts to set priorities and monitor implementation.

Albanian Competitiveness Council

This report recommends that key private-sector leaders establish the Albanian Competitiveness Council (ACC) to identify initiatives for improving Albanian businesses' competitiveness. The ACC would need to work with the Business Advisory Council in institutionalizing the dialogue between the private and public sectors. Functioning in the same way as the Business Advisory Council, the ACC would establish priorities for reform, communicate them clearly to government, and then monitor implementation. It would also undertake its own initiatives and help coordinate the work of various industry clusters.

The ACC would establish initiatives such as:

- Encouraging the development of a world-class business school in Albania with significant involvement by the private sector
- Conducting an annual survey of SMEs and systematically removing bureaucratic constraints to business formation and entrepreneurial activity
- Supporting the institutionalization of private-public dialogue by identifying the priority concerns
- Cooperating with the government in negotiating access to foreign markets on good terms

In the early months, encouragement from the Government of Albania would be helpful, as would technical and perhaps financial support to jump-start such a Council. The ACC would meet monthly, or more often if necessary, and would commission specific initiatives designed to build Albania's competitiveness. The ACC would then review the initiatives for progress, providing leadership and vision.

The ACC should work through existing business associations and research institutes rather than attempting to duplicate them. It should build on prior research on Albanian competitiveness, policy reform, and specific industry clusters. The goal should be to build a self-reinforcing virtuous cycle of private-public cooperation to implement change.

Building Albania's competitive advantage will require much work. The recommendations above suggest some of the priorities that need to be undertaken. More important, this study recommends a mechanism in the ACC to move toward action while building the trust and private-public partnerships necessary for a strong economy and a civil society.

With only limited scope and resources, accurately addressing all of the constraints or laying out a comprehensive set of well-sequenced recommendations in a study of four countries is impossible. Nevertheless, this report is presented in the hope that it will

serve as a stimulus for discussion and analysis, thereby providing Albania's leaders with the information necessary to arrive at a consensus and to move forward with a preliminary action plan for strengthening Albania's global position.

ANNEX 1

COMPETITIVENESS BENCHMARKS

ANNEX 2

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Current Webography of Competitiveness Resources

1. http://europa.eu.int/comm/enterprise/enterprise_policy/competitiveness/
EU White Paper on competitiveness policy.
2. <http://www.compete.org/>
US Council on Competitiveness: Includes a benchmarking of US competitiveness and descriptions of an ongoing cluster analysis project led by Michael Porter.

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3. <http://www.cid.harvard.edu/andes/>
Harvard's Andean Competitiveness Project: With leadership from Jeffrey Sachs and Michael Porter. See especially the project description and outline.
 4. <http://wbln0018.worldbank.org/psd/compete.nsf/d3fe1ba1940f13908525650d0053554f/c2b07f0ad3cc44d68525650d00536564?OpenDocument>
World Bank Competitiveness Indicators: Data available for nearly all countries.
 5. <http://www.competitiveness.org>
The Competitiveness Institute, a professional group for cluster development advisors, which held its first international conference on cluster development in Barcelona in 1998. Most resources available only to members.
 6. <http://www.competitiveness.com>
Competitiveness.com is an international group with headquarters in Barcelona, specialized in the implementation of business to business vertical portals with a cluster approach.
 7. <http://www.cofi.org/blueprint.html>
Blueprint for competitiveness in forestry products for British Columbia, Canada.
 8. <http://www.dist.gov.au/itt/tskforce/allen/index.html>
Extensive report from 1997 on competitiveness of information industries in Australia.
 9. <http://www.changingnations.com/new/wldbnk.zip>
Changingnations.com (Monitor Group) World Bank training manual on discussing and fostering competitiveness.
 10. <http://www.cipe.org/mdf1997/advantge.htm>
Michael Porter comments on ten of the most important preconditions to improving competitiveness in a country (or geographic area). They are most applicable in cases where a country is conducting a formal project to enhance competitiveness.
 11. <http://www.worldbank.org/wbi/mdf/mdf1/product.htm>
The World Bank Group internet site presenting the selections from the Mediterranean Development Forum: Knowledge and Skills for Development in the Information Age held at Morocco between May 12-17, 1999.

Selected Organizations Undertaking Studies and Assessments of Competitiveness

1. The Organization for Economic Co-operation and Development, 2 rue Andre Pascal, 75775 Paris, CEDEX 16, France.
2. The International Labor Office, 4 route des Morillons, CH-1211, Geneva 22, Switzerland.
3. The World Bank, 1818 H Street, N.W., Washington DC 20433, USA.
4. IMD International, P.O.Box 915, Chemin de Bellervive 23, CH-1001, Lausanne, Switzerland.
5. International Trade Center, 54-56 rue de Montbrillant, 1202 Geneva, Switzerland.
6. The Commonwealth Secretariat, Marlborough House, Pall Mall, London SW1 9SY, England.

