Albania Gap Analysis
Strategic Planning & Analysis Division
E&E Bureau
USAID
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Highlights. Albania's economic and democratic reform progress is Southern Tier CEE average. Albania made substantial gains in first-stage ***economic reforms*** early on in the transition, and since 1995, it has undertaken more modest incremental gains. Second-stage economic reforms in Albania lag considerably behind first stage, although steady, albeit modest, gains in second-stage reforms have been realized since the mid-1990s as well.

In a business survey in 2008, the absence of reliable electricity was rated as problematic by more Albanian businesses (80% of those surveyed) than any other possible constraints considered. This was followed by burdensome tax rates (60%), challenges stemming from Albania's telecommunications infrastructure (55%), and inadequate skills and education of the work force (53%). Three of these issues, all but burdensome tax rates, were perceived to be more problematic in 2008 than they were in 2005.

Democratic reforms in Albania have gone through four apparent stages: (1) rapid and significant democratic reform gains in the early transition years; (2) democratization backsliding from 1992 to 1996; (3) steady advances from 1996 to 2004; and (4) little change or stagnation from 2004 to 2009 (latest year for which data are available). The trends in the seven democracy components tracked by Freedom House generally mirror the trends in the aggregate; in particular, none of the sectors have advanced on balance since 2005-2006. Local governance and civil society are the most advanced democratization areas in Albania; anti-corruption reforms are the least advanced. According to Freedom House, of the Southern Tier CEE countries, only Kosovo has greater corruption than Albania.

Of the nine Southern Tier CEE countries, only the economies of Bulgaria and Romania have outperformed Albania's economy as measured by the MCP ***macro-economic performance*** index. However, progress across the economic performance dimensions in Albania is very uneven.

From 2003 to 2008, Albania's economy expanded by an annual average rate of 6%, well above global standards as well as Eastern Europe standards. Albania's economy weathered the global economic crisis in 2009 relatively well, due in no small part to its relative isolation from the global economy. Macroeconomic imbalances in Albania's economy have been significant in recent years. Although the size of the export sector in Albania remains small by regional standards, its growth has been outpacing GDP growth since at least early 2002. Similarly, foreign direct investment (FDI) as a percent of GDP has been increasing in Albania in recent years, although it too remains low compared to the volume of FDI flows to most other countries in the region. As a percentage of GDP, remittances have exceeded FDI inflows in Albania; however, the differential has been narrowing as FDI has increased and remittances have decreased as a percentage of GDP.

Of the Southern tier CEE countries, only Kosovo lags more on ***human capital*** than does Albania. Albania's human capital profile is very skewed or unbalanced; the population is relatively healthy but also also relatively poor and poorly educated.

As elsewhere in the Balkans, the unemployment rate in Albania is very high, perhaps close to 14% today.

Test results of Albanian students are quite poor, low relative to OECD standards. This was true both in 2006 and 2009 with test results from the Program for International Student Assessment (PISA). Albanian students in 2009 performed at 77% of OECD standards; in 2006, 74%. Secondary and tertiary enrollment rates in Albania also lag behind OECD as well as CEE standards, although the rates in Albania have been increasing overall in recent years. Educational enrollments are notably higher in Tirana than they are in the rest of the country.

Albania's health indicators are quite favorable. Life expectancy in Albania, at 77 years, exceeds the CEE average of 75 years. Life expectancy in Albania has been steadily increasing; in 1990, it was only 72 years.

Overall, Albania's ***peace and security*** score is low by CEE standards. By this measure, of all the CEE countries, only Kosovo is less peaceful and secure than Albania.

Introduction. This analysis draws largely on the dataset and methodology of the Europe & Eurasia Bureau's *Monitoring Country Progress* (MCP) system. The core of the MCP system consists of five indices: (1) economic reforms; (2) democratic reforms; (3) macroeconomic performance; (4) human capital; and (5) peace and security. We draw on readily available public data and standardize the metrics to a 1 to 5 scale in which a 5 represents the most advanced standards worldwide. Supplemental data and analysis are drawn from a handful of Albania-specific documents, primary among them are the World Bank, *Albania, the New Growth Agenda* (November 2010), the European Commission, *Analytical Progress Report: Albania* (November 2010), UNDP, *Human Development Report of Albania* (2010), and the Economist Intelligence Unit, *Albania* (November 2010).

Economic and democratic reforms (*Figure 1*). *Figure 1* highlights economic and democratic reform progress of the three geographic sub-regions that the MCP system has been tracking over the years: the eight Northern Tier Central & Eastern Europe (CEE) countries; the nine Southern Tier CEE countries; and the twelve Eurasian countries. Economic reform data are drawn from the EBRD, *Transition Report* (November 2010); democratic reform data from Freedom House, *Nations in Transit* (June 2010). Both sources provide E&E region-specific data and analysis. Reform changes from the previous year (2009-2010 for economic reforms; 2008-2009 for democratic reforms) are highlighted by arrows. Albania's reform progress is roughly average for the twenty-nine transition country region or, similarly, Southern Tier CEE average on both reform dimensions. No measurable economic reform progress was made in Albania in 2010 by EBRD measures; some backsliding in democratization occurred in Albania in 2009 (latest year available) according to Freedom House scores.

Economic reforms (*Figures 2-6*). We categorized the economic reform indicators from the EBRD into two stages (*Figure 2*). First-stage reforms involve liberalization (of domestic prices and trade and foreign exchange) and privatization (small- and large-scale); i.e., reforms which reduce government intervention in the economy. Second-stage economic reforms entail building government capacity to regulate and oversee the private sector; in some sense, they involve getting government back in the economic sphere, albeit in a market-friendly way. Second-stage reforms include enterprise reform, competition policy, banking reform, infrastructure reform, and non-bank financial reform. More explicit elaboration of all the MCP indicators and our method of using them is provided in the appendix of the annual *Monitoring Country Progress in Eastern Europe and Eurasia* report, available on our website (http://www.usaid.gov/locations/europe_eurasia/wp/).

As shown in *Figure 2*, Albania made substantial gains in first-stage reforms early on in the transition, and since 1995, has undertaken more modest incremental gains. Second-stage reforms in Albania lag considerably behind first-stage, although incremental modest gains in second-stage reforms have been realized since the mid-1990s as well. The gap between first- and second-stage economic reforms is large in Albania by transition region standards. This is evident from a comparison of reform profiles between Albania and Bosnia and Herzegovina in *Figure 2*. It is also highlighted in *Figure 3* which shows progress in each of the nine economic reform indicators. First-stage reforms in Albania are complete or near complete; most second-stage reforms (banking reforms the exception) have far to go.

We supplement the EBRD macroeconomic reform trends with microeconomic reform trends from the World Bank's global *Doing Business*[1] database (*Figures 4* and *5*). The findings are similar: as with the macro reforms, business environment reforms in Albania are roughly Southern Tier CEE average. They are more advanced than in Kosovo and Bosnia and Herzegovina in particular, and to a lesser extent than in Croatia and Serbia; they are considerably less advanced than in Macedonia, Bulgaria, and Romania, and to a lesser extent Montenegro. By these measures, the business environment in Albania is slightly less business friendly than that found in China. Overall, Albania's business environment ranks 82 out of 183 countries; Singapore's ranks first; Chad's last. *Figure 5* shows significant improvements in Albania's business environment in the past five years by global standards.

Figure 6 draws from a business survey periodically done by the World Bank and the EBRD, the Business Environment and Enterprise Performance survey or BEEPS. From a menu of fourteen possible business constraints, enterprises are surveyed on the extent to which such issues are problematic towards doing business. In Albania in 2008, the absence of reliable electricity was rated as problematic by more businesses (80% of those surveyed) than any other possible constraint. This was followed by burdensome tax rates (60% of businesses felt as such); challenges stemming from telecommunications (55%), and fourth, inadequate skills and education of the work force (with 53% of Albanian businesses surveyed finding such an issue problematic). Three of these problems seem to be getting worse; the challenges stemming from inadequate electricity, telecommunications, and labor skills were problematic for a notably larger proportion of businesses surveyed in 2008 than in 2005.

Democratic reforms (*Figures 7-13*). *Figure 7* highlights democratic reform trends over time in Albania and in the E&E region. Four stages are apparent in the case of Albania: (1) rapid and significant democratic reform gains occurred in the early transition period through 1992; (2) democratization backsliding ensued through 1996; (3) this was followed by steady advances through 2004; and (4) little change or stagnation through 2009 (latest data available).

Figures 8 and *9* disaggregate the democracy trends in Albania by democracy sectors or components from 1999 to 2009. All of the democracy components have advanced on balance since 1999, although, with the exception of the development of civil society, not without occasional temporary backsliding. This has included regression in 2009 in governance and in independent media. According to Freedom House, the regression in public governance was due to opposition party parliamentary boycotts and a weakening of local government autonomy through local tax reductions imposed by the national government. The independent media score worsened in 2009 due to increased intimidation of investigative journalists and an increased politicization of the media regulatory bodies. The trends in the democracy components generally mirror the trends in the aggregate; in particular, none of the sectors have advanced on balance since 2005-2006.

[1] The analysis is based on 10 aspects: starting a business; dealing with construction; hiring and firing workers; registering a property; getting credit; protecting investors; paying taxes ; trading across borders; enforcing contracts; and closing a business.

The *Media Sustainability Index* (*MSI*), commissioned by USAID and managed by IREX, provides another measure of trends in media in Albania and elsewhere in the transition region (*Figure 10*). According to the *MSI*, the development of media in Albania has made modest gains in the past decade, since 2001. This contrasts with Freedom House's analysis and measure which has no advancement in independent media in Albania in this time period.

Figure 11 disaggregates the democracy components in 2009 as measured by Freedom House. Local governance and civil society are the most advanced areas; anti-corruption reforms are the least advanced. According to Freedom House, of the Southern Tier CEE countries, only Kosovo has greater corruption than does Albania (*Figure 12*). Transparency International finds a very similar result in its efforts to measure the perceptions of corruption (*Figure 13*).

Economic and democratic reforms projected (*Figure 14*). We averaged the progress of economic and democratic reforms over the past five years in Albania and projected the rate of progress forward to see how soon Albania might approach the proposed economic and democratic reform threshold (of reform progress on average of Bulgaria, Romania, and Croatia in 2006). Recognizing the limitations of taking projections out too far, we find that Albania will not cross this threshold until the year 2023 if it continues at the average rate of progress from the past five years.

Economic performance and human capital (*Figures 15-16*). *Figure 15* shows the bird's eye view of progress across the transition region in macroeconomic performance and human capital. *Figure 16* shows the components of the two indices. The economic performance index includes key structural economic indicators as well as macroeconomic stability and growth. The human capital index includes indicators of health, education, and income.

By these aggregate measures, Albania's economic performance exceeds Southern Tier CEE performance; of the nine Southern Tier CEE countries, only the economies of Bulgaria and Romania outperform Albania's economy as measured by the MCP economic performance index (*Figure 15*). However, progress across the economic performance dimensions in Albania is very uneven (*Figure 16*). This may call into question the ability of Albania's economy to sustain the gains and to continue to move forward unless key gaps are sufficiently addressed and, in particular, challenges in the labor market and in export competitiveness.

Human capital in Albania lags behind the Southern Tier CEE average (*Figure 15*). Of the Southern tier CEE countries, only Kosovo lags more on human capital than does Albania. As with economic performance, Albania's human capital profile is very skewed or unbalanced; the population is relatively healthy but also relatively poor and poorly educated (*Figure 16*).

Economic performance (*Figures 17-29*). Economic growth in Albania has been high by many standards for most of the transition years (*Figures 17-21*). From 2003 to 2008, Albania's economy expanded by an annual average rate of 6%, well above global standards as well as Eastern Europe standards (*Figure 17*). Albania's economy weathered the global economic crisis in 2009 relatively well, due in no small part to its relative isolation from the global economy. Of the CEE countries, only the economies of Kosovo and Albania experienced economic growth in 2009 of any magnitude, albeit modest (*Figure 18*). Modest economic growth for Albania's

economy is forecast for 2010 as well (*Figure 19*). Recognizing a number of caveats in making this comparison, the current size of Albania's economy is roughly 70% larger than what it was in 1989 (*Figure 21*). This is higher than even Northern Tier CEE average performance.

Macroeconomic imbalances in Albania's economy have been significant in recent years and could certainly adversely affect economic growth (if they have not already) if not adequately addressed in the near term. The fiscal deficit has ranged in recent years from 3.5% of GDP in 2007 to 7.4% of GDP in 2009. The current account deficit has been close to 10% of GDP or higher since 2007 (*Figure 22*). How the deficits are financed has economic implications. In this regard, it is encouraging to see the growth of the export sector outpace GDP growth (*Figure 22*), although the size of the export sector in Albania remains small by regional standards (*Figure 23*). Similarly, foreign direct investment (FDI) as a percent of GDP has been increasing in Albania in recent years, although it too remains low compared to the volume of FDI flows to most other countries in the region. We estimated (in *MCP in E&E* #12 May 2010) that net FDI flows over the past five years on a per capita basis were lower in Albania than anywhere else in CEE, except (anomalously) in Slovenia.

Remittances have also been a significant inflow for Albania (*Figures 22, 24-25*). As a percentage of GDP, remittances have exceeded FDI inflows in Albania, though the differential has narrowed in recent years as FDI has increased and remittances have decreased (*Figure 22*). As is true in other Southern Tier CEE countries (particularly Kosovo, Bosnia-Herzegovina, and Serbia), remittances relative to GDP are among the highest worldwide in Albania, perhaps among the top twenty remittance receiving countries worldwide (*Figures 24-25*).

Agriculture has played an important role in the Albanian economy, although much less so today than in years past (*Figures 26* and *27*). Productivity in the sector remains dismally low in Albania and has not increased in recent years (*Figure 26*). In contrast, agricultural value added per worker is much higher in Slovenia and to a lesser extent in Croatia and Bosnia and Herzegovina. Moreover, it has more than doubled in these three countries from 2000-2008. In 2009, almost 20% of the Albanian economy was attributed to agriculture. Yet, a much higher proportion of the workforce, 44%, was employed in the sector. Still, there has been a very significant reduction in the proportion workers employed in Albania since 2000 when it was 72% of the workforce contributing 26% of GDP (*Figure 27*).

We noted above (and as shown in *Figure 6*) the business survey which found that a large and growing number of Albanian businesses (about 55% of businesses surveyed in 2008) felt the challenges of the telecommunication infrastructure were problematic. *Figures 28* and *29* add some context and further information. Since 2005 there have been some gains in communication technology in Albania, although overall the sector continues to lag considerably. While land lines and mobile telephone subscribers have almost doubled in growth from 2005 to 2008, personal computers and fixed broadband internet remain out of reach for the large majority of Albanians. Moreover, internet usage remains among the lowest in the Southern Tier CEE countries at 24% in 2008, comparable to that found in Moldova (*Figure 29*).

Human capital (*Figures 30-36*). As elsewhere in the Balkans, the unemployment rate in Albania is very high, perhaps close to 14% today (*Figure 30*). Prior to the global economic

crisis in 2009, Albania's unemployment rate had been gradually declining. Unemployment rates are higher still most elsewhere in the Balkans and, in particular, in all of the former communist Yugoslavia except Slovenia.

To what extent are the high unemployment rates in the Balkans a function of inadequate demand for labor versus a lack of workers with appropriate training and skills? To the extent that the latter contributes to high unemployment rates, to what extent are the education systems part of the problem? *Figure 31* highlights results from three periodic tests provided to students in OECD countries and increasingly in other countries including a number now in E&E. These tests are designed to some extent to measure how students will likely manage to function in a market economy; i.e., functional literacy in reading, math, and science. Test results of Albanian students are quite poor, low relative to OECD standards. This was true in a 2006 test results from the Program for International Student Assessment (PISA) as well as very recent and very similar results from PISA 2009. Albanian student results in 2009 were 77% of OECD standards; in 2006, the results were 74% of OECD.

Secondary and tertiary enrollment rates in Albania also lag behind OECD as well as CEE standards, though the rates in Albania have been increasing overall in recent years (*Figures 32* and *33*). For comparison, tertiary enrollment rates in the Northern Tier CEE countries range from the mid 40% to almost 70%. Albania's tertiary enrollment rate of 39% may be roughly Southern Tier CEE average.

As noted earlier, Albania's health indicators are quite favorable. Life expectancy in Albania, at 77 years, exceeds the CEE average of 75 years. It has been steadily increasing; in 1990, it was only 72 years. Under five and infant mortality rates have decreased significantly in Albania during the transition. Tuberculosis incidence is low at Northern Tier CEE standards, not far from Western Europe standards (*Figures 35* and *36*). TB has been gradually decreasing in Albania over the transition years.

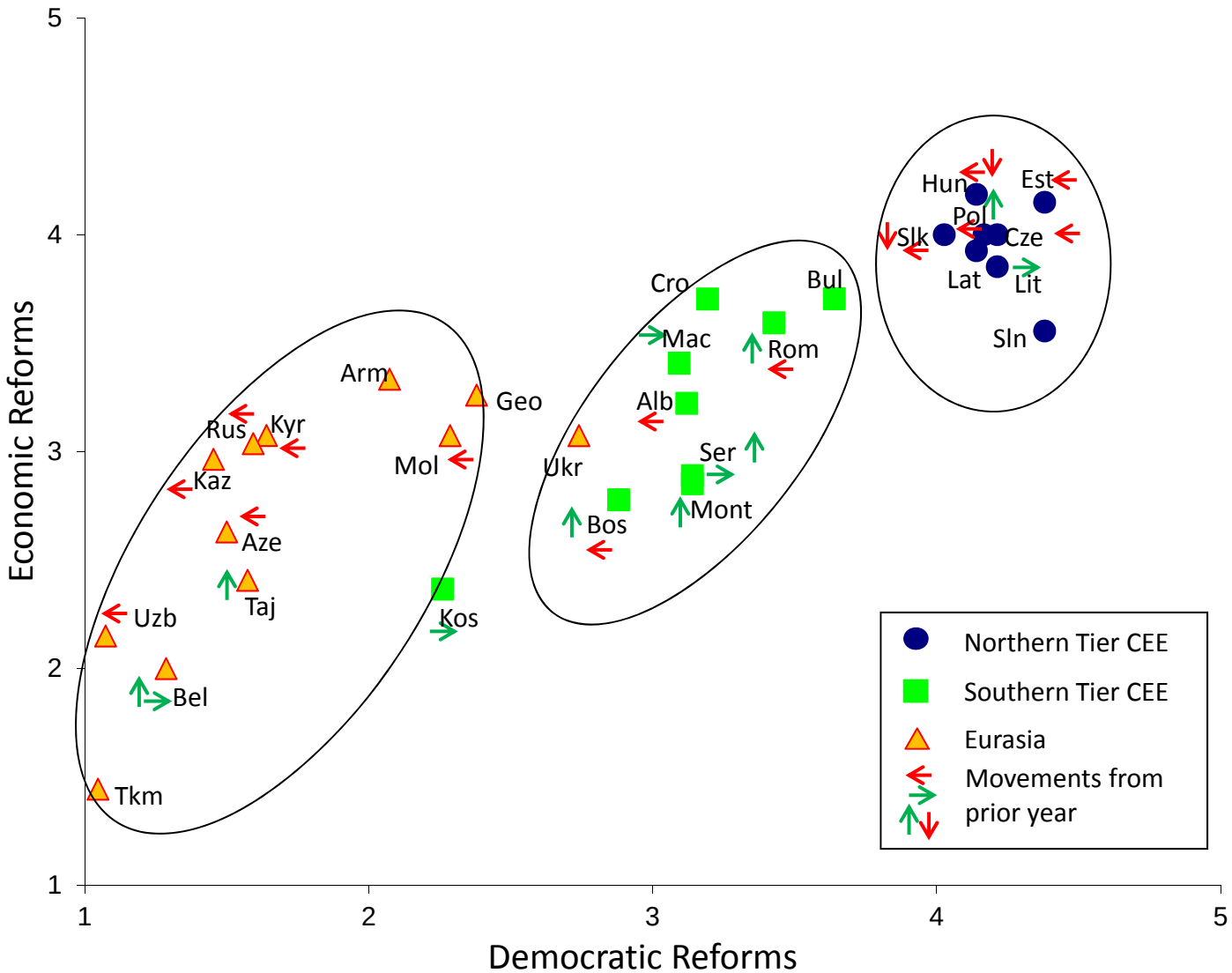
Regional disparities within Albania (*Figure 37*). Country-wide indicators often mask considerable disparities within sub-regions of a country. We examine this observation by drawing from UNDP estimates of three development indicators disaggregated by the four main regions within Albania: Tirana; the coastal region; the central region; and the mountainous region (*Figure 37*). We find that on the most basic indicator of health (namely, life expectancy), there is no differentiation across the regions; i.e., all four areas have the same life expectancy of 77 years. However, this equality is not found in the case of education and income or poverty rates. Specifically, educational enrollments are notably higher in Tirana than they are in the rest of the country. In addition, the poverty rate in the mountainous region is two to three times greater than it is elsewhere in Albania.

Peace and Security (*Figures 38* and *39*). The MCP peace and security index was developed to mirror the six primary elements of the peace and security objective developed several years back by the Director of Foreign Assistance. These elements include combating weapons of mass destruction, combating transnational crime, counter-narcotics, counter-terrorism, stabilization operations and security sector reforms, and conflict mitigation. Overall, Albania's peace and security score is low by CEE standards (*Figure 38*). By this measure, of all the CEE countries,

only Kosovo is less peaceful and secure than is Albania. Albania's low scores are due to a host of challenges stemming from transnational crime, counter-narcotics, counter-terrorism, and most notably from the government's low capacity to combat weapons of mass destruction.

Figure 1

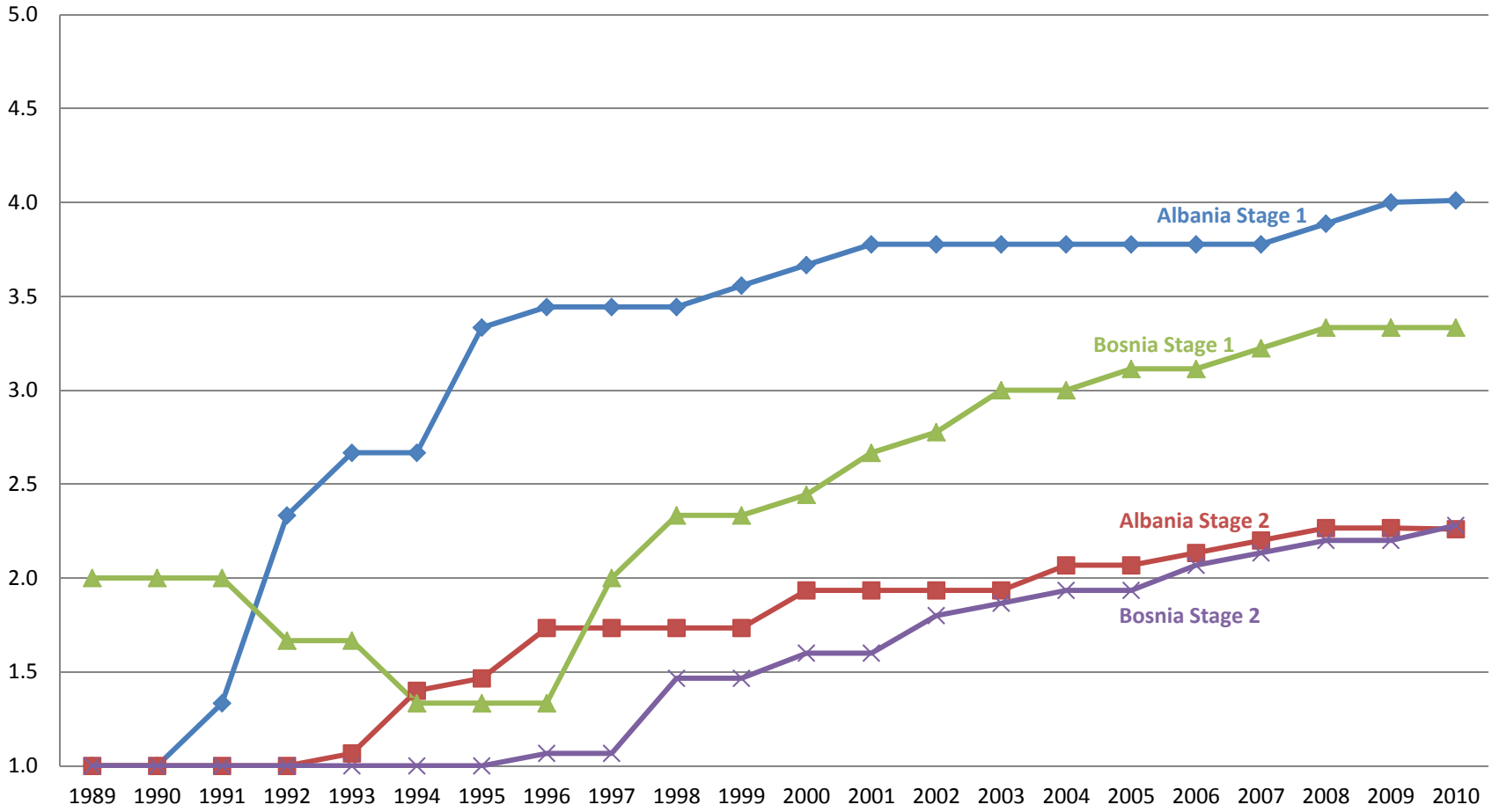
Economic and Democratic Reforms in 2009-2010



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2010* (2010); and EBRD, *Transition Report 2010* (November 2010). Economic reform data are 2010; democratic reform, 2009.

Figure 2

Economic Reform in Albania (& Bosnia)
Stage 1 vs. Stage 2 Reforms

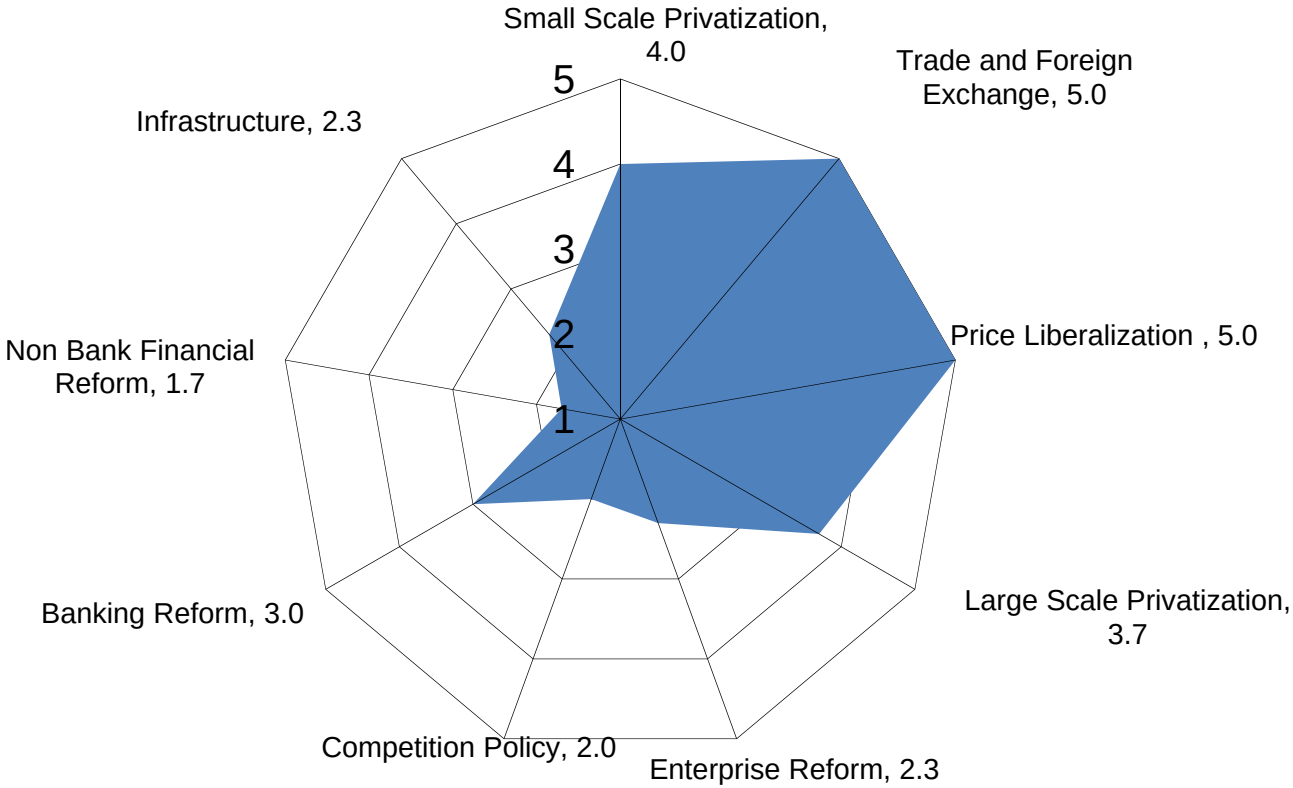


Stage 1: Small Scale Privatization, Trade and Foreign Exchange, Price Liberalization, Large Scale Privatization. Stage 2: Enterprise Reform, Competition Policy, Banking Reform, Non-Bank Financial Reform, Infrastructure.

Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Data are drawn from the EBRD, *Transition Report* 2010

Figure 3

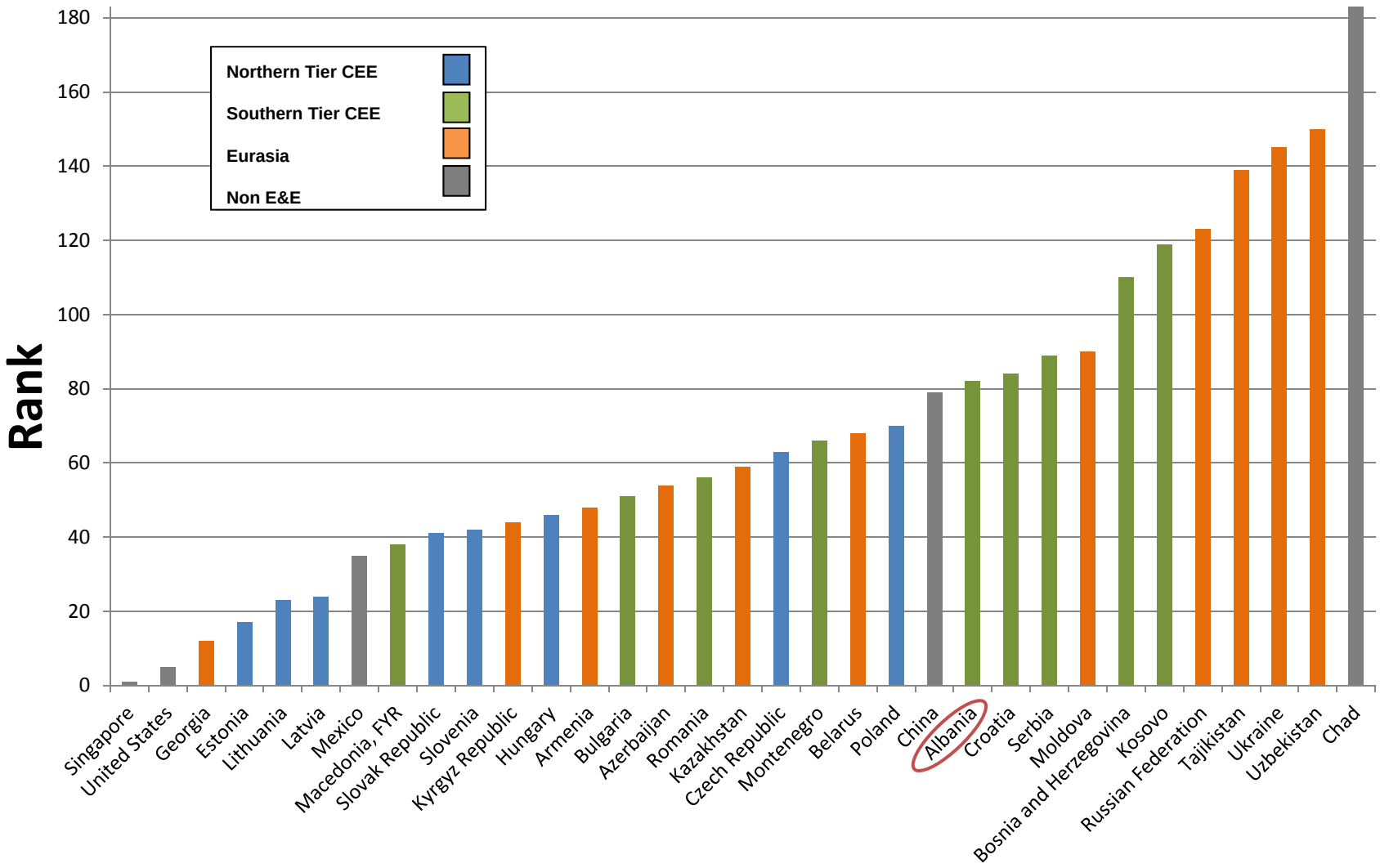
Economic Reforms in Albania 2010



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Data are drawn from the EBRD, *Transition Report* 2010

Figure 4

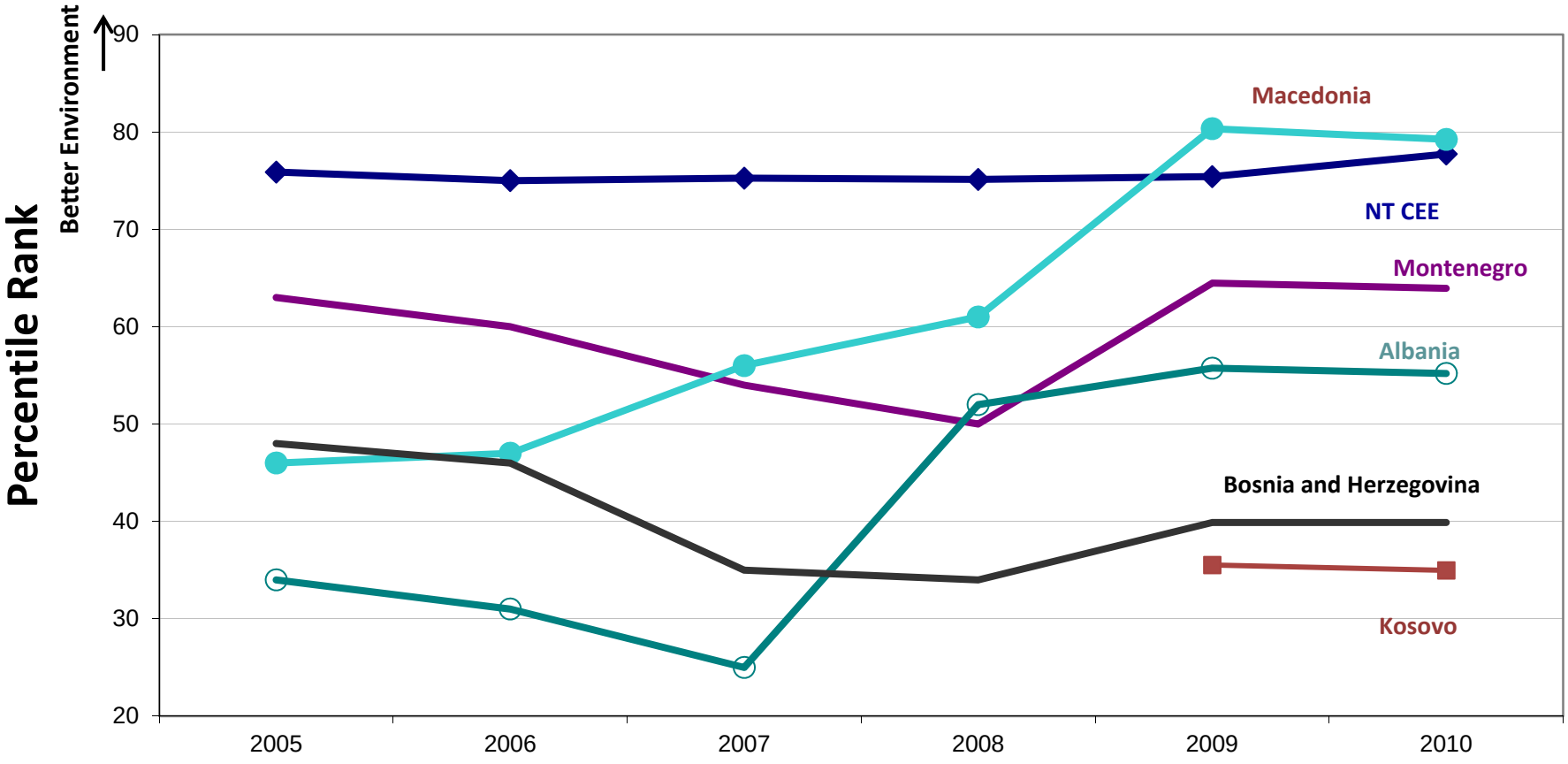
Business Environment in 2010



World Bank Doing Business in 2011 (October 2010), 183 countries are included in the analysis. The business environment is gauged based on 10 aspects: starting a business; dealing with construction; hiring and firing workers; registering a property; getting credit; protecting investors; paying taxes ; trading across borders; enforcing contracts; and closing a business.

Figure 5

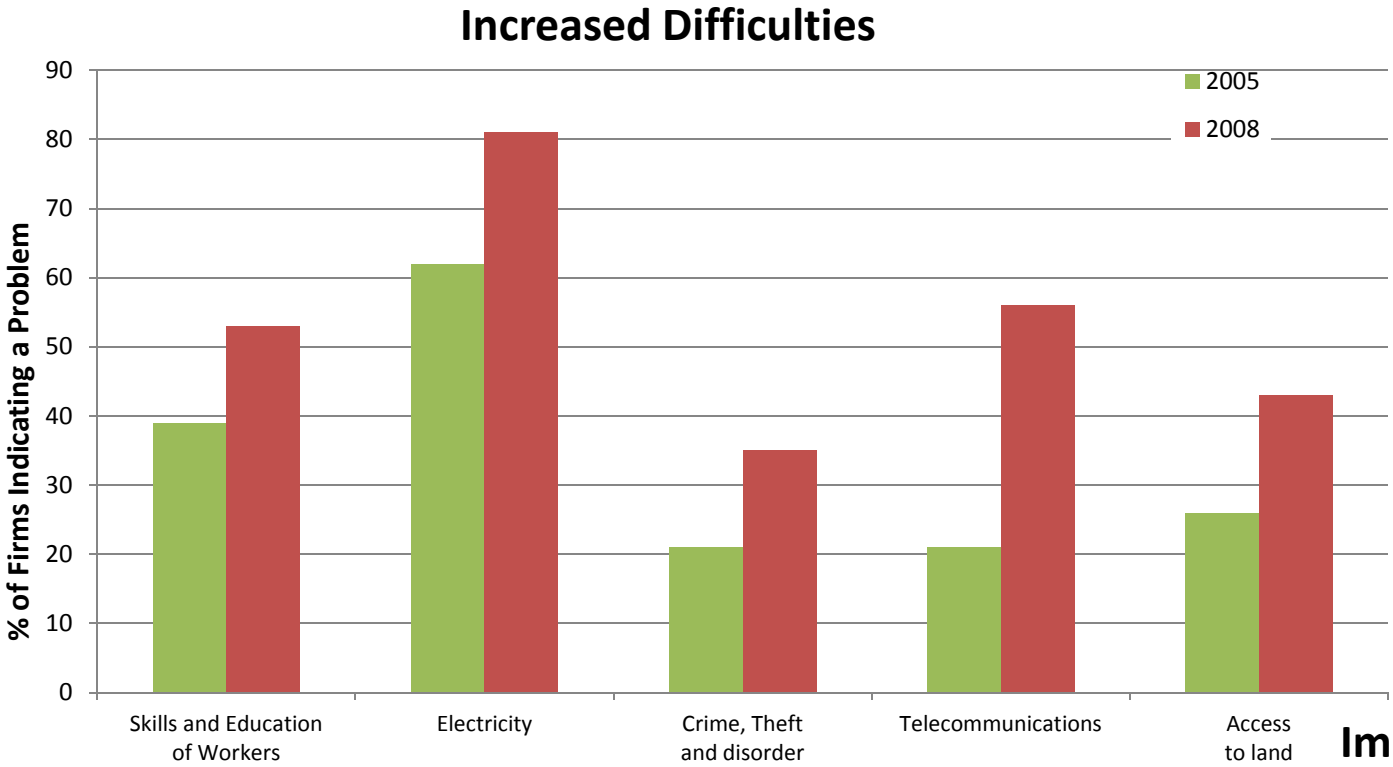
Business Environment

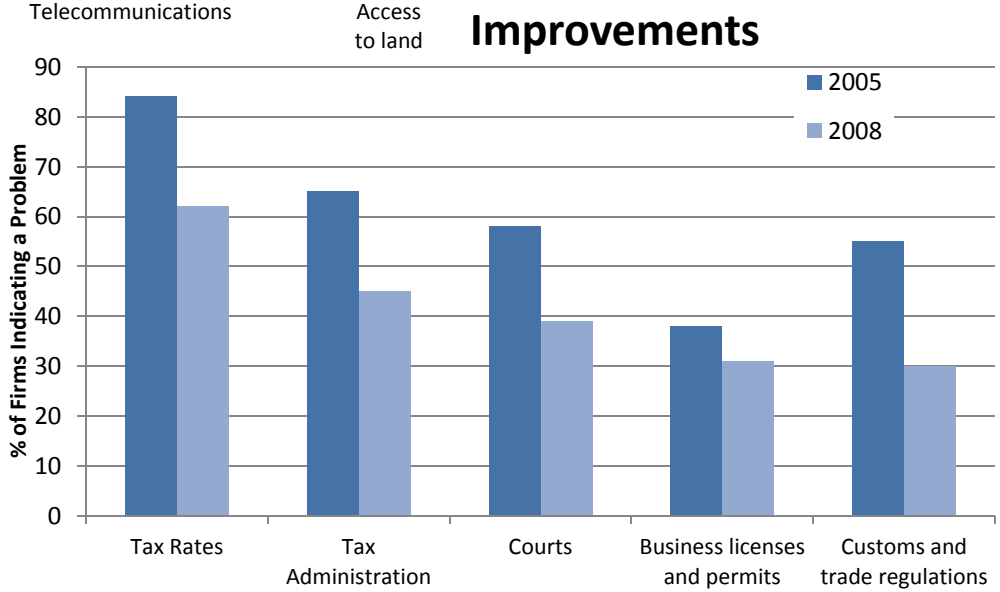


World Bank, Doing Business 2011 (October 2010). The analysis is based on 10 aspects: starting a business; dealing with construction; hiring and firing workers; registering a property; getting credit; protecting investors; paying taxes ; trading across borders; enforcing contracts; and closing a business.

Figure 6

Business Problems as Indicated by Firms

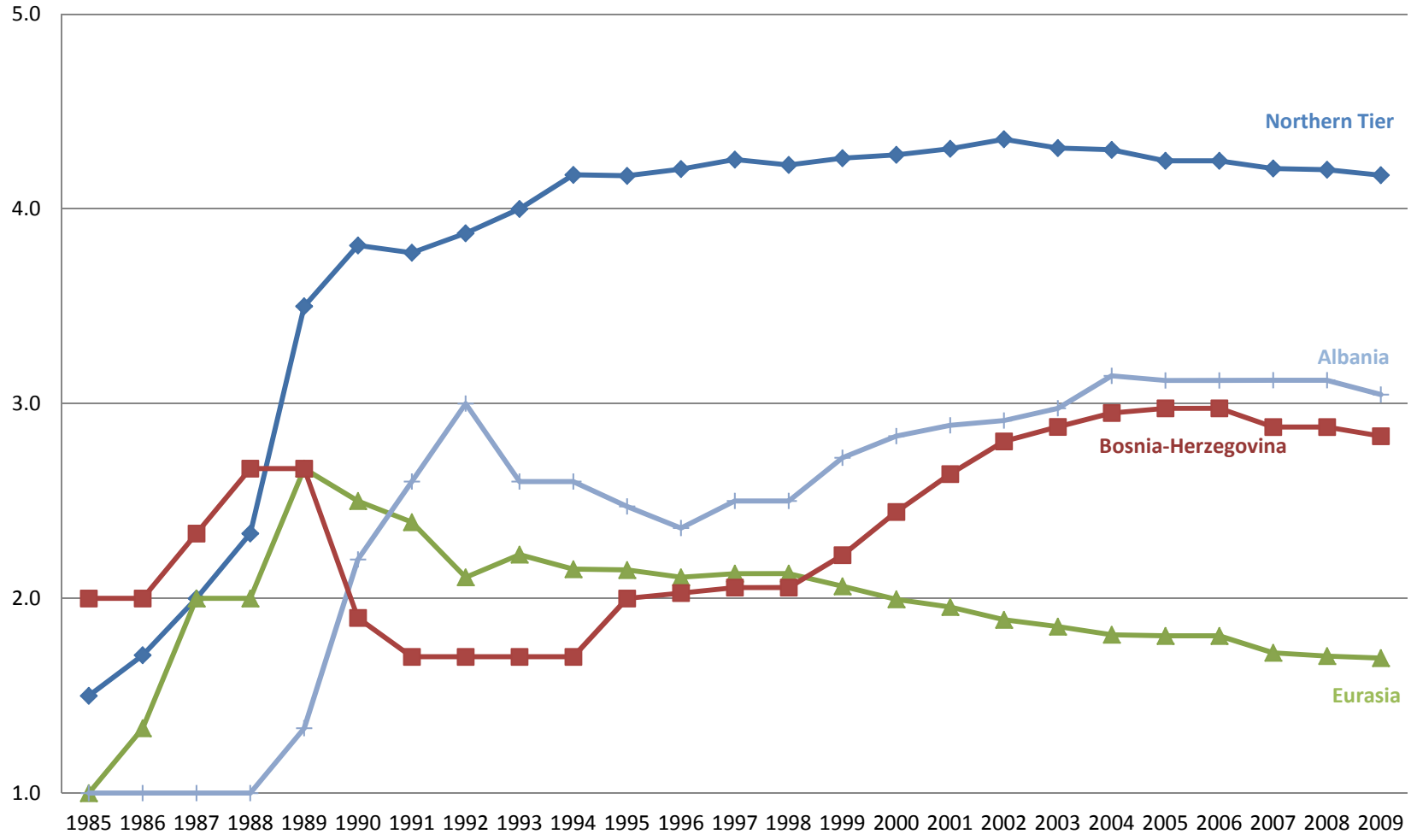




EBRD: BEEPS 2008

Figure 7

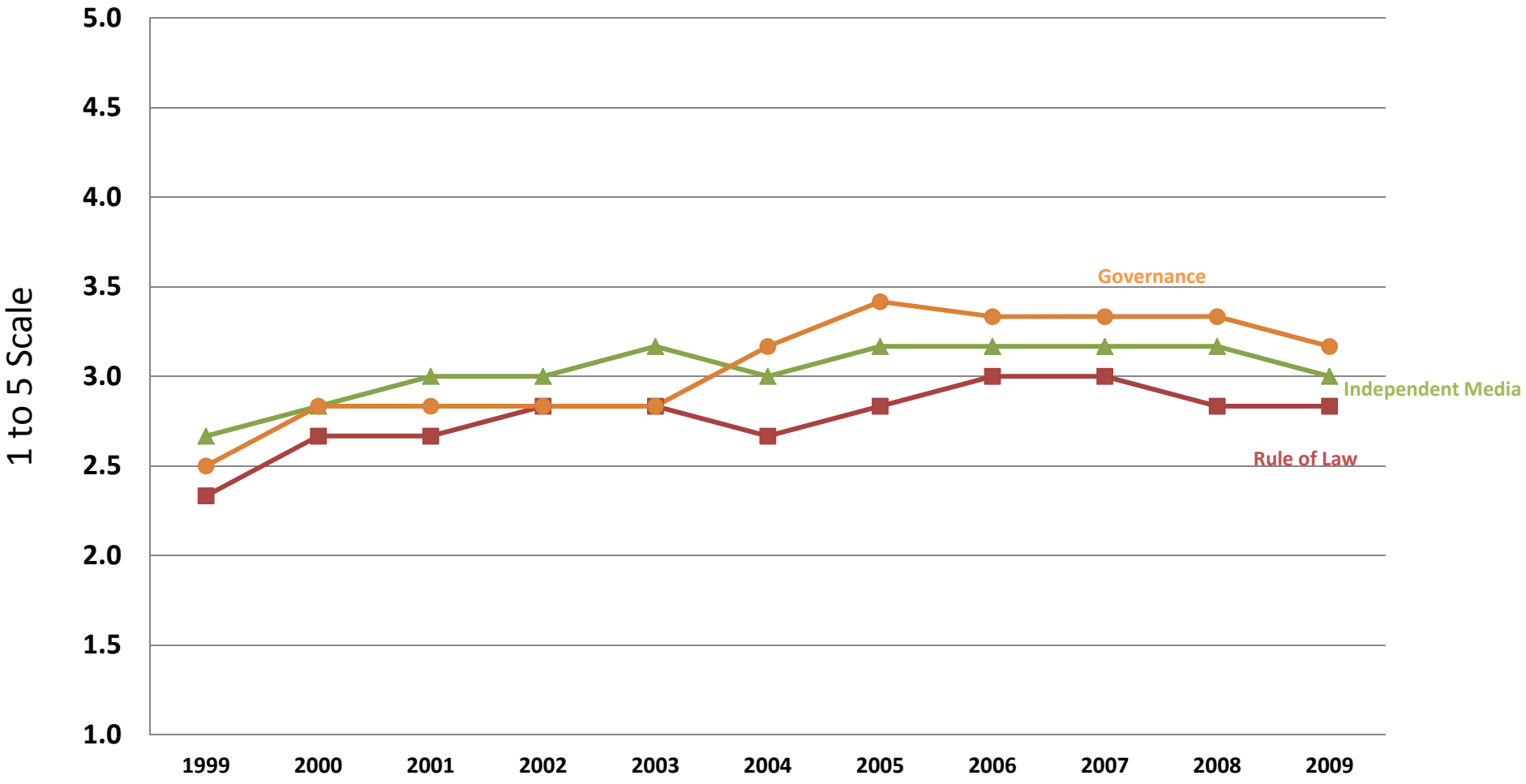
Democratic Reforms



Ratings from 1 to 5, with 5 representing greatest development of democratic reforms. Freedom House, *Nations in Transit* 2010, and *Freedom in the World* (earlier years). .

Figure 8

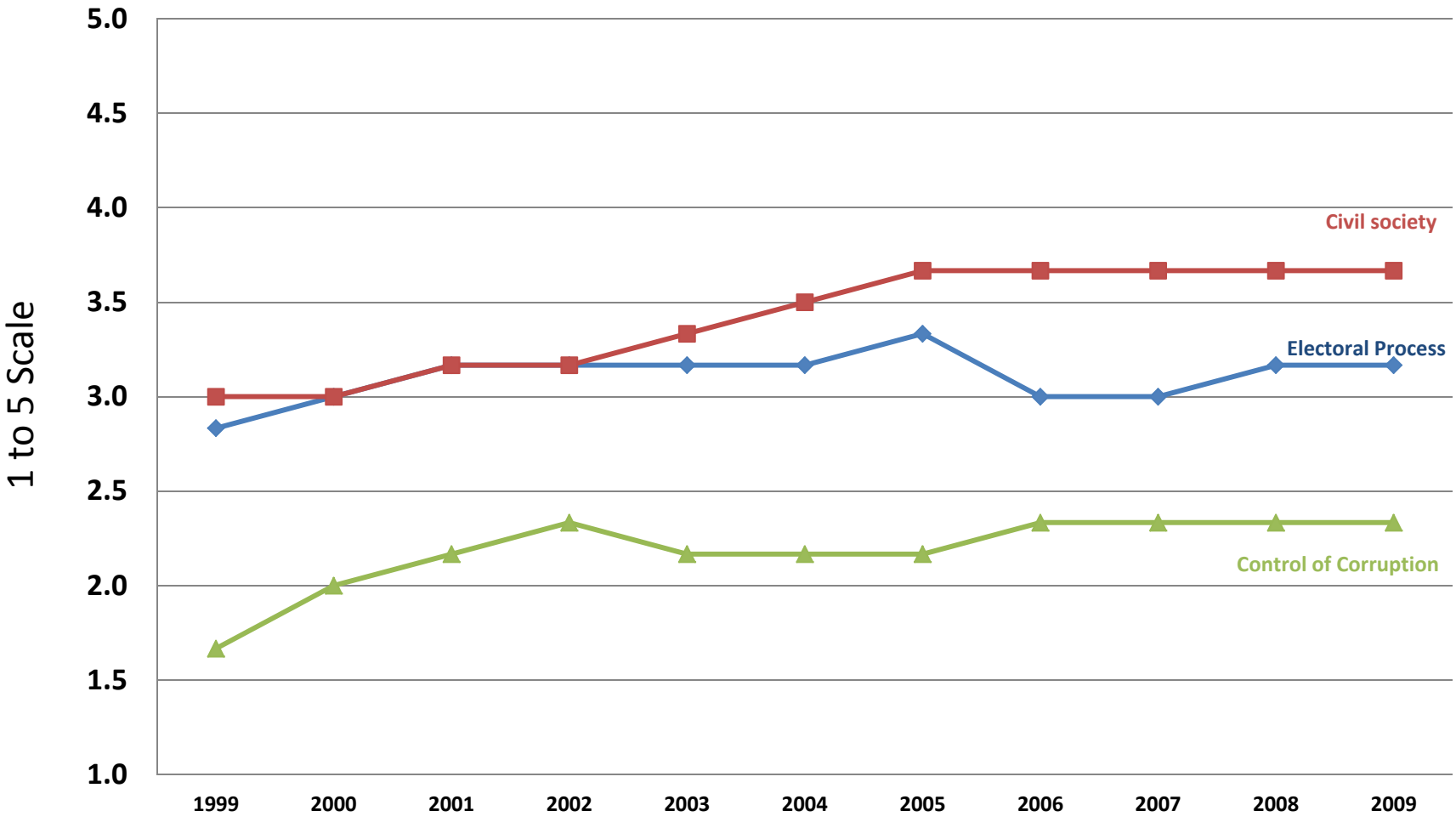
Democratic Reforms in Albania over Time



Freedom House, *Nations in Transit 2010*

Figure 9

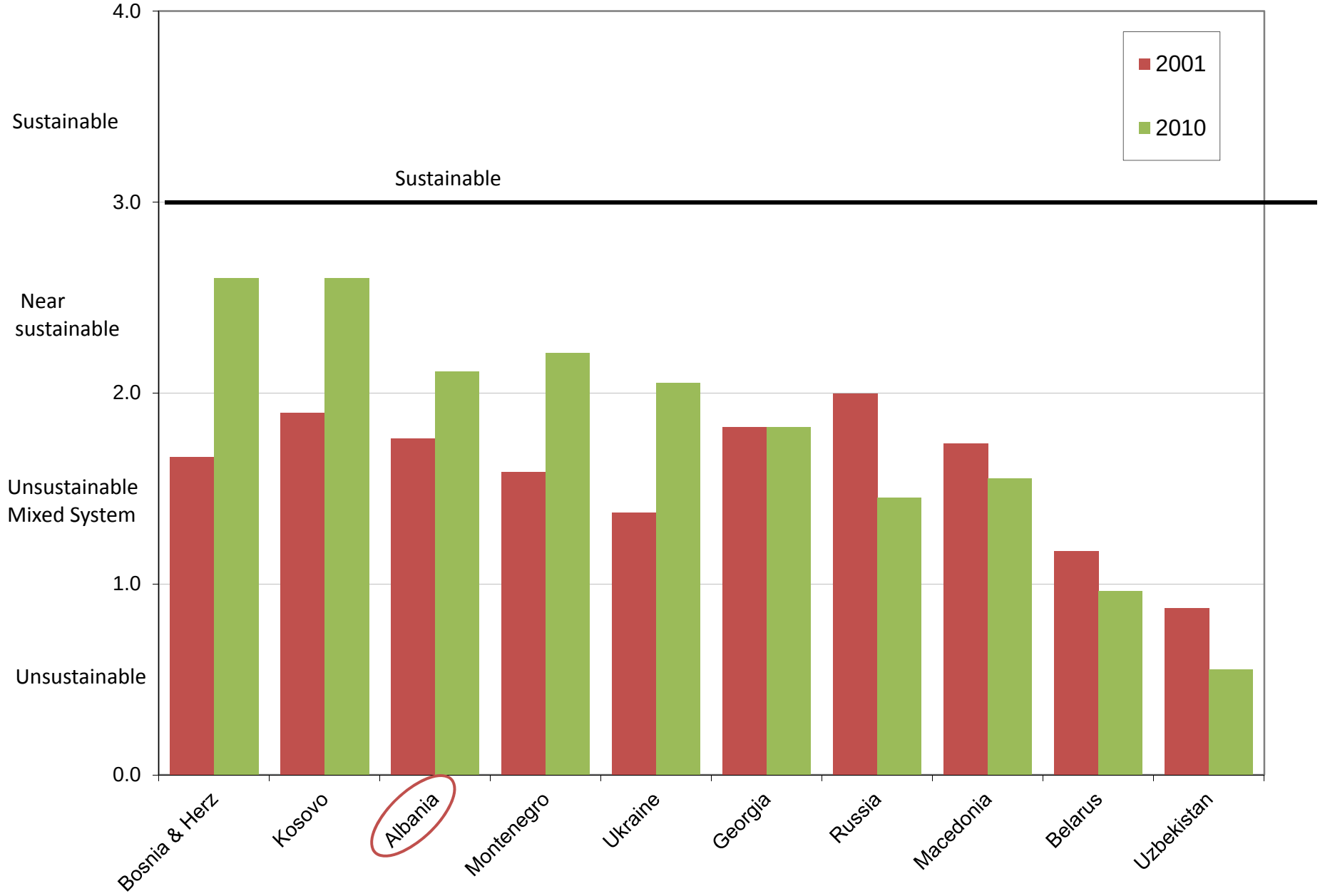
Democratic Reforms in Albania over Time



Freedom House, *Nations in Transit 2010*

Figure 10

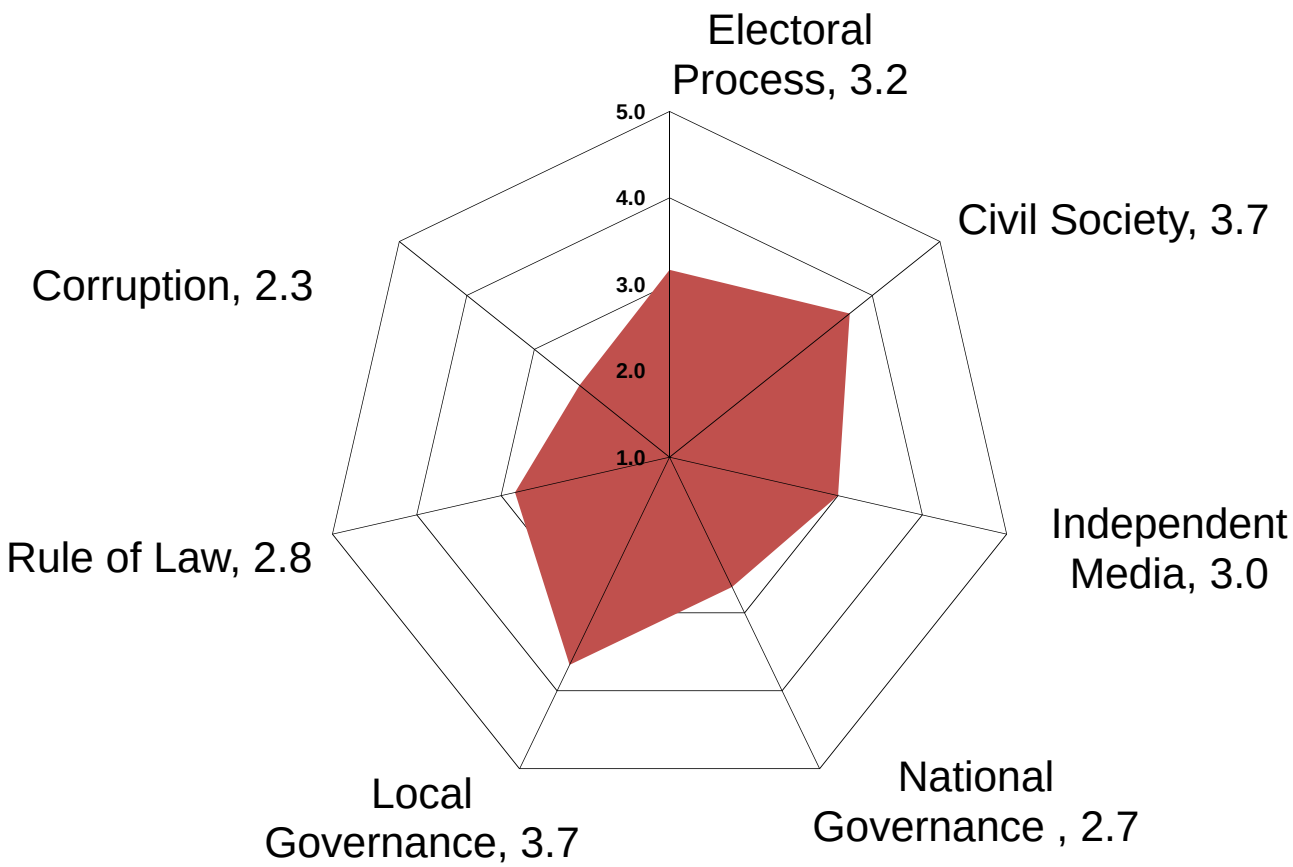
Media Sustainability Index



IREX, *Media Sustainability Index 2010.* Scale of 0 to 4 where 4 is the most sustainable.

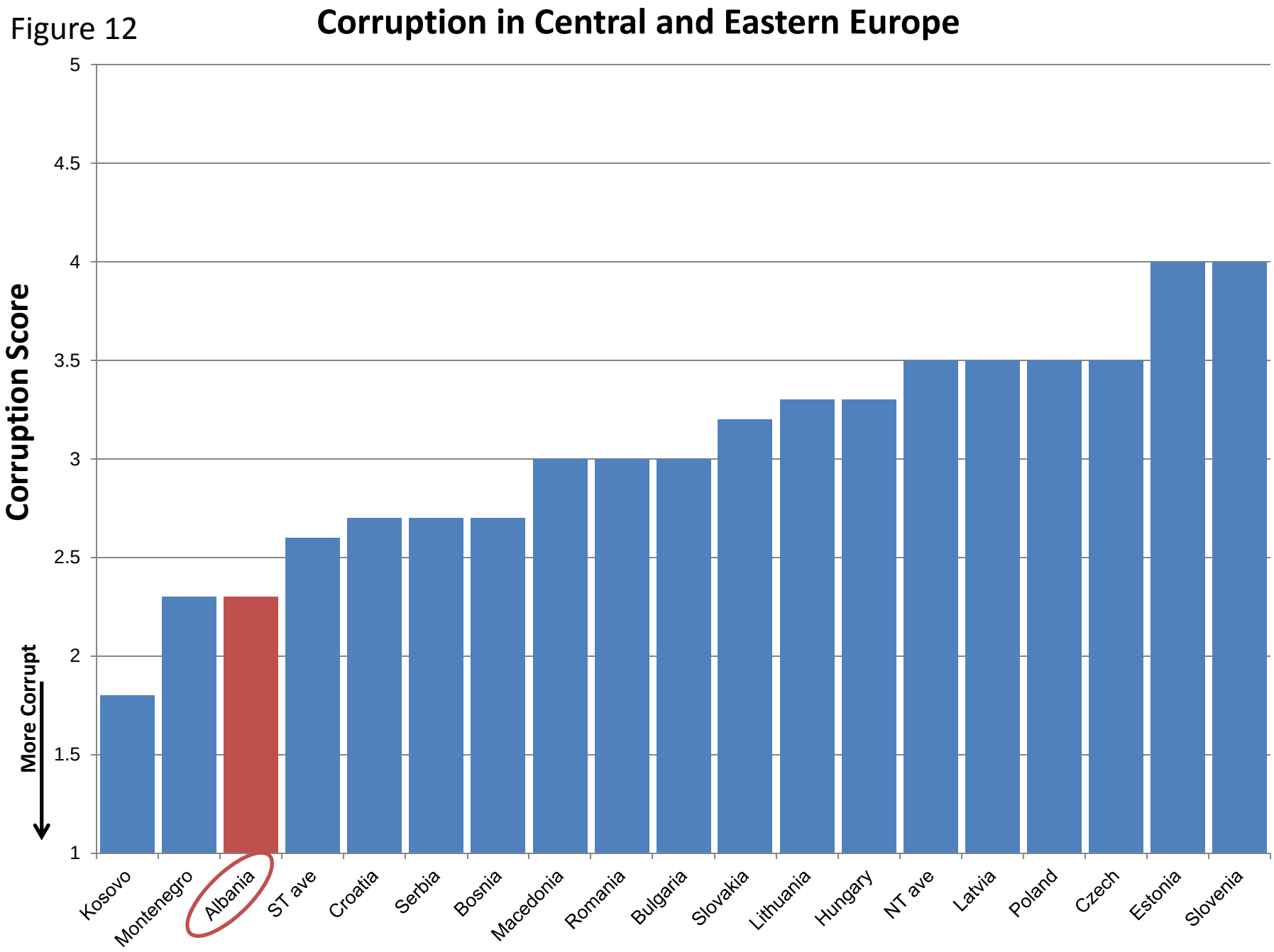
Figure 11

Democratic Reforms in Albania in 2009



Freedom House, *Nations in Transit 2010*

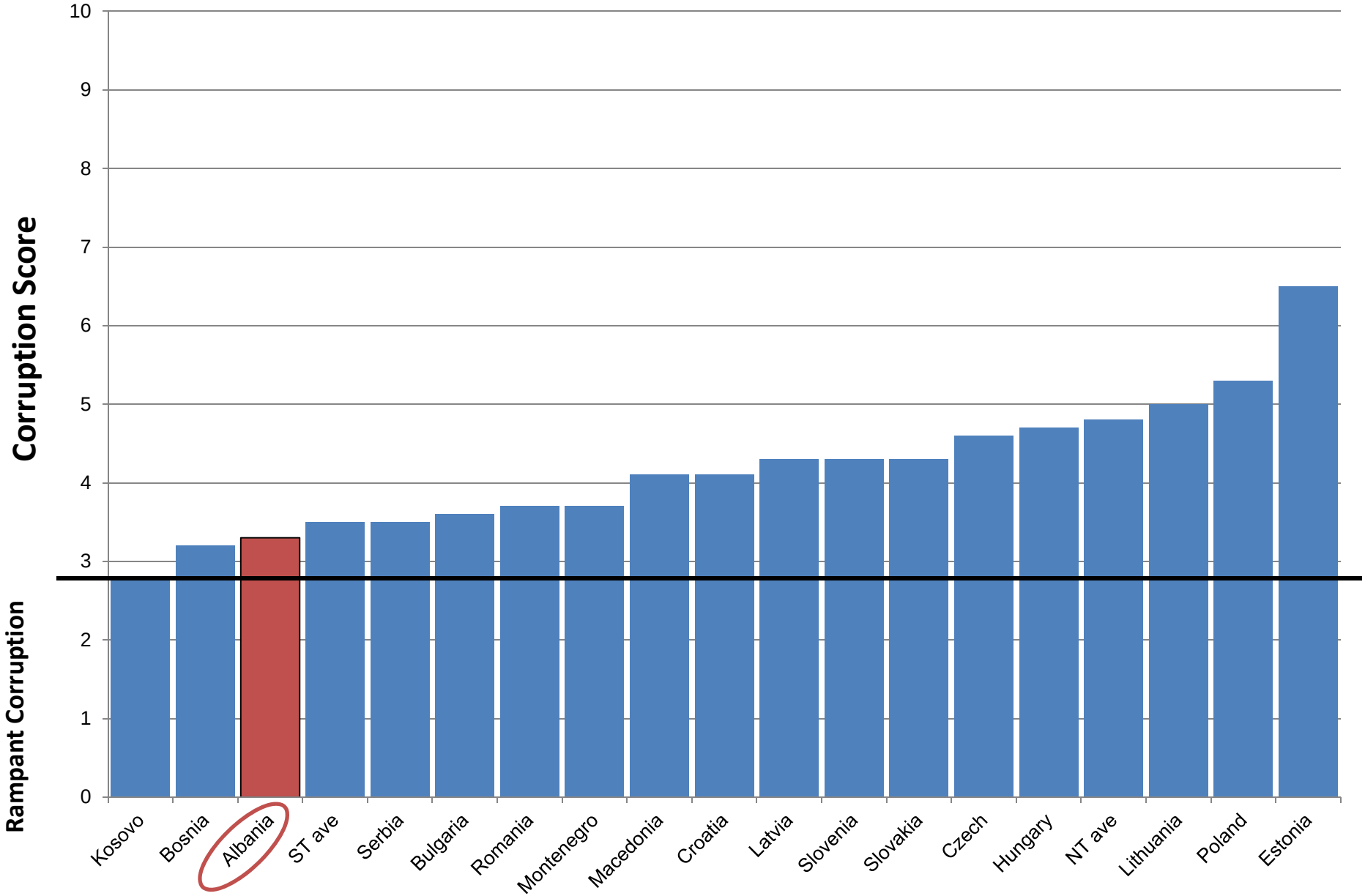
Figure 12



Freedom House Nations in Transit 2010.

Figure 13

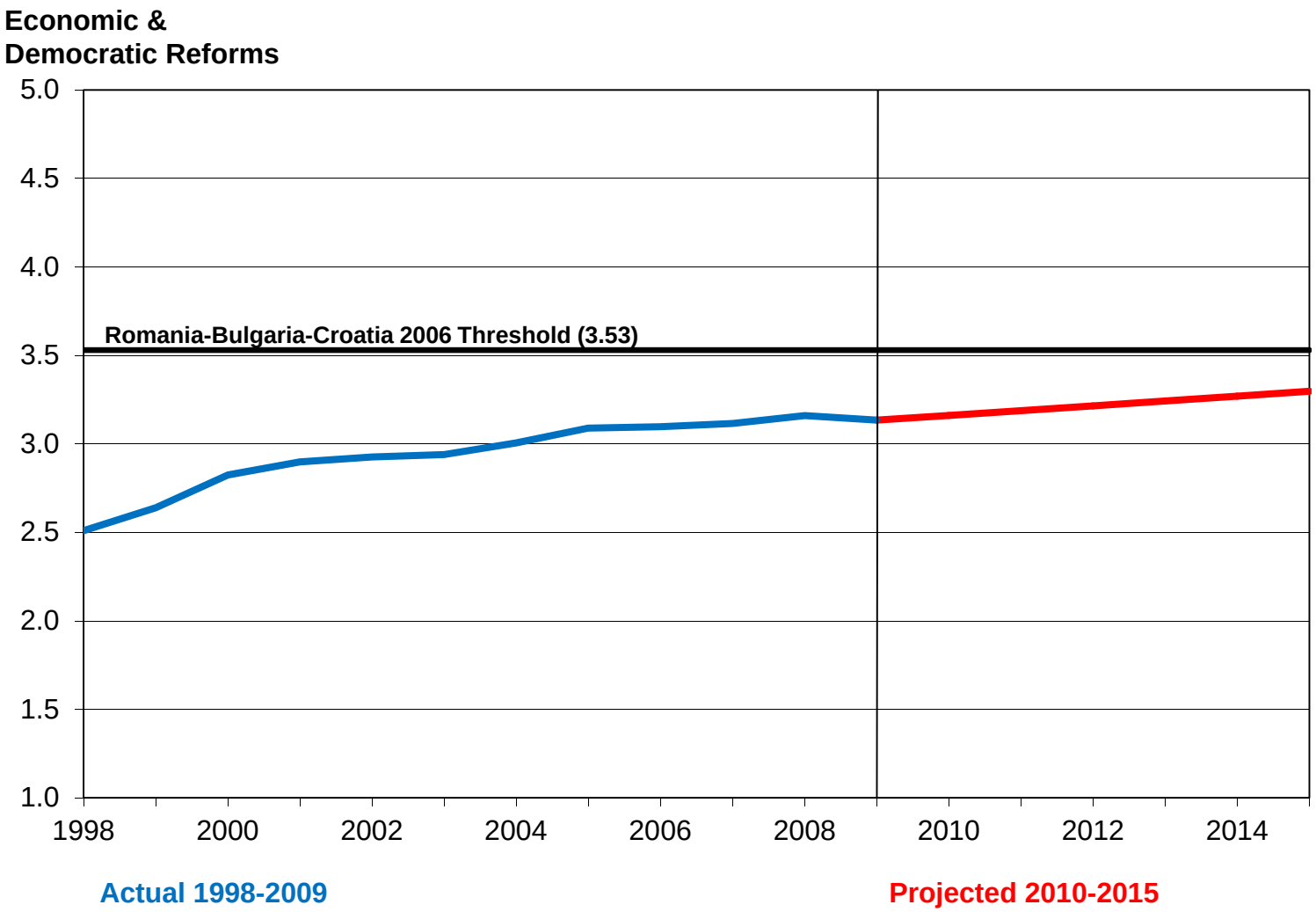
Corruption Perceptions in Central and Eastern Europe



Transparency International, Corruption Perception Index (2010).

Figure 14

Albania



EBRD Transition Report; Freedom House Nations in Transit (various years). Extrapolation based on annual average rate of change from 2004-2009.

Figure 15

Economic Performance and Human Capital in 2008-2010

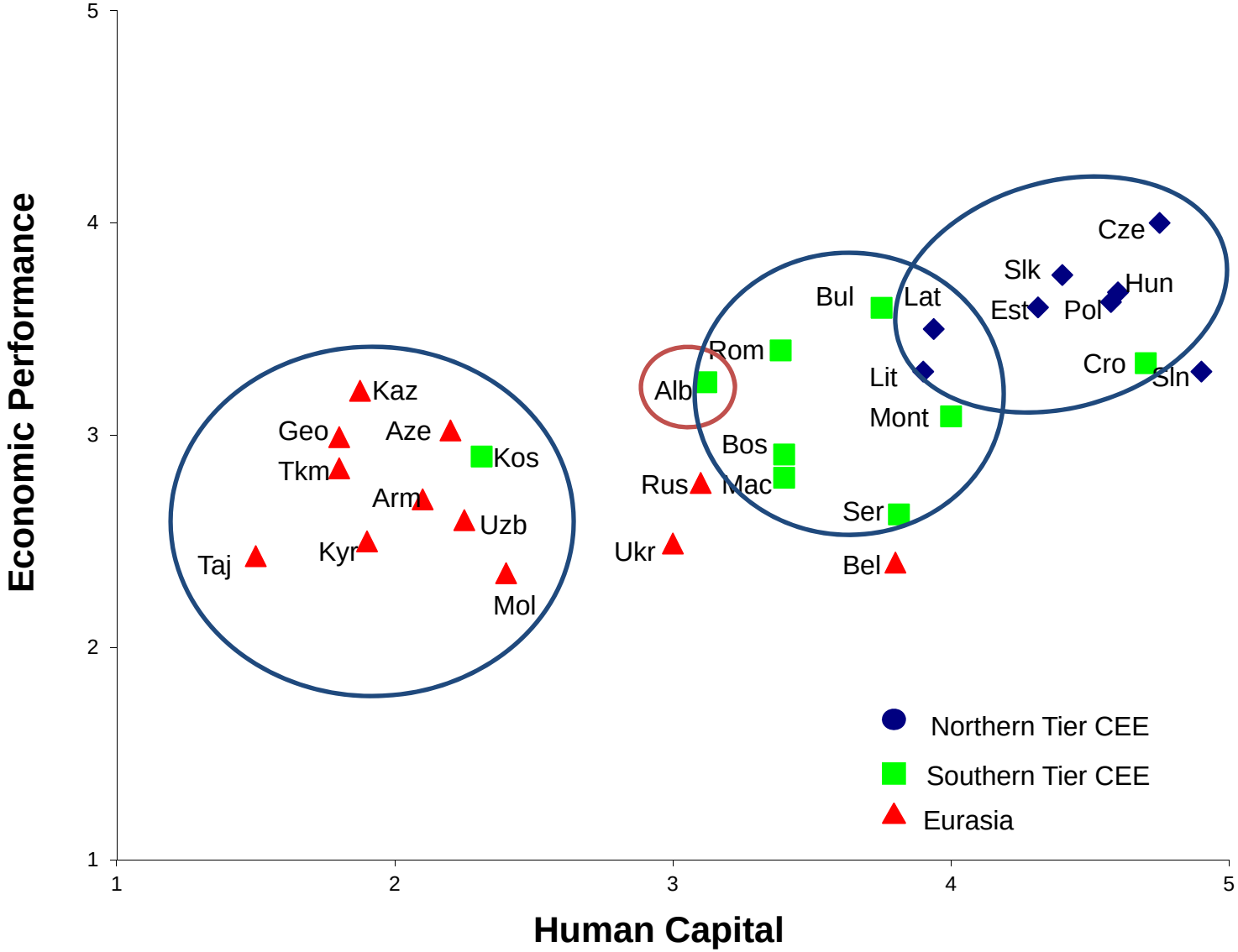
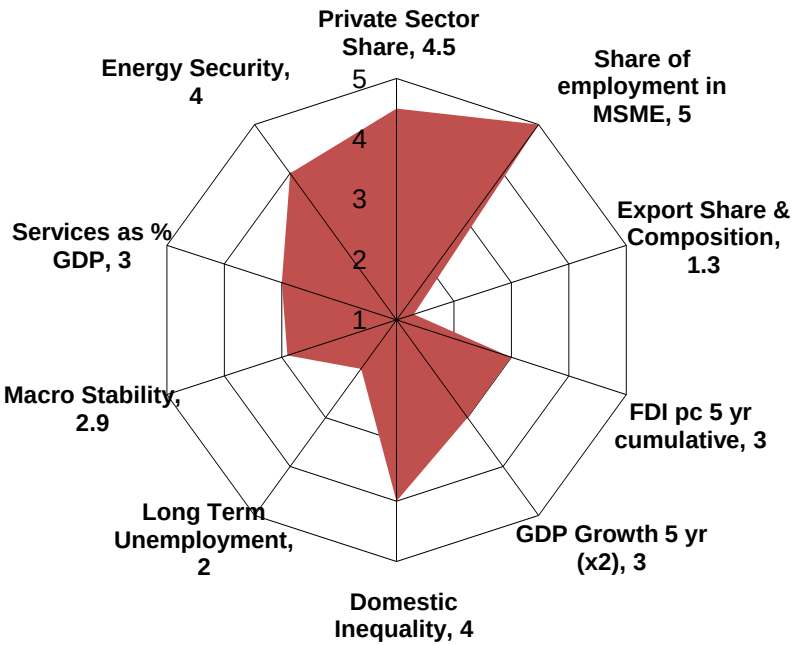


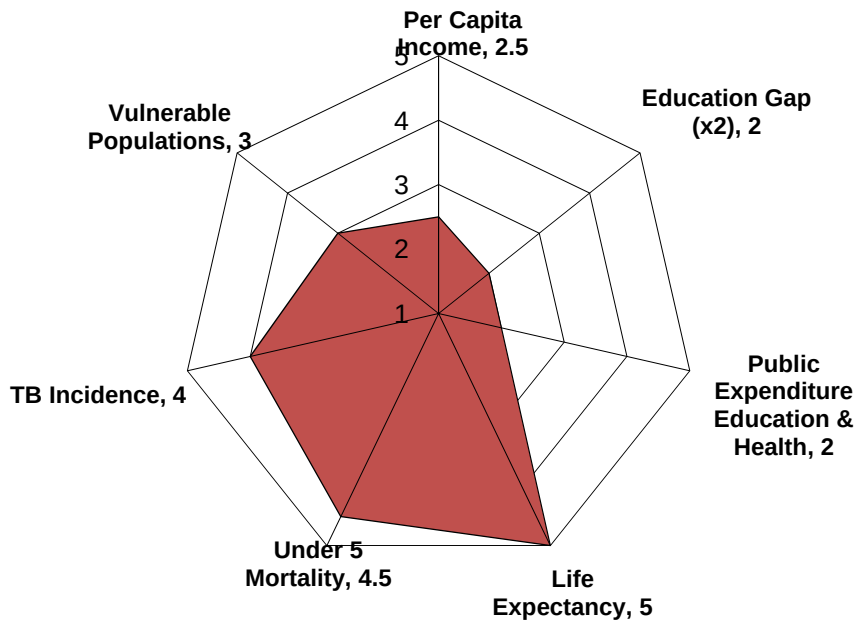
Figure 16

Economic Performance & Human Capital in Albania

Economic Performance in 2008-2010



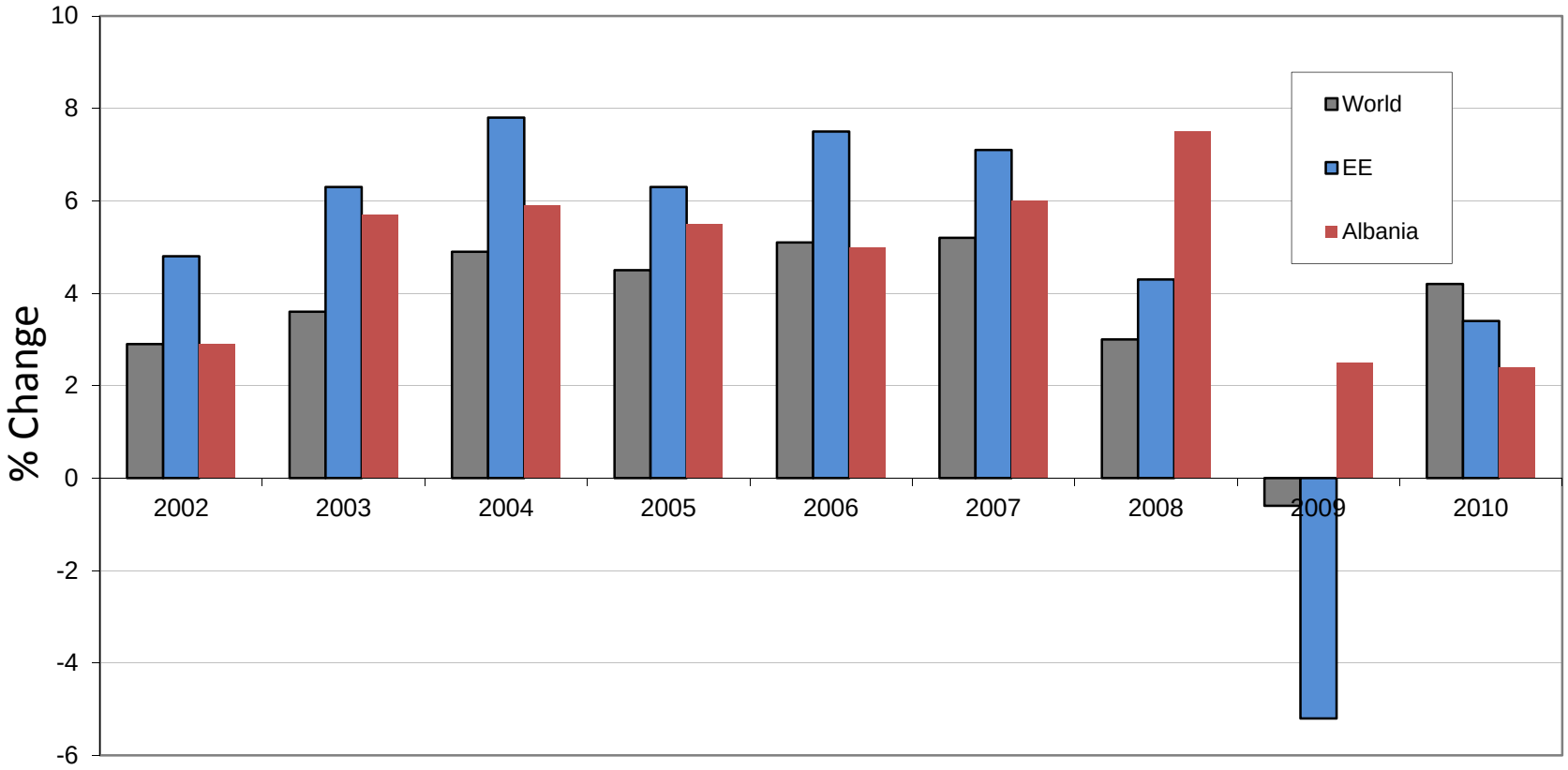
Human Capital in 2008-2010



Ratings are based on a scale from 1 to 5, with 5 representing the best score. World Bank, *World Development Indicators 2008* (April 2008); EBRD, *Transition Report 2010* (November 2010),

Figure 17

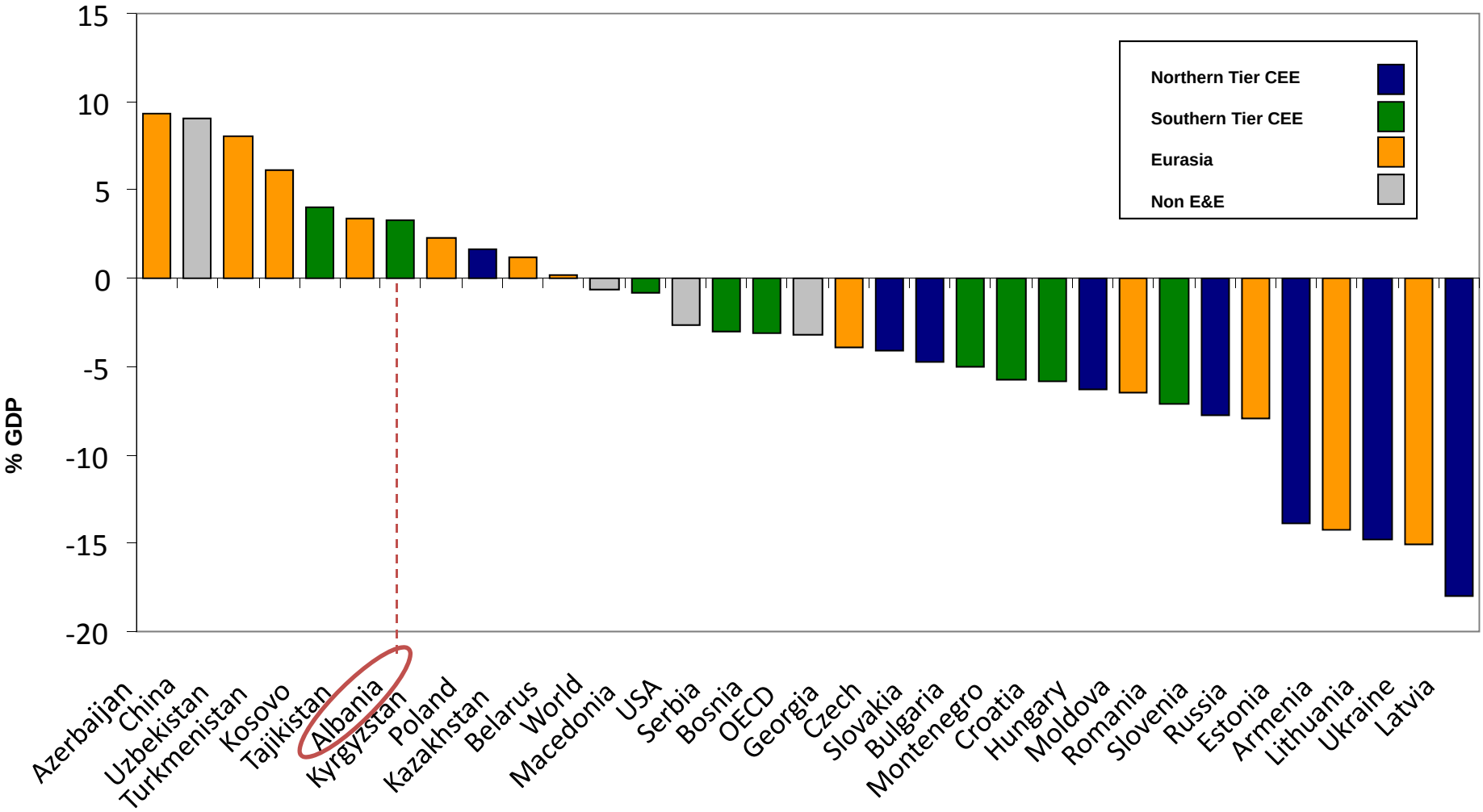
Economic Growth in Albania compared to The World and EE



IMF, World Economic Outlook October 2010

Figure 18

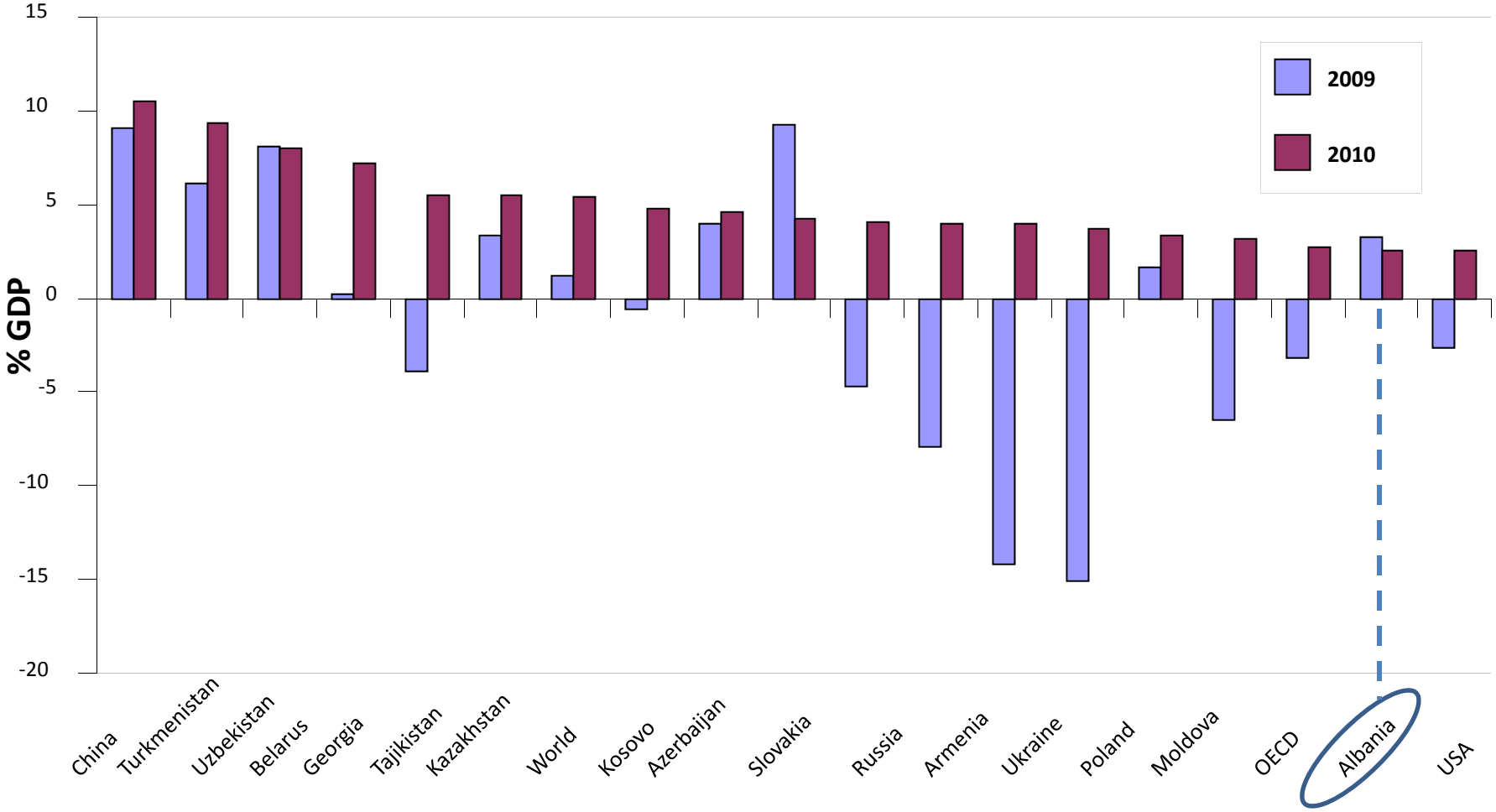
GDP Growth Estimates, 2009



IMF, *World Economic Outlook* (October 2010).

Figure 19

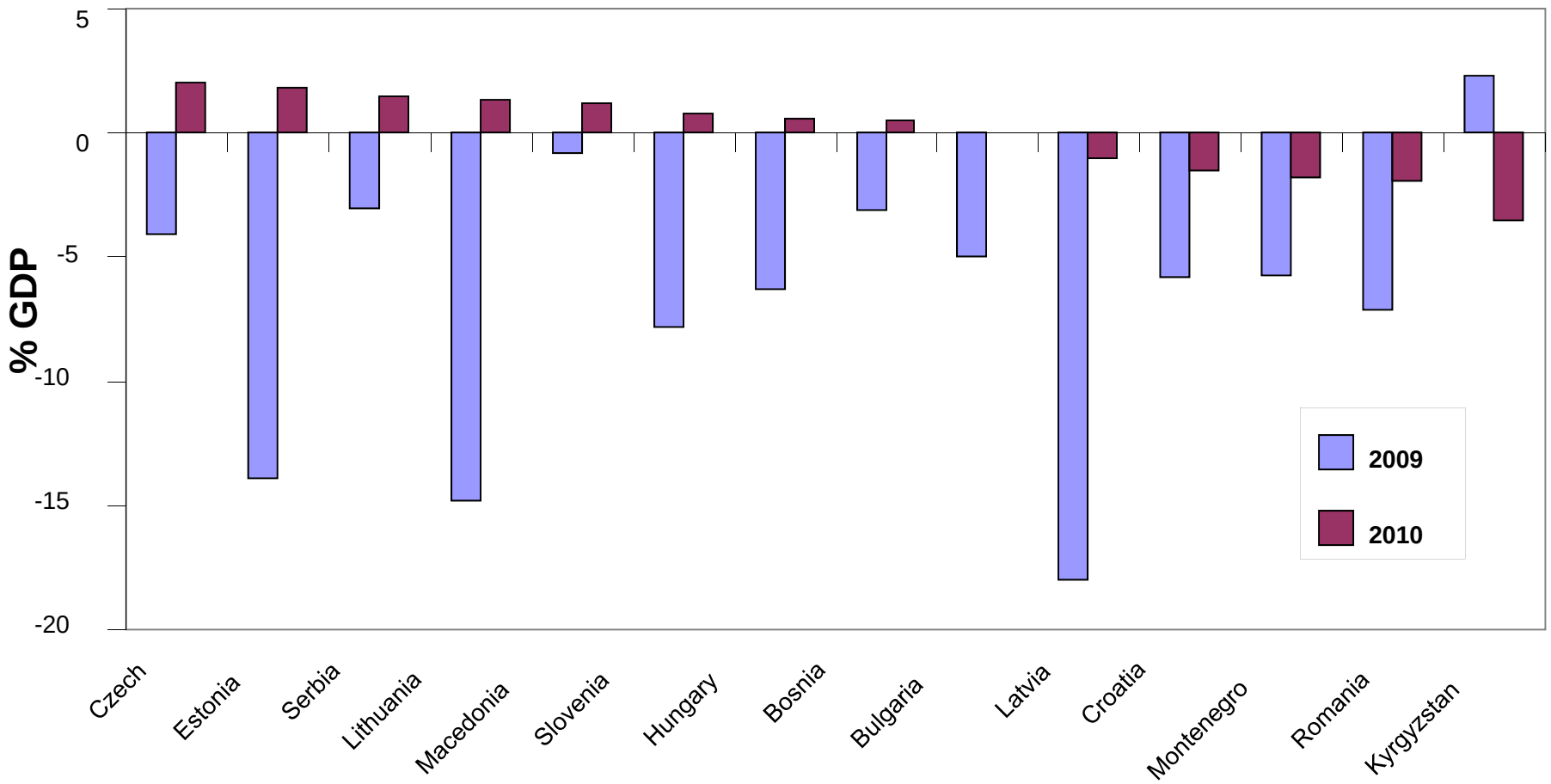
Economic growth and contraction: the better performers in 2010



IMF, World Economic Outlook (October 2010).

Figure 20

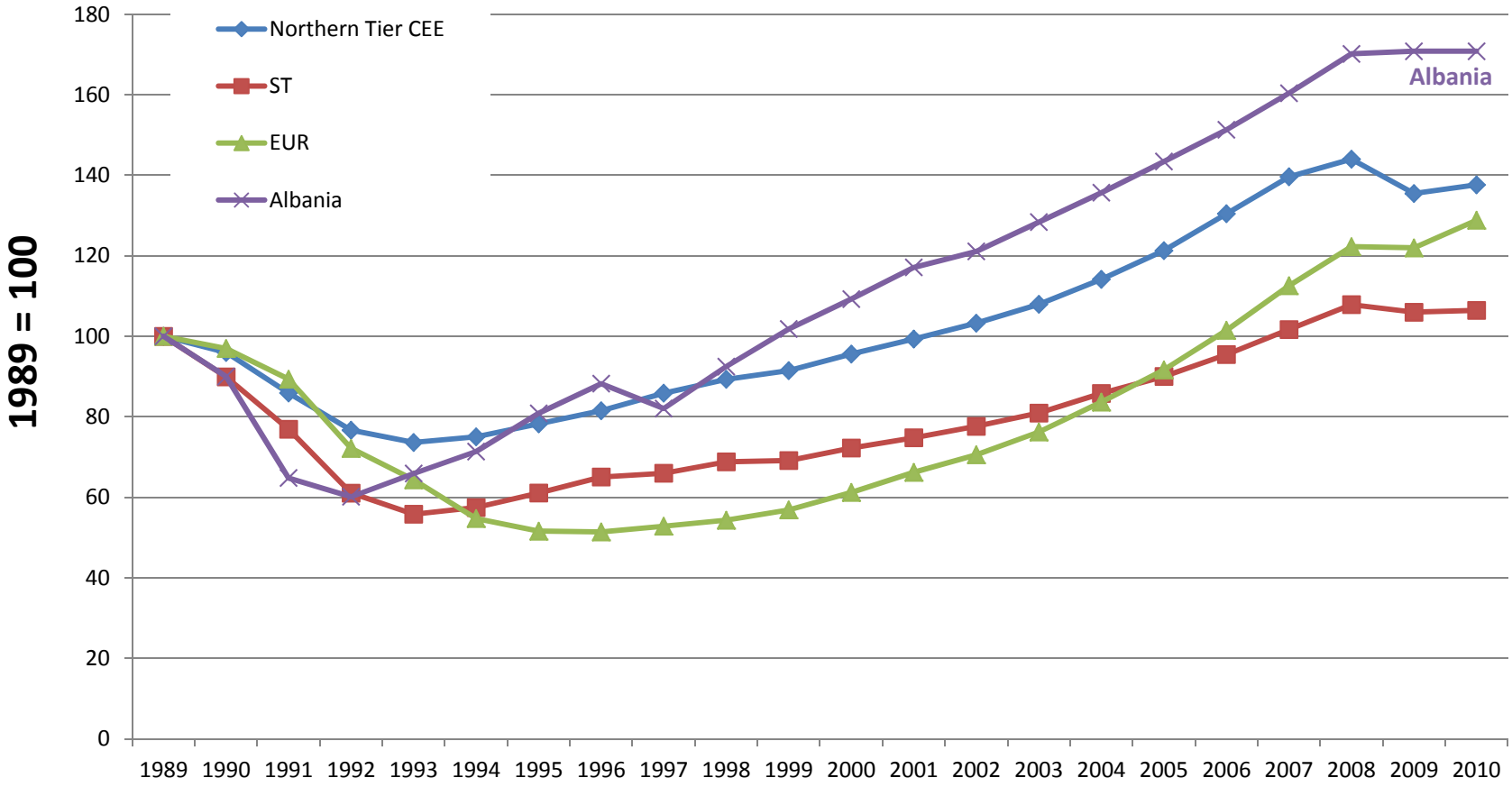
Economic growth and contraction: the poorer performers in 2010



IMF, World Economic Outlook (October 2010).

Figure 21

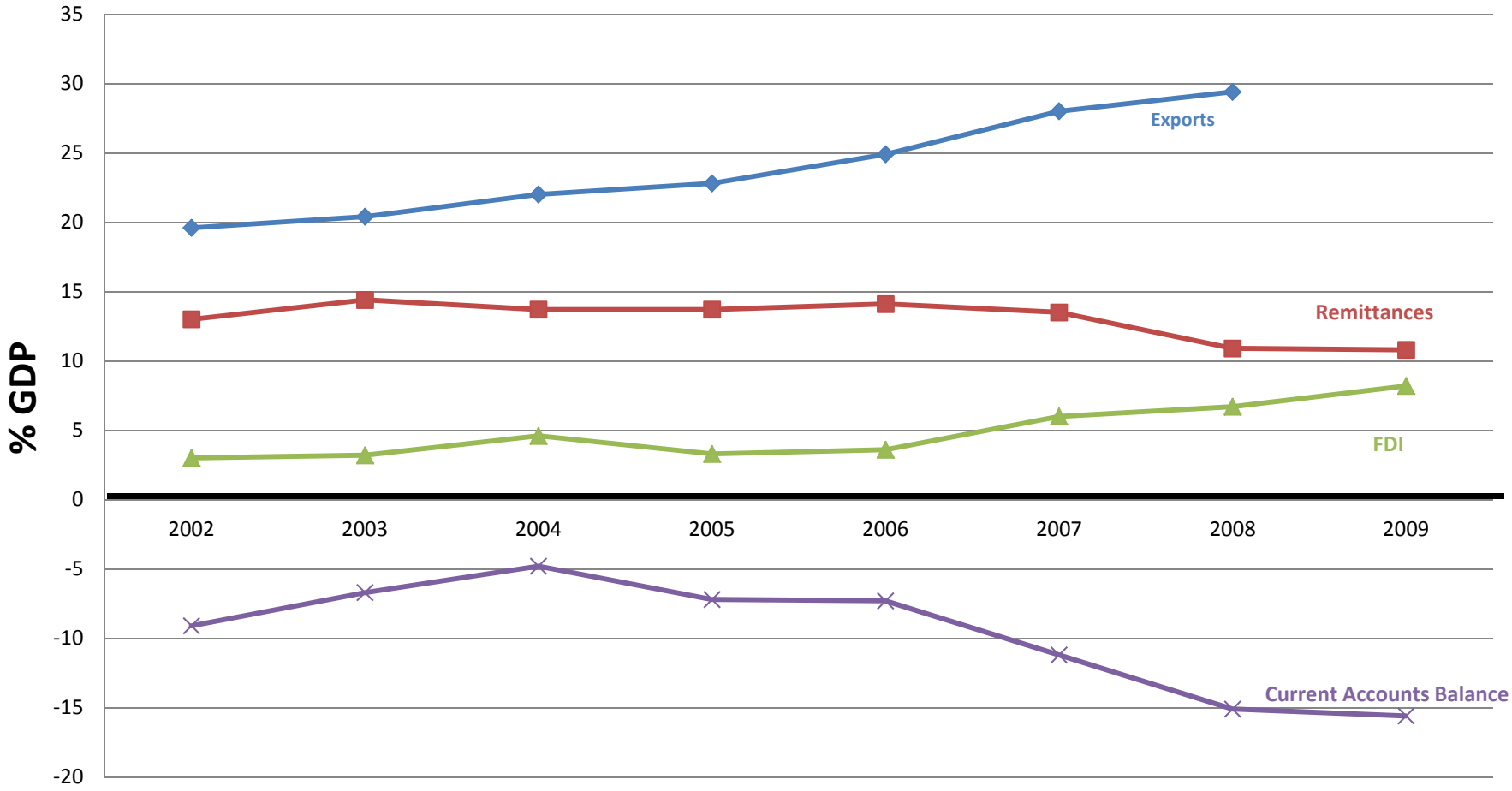
GDP as % of 1989 GDP



EBRD, *Transition Report 2010* (November 2010), World Economic Outlook Update (October 2010).

Figure 22

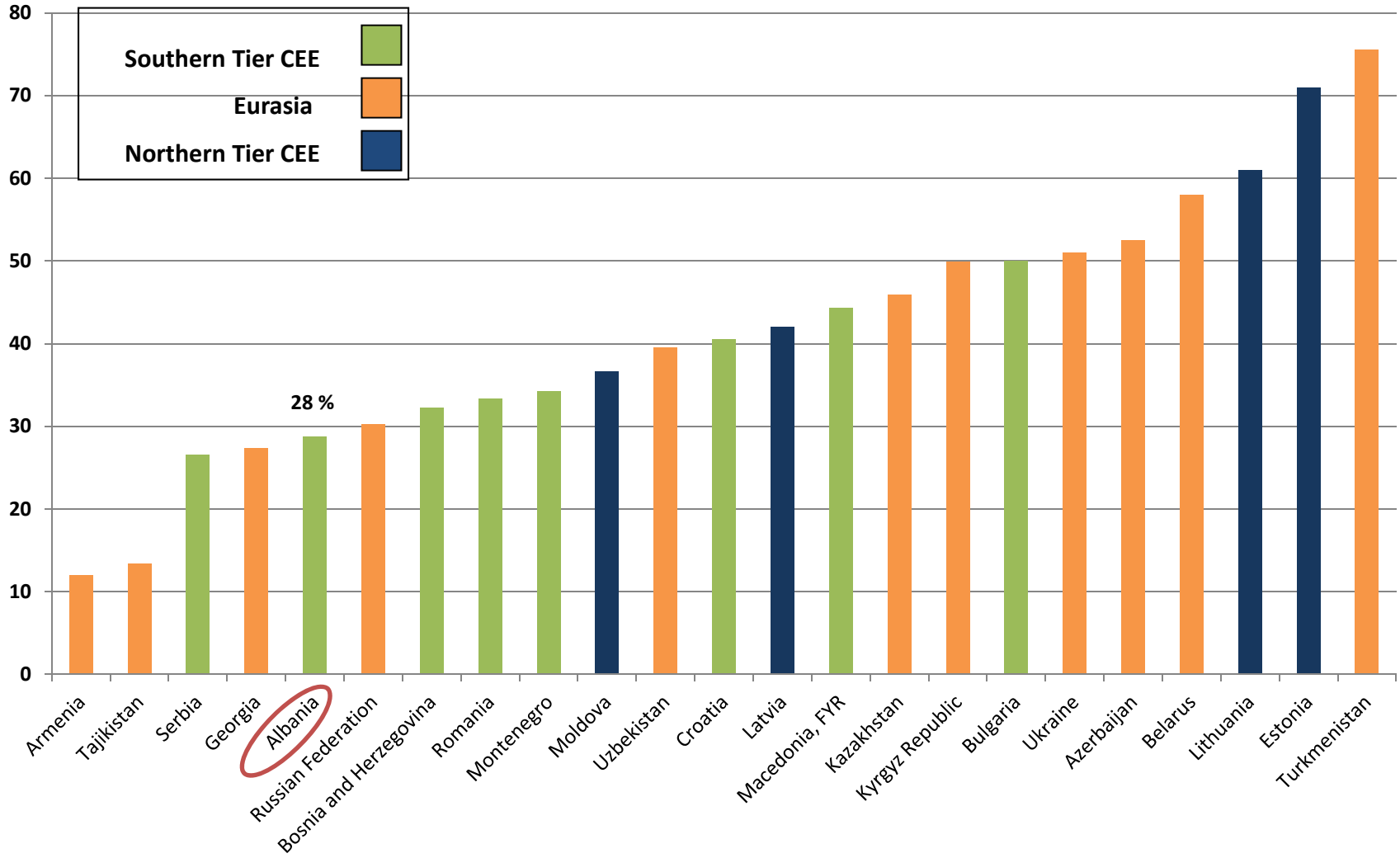
Albania's Integration into The Global Economy



World Bank, Albania, The New Growth Agenda (November 2010), and European commission, Analytical Report: Albania (November 2010).

Figure 23

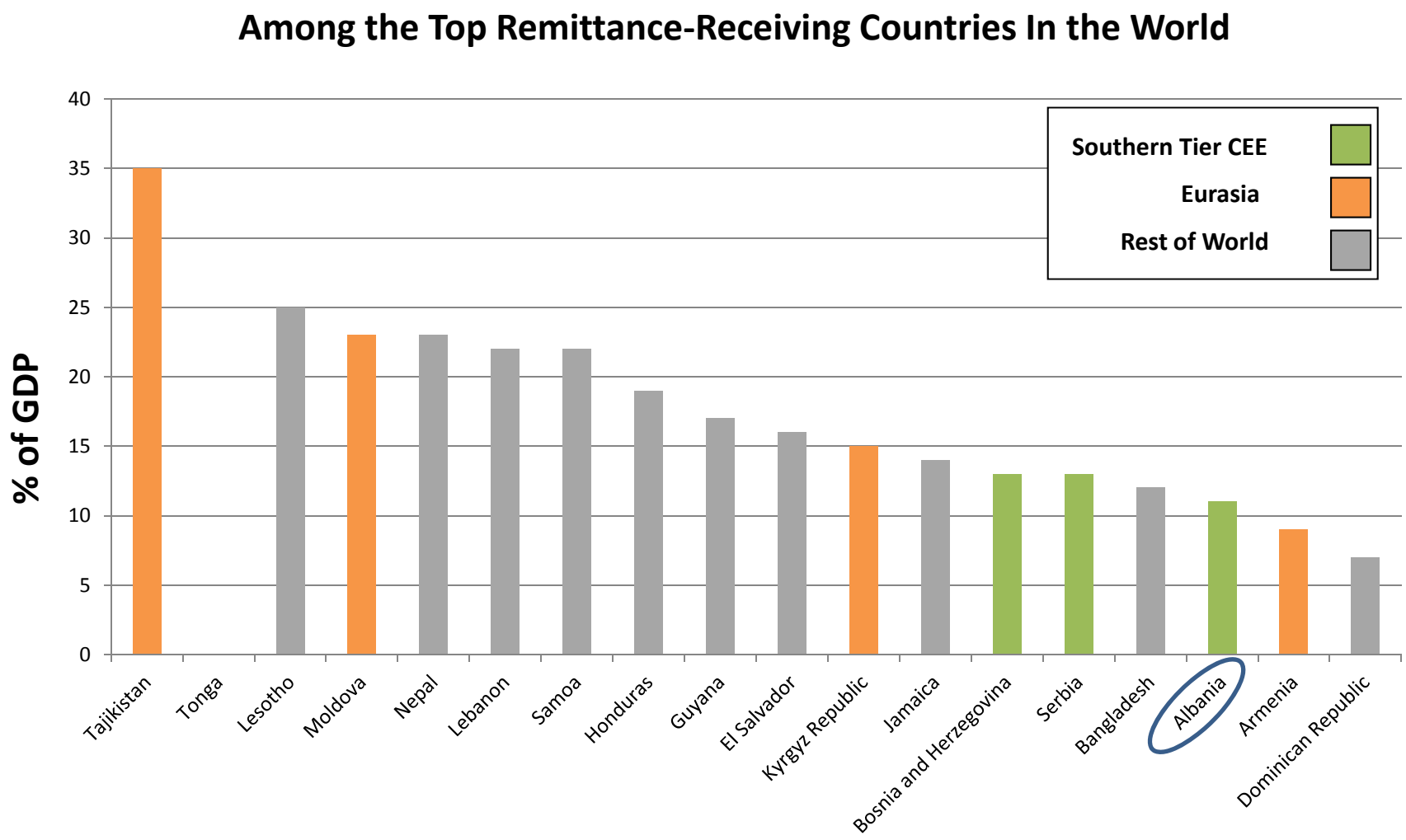
Exports as % of GDP



World Bank Development Indicators; 2009

Figure 24

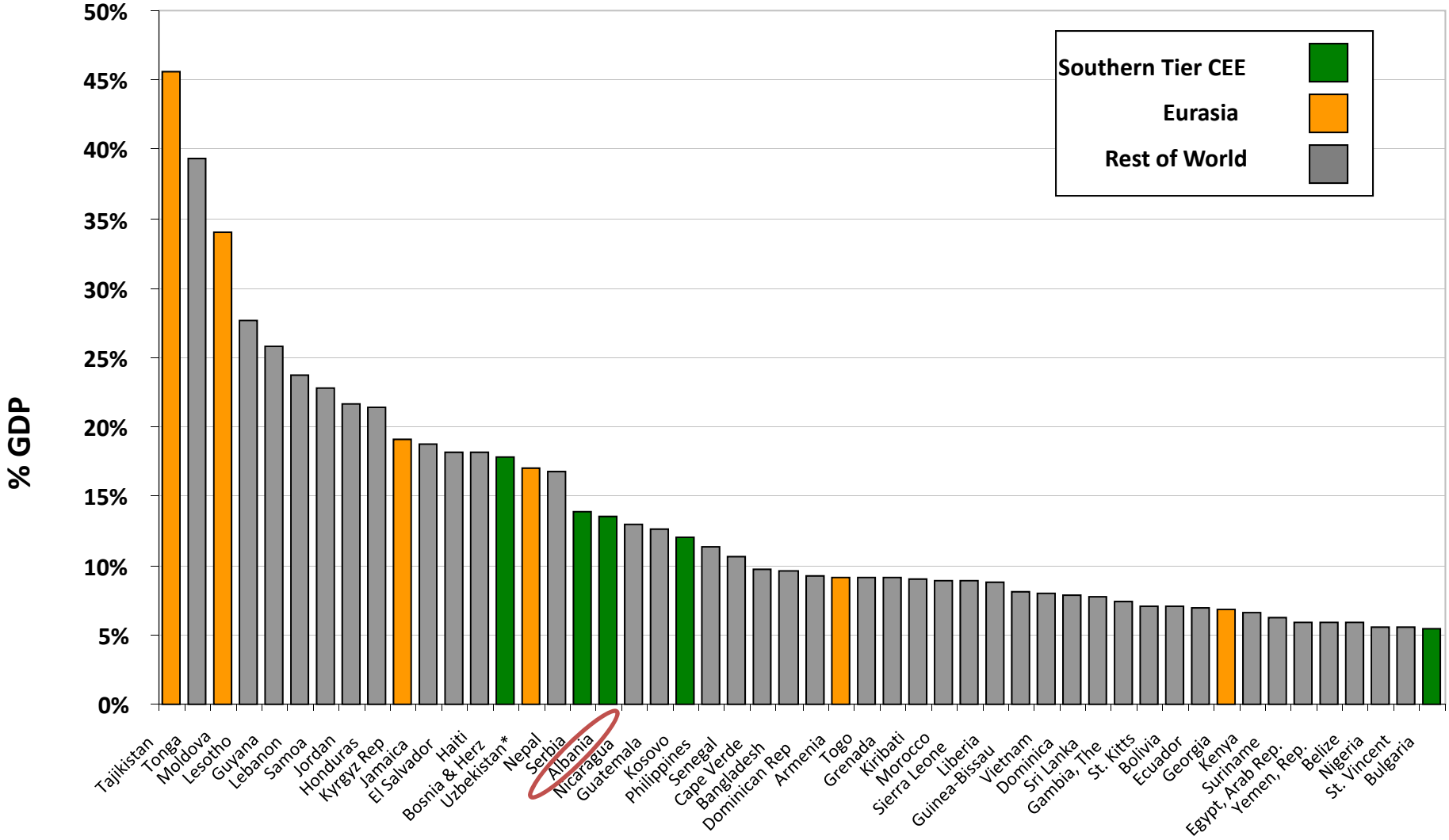
Remittances 2009



Development Prospects Group, World Bank 2009.

Figure 25

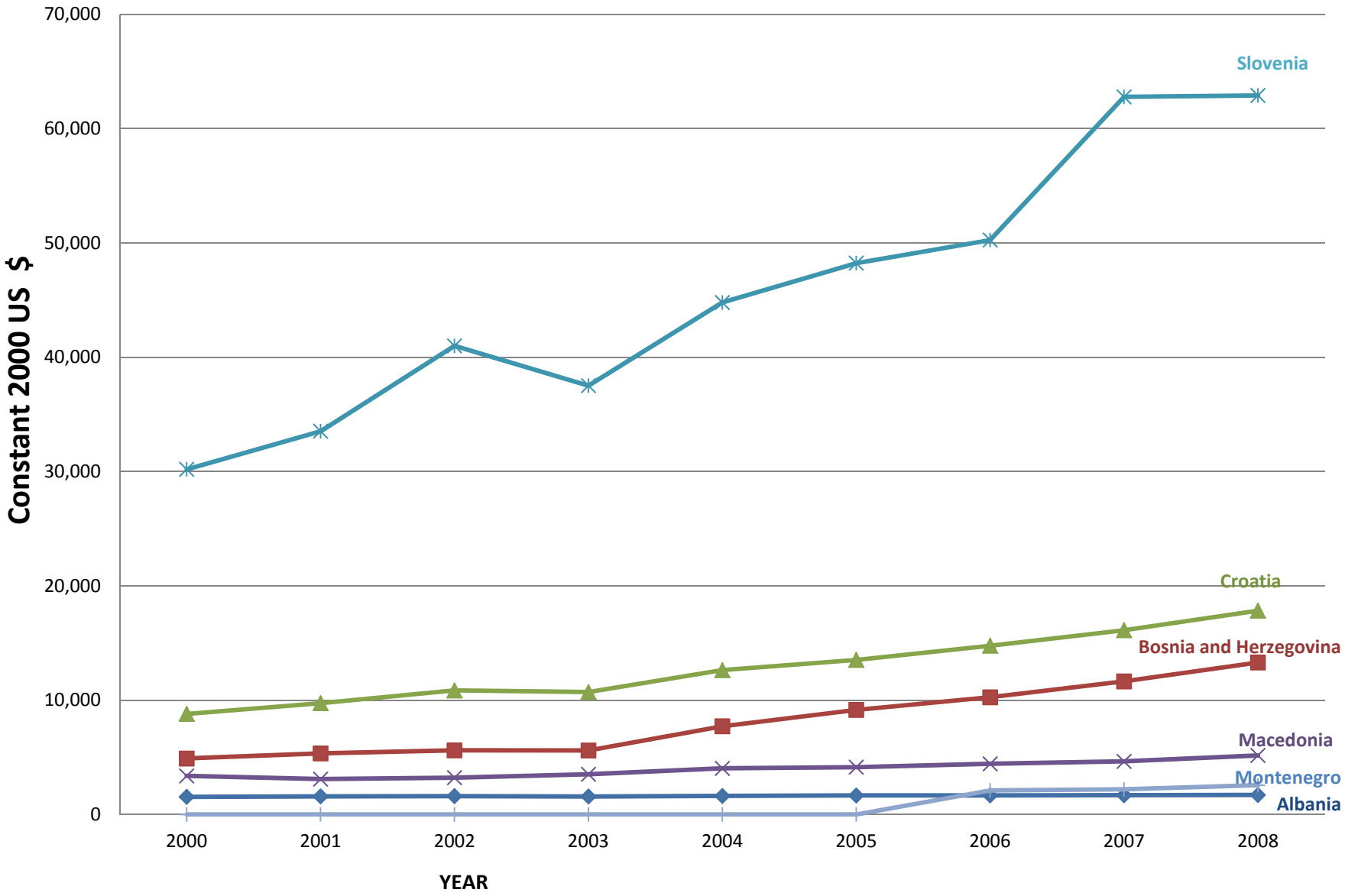
Top 50 Remittance Receiving Countries, 2007



Sources include World Bank staff estimates based on the International Monetary Fund's *Balance of Payments Statistics Yearbook* (2008), IFAD presentation (2006), and UNDP, *Kosovo Human Development Report* (2007).

Figure 26

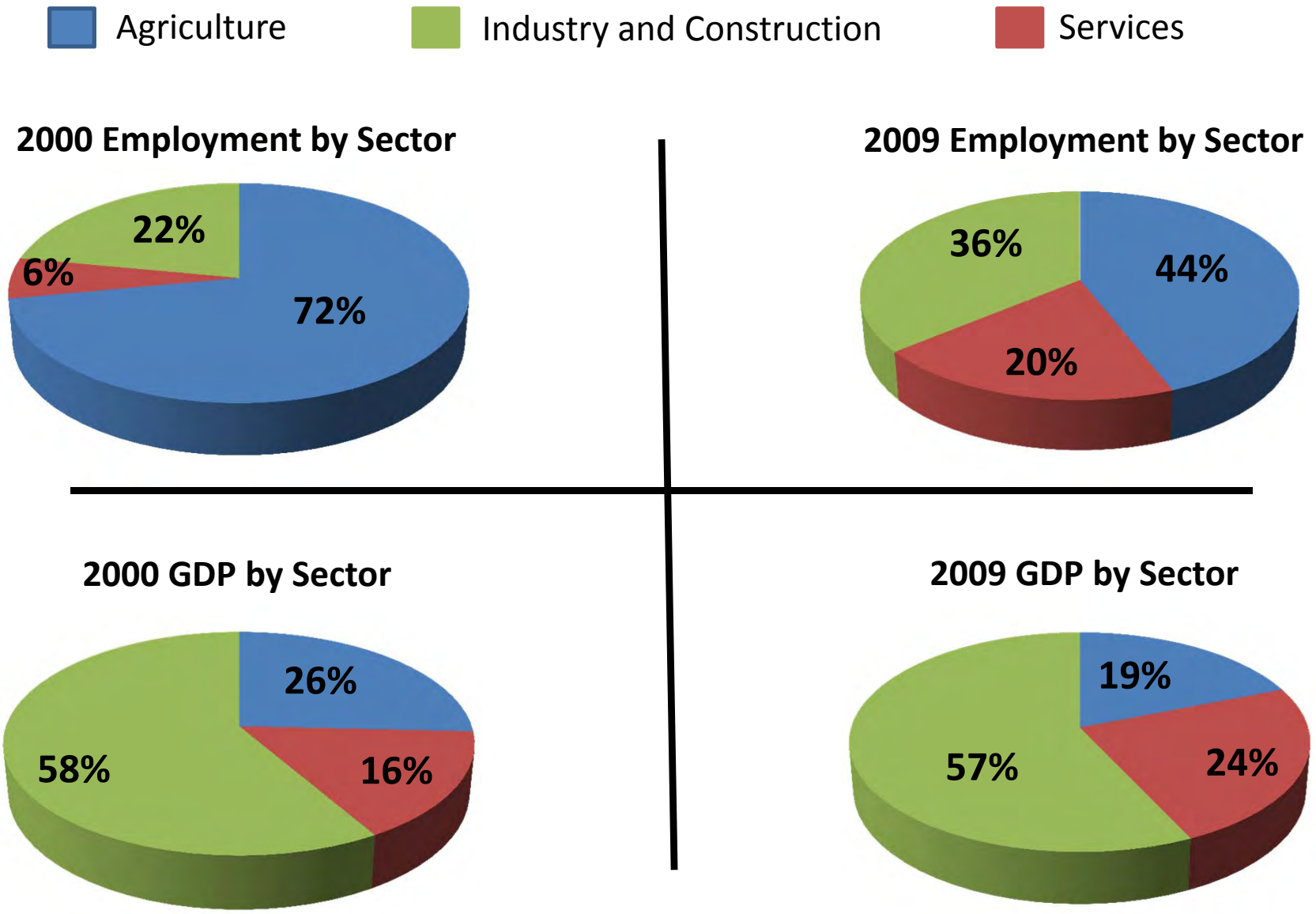
Agricultural Value Added per worker



World Bank Development Indicators; 2009

Figure 27

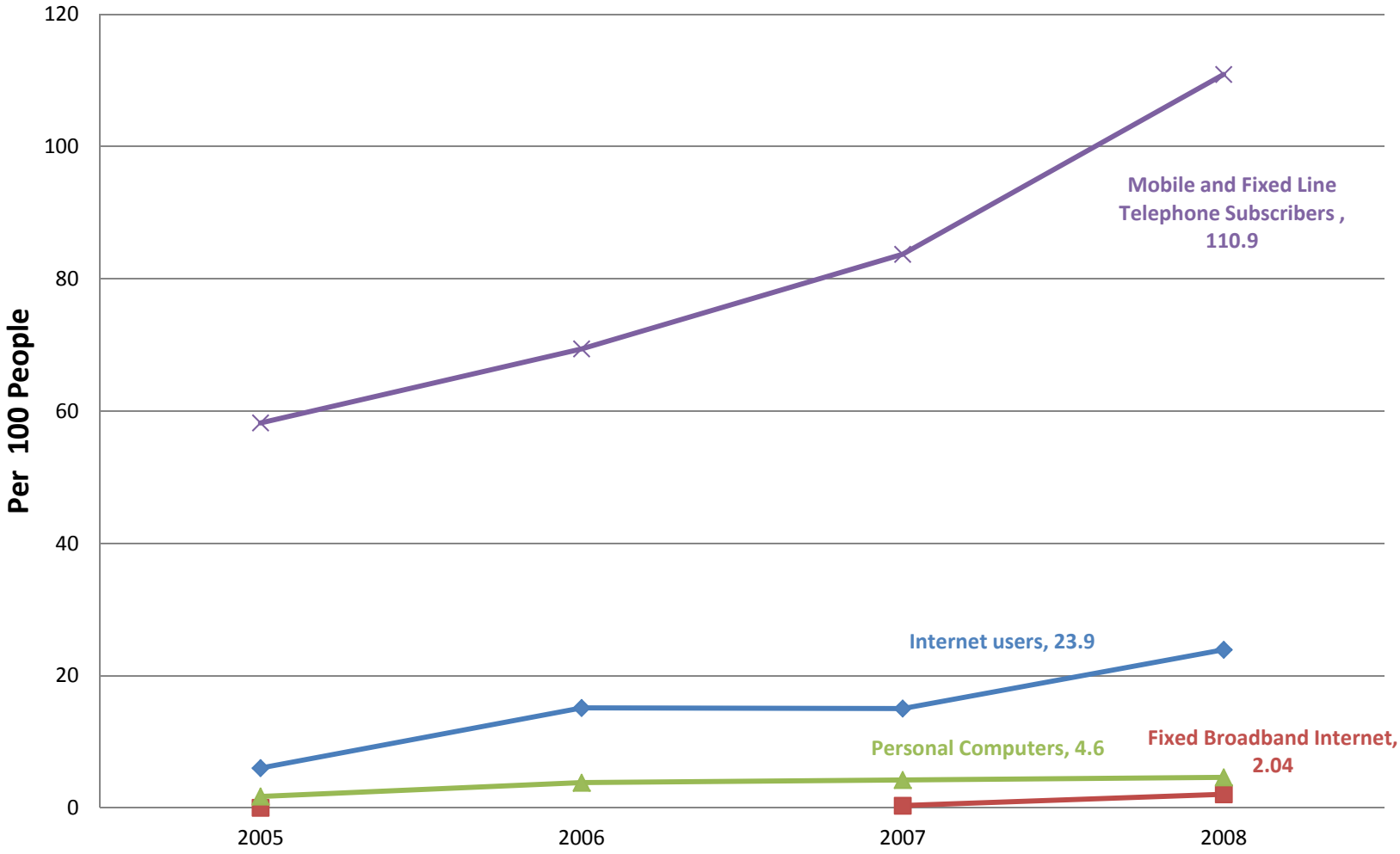
Sector Employment and Contributions to GDP



European Commission, *Albania* (November 2010).

Figure 28

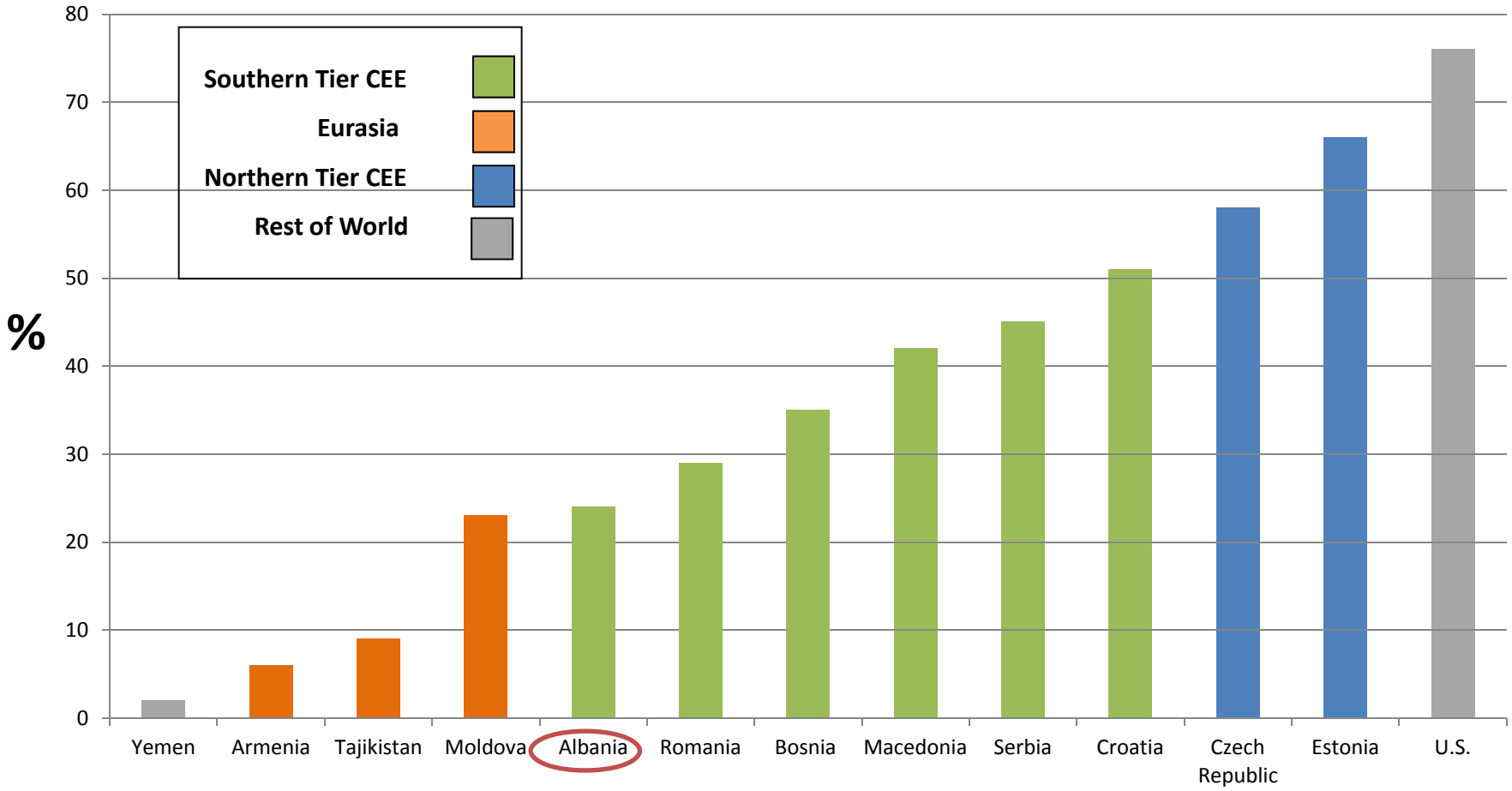
Communication Technology



International Telecommunication Union, World Telecommunication Development Report and database 2008

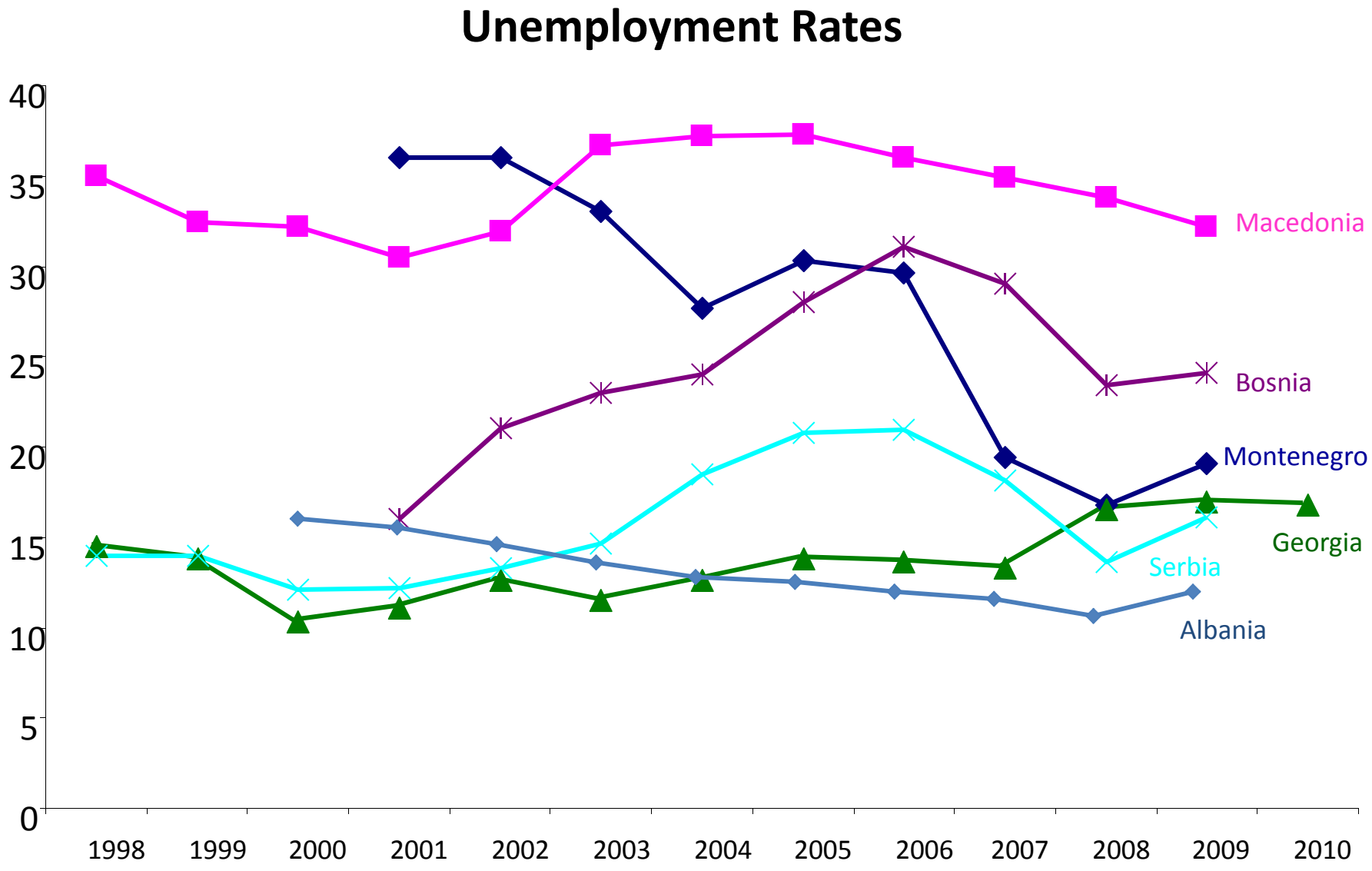
Figure 29

Internet Users



World Bank Development Indicators; 2009

Figure 30

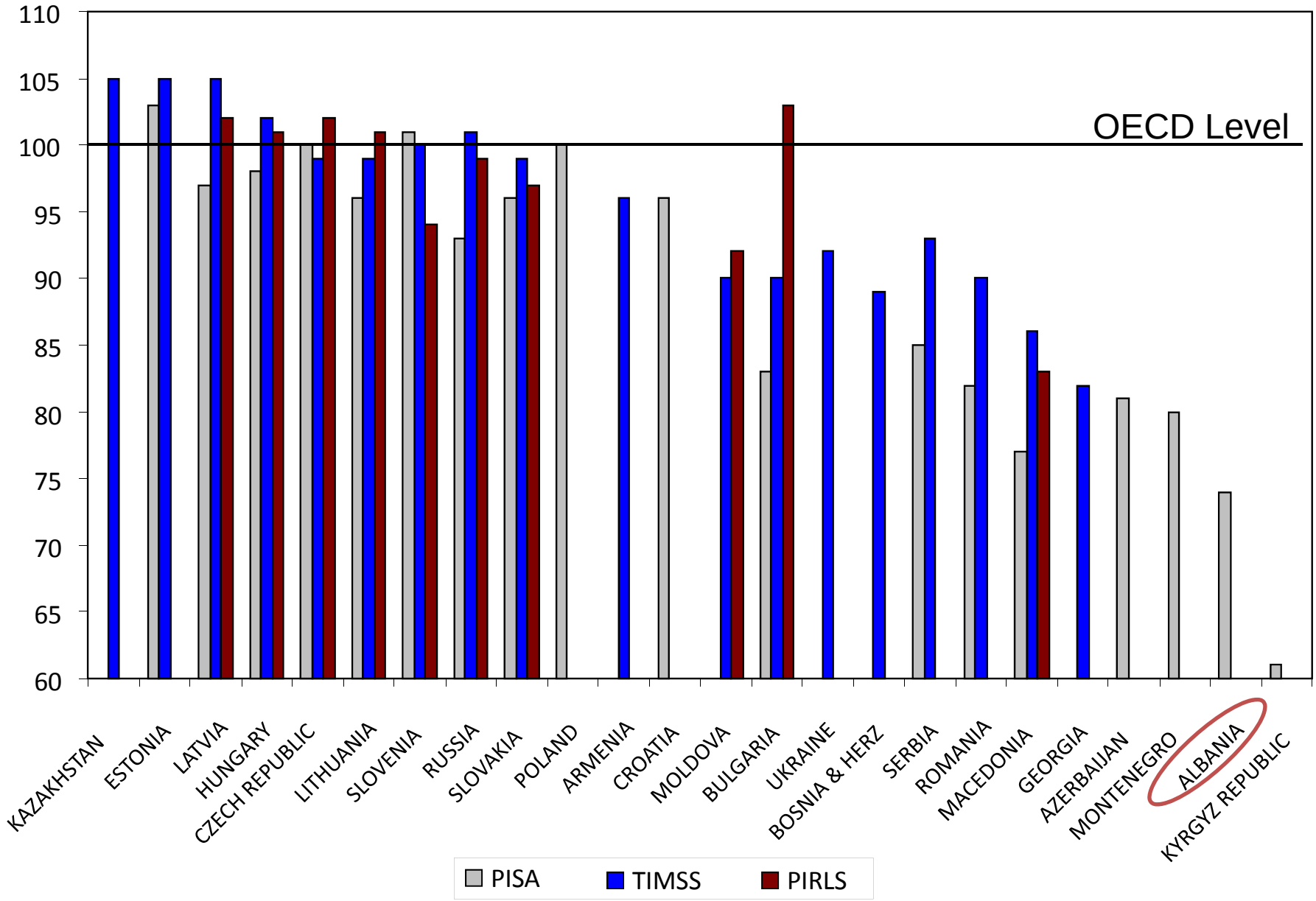


IMF World Economic Outlook (October 2010), European Commission (November 2010)

Figure 31

Functional Literacy

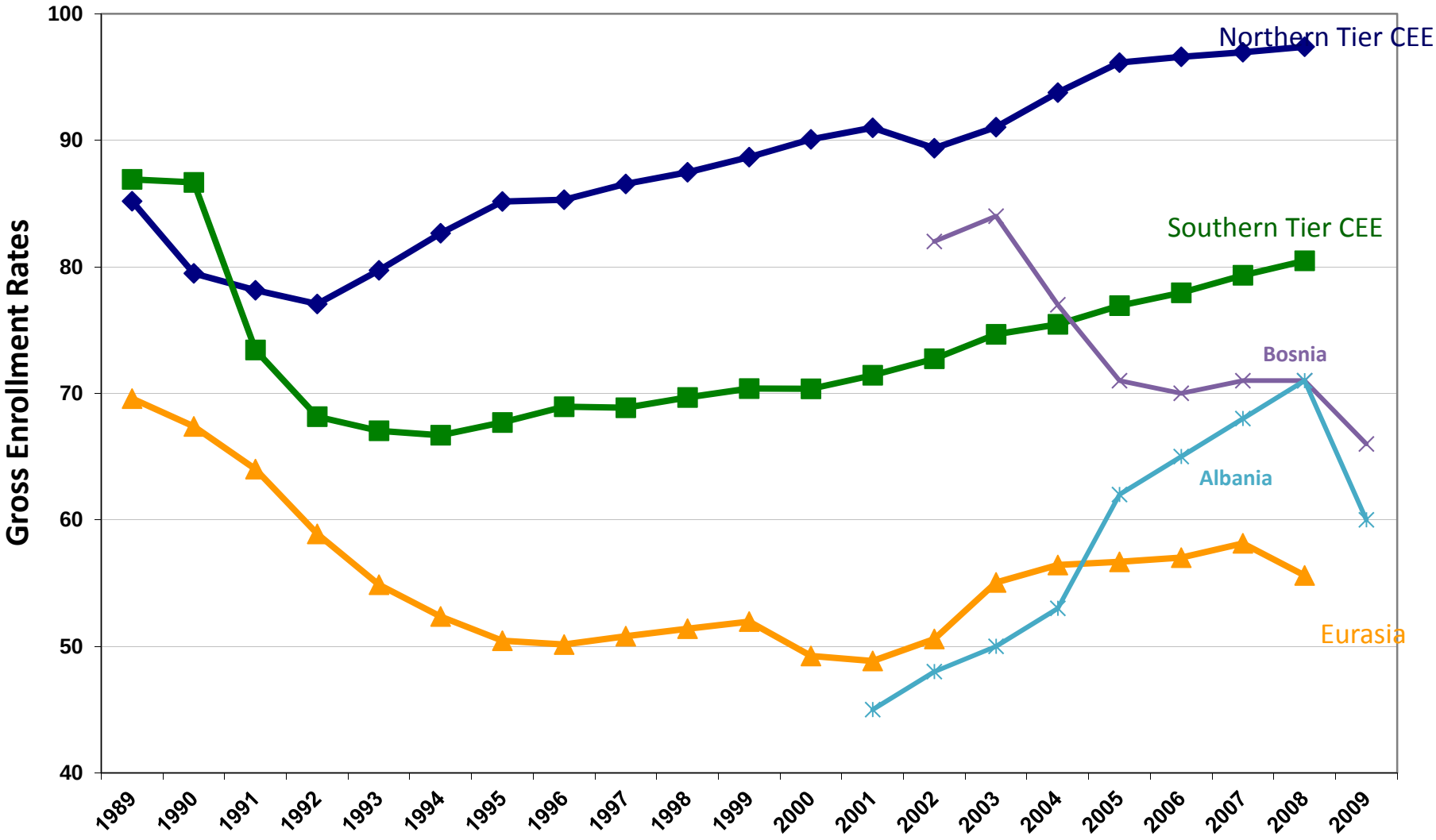
PISA vs. TIMSS vs. PIRLS



International Association for the Evaluation of Educational Achievement (IEA), *TIMSS International Mathematics Report* (2008), *TIMSS International Science Report* (2008) and *PIRLS International Report* (2008); and Organization for Economic Cooperation and Development (OECD), *First Results from PISA 2006* (2007).

Figure 32

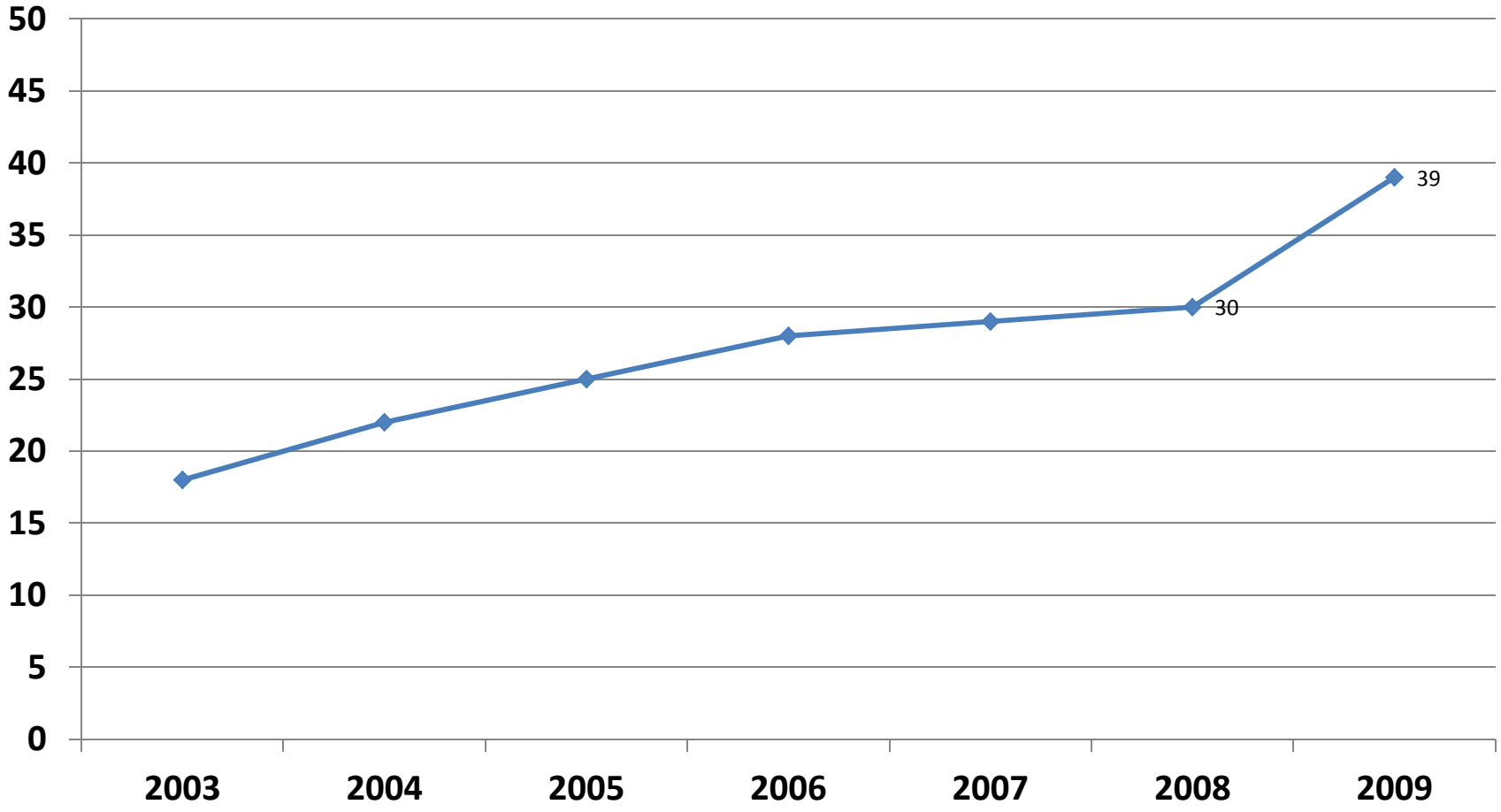
Total Secondary Enrollment



UNICEF, *TransMONEE Database* (May 2009 and earlier editions).

Figure 33

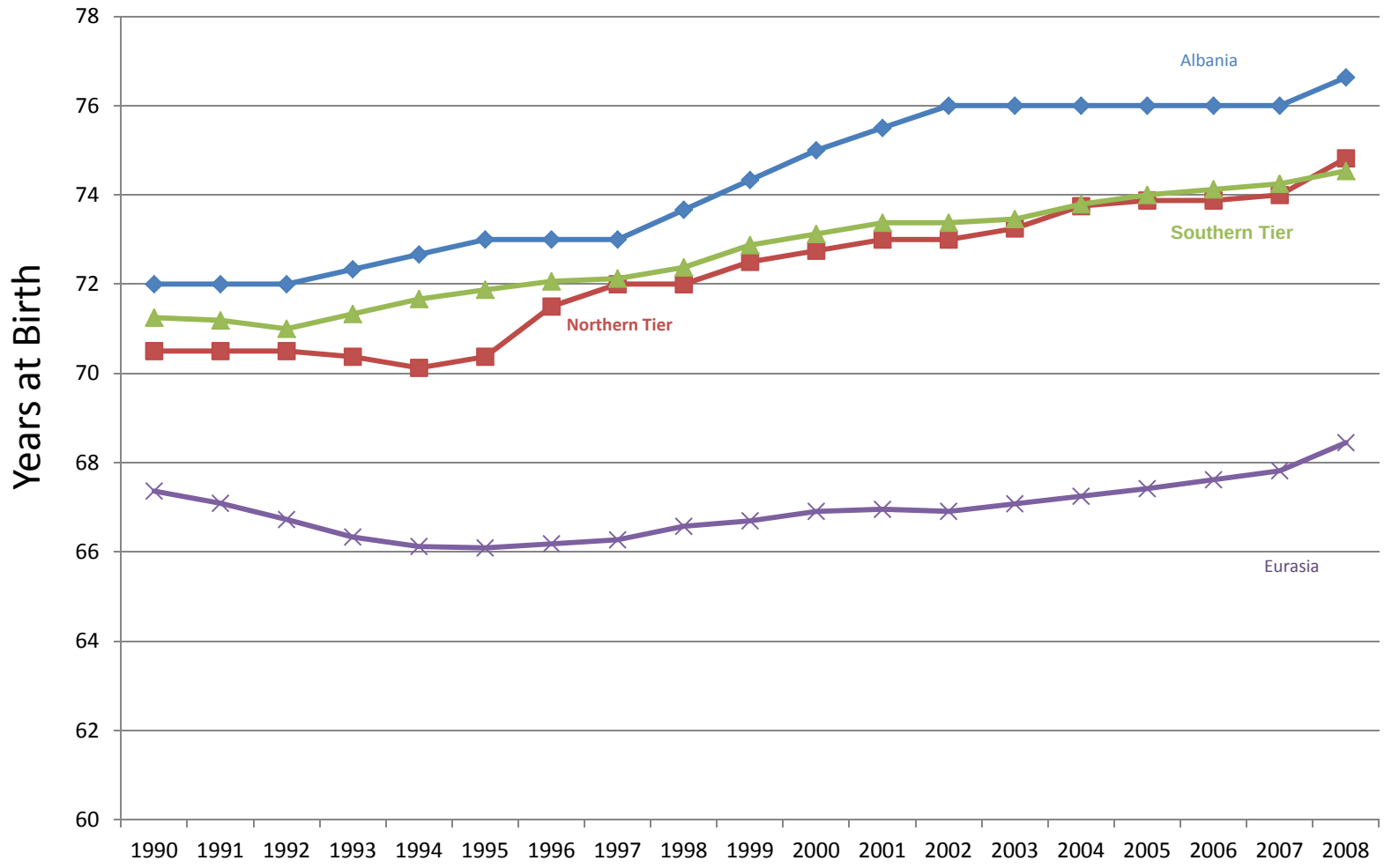
Tertiary Gross Enrollment Albania



World Bank, *Albania* (November 2010).

Figure 34

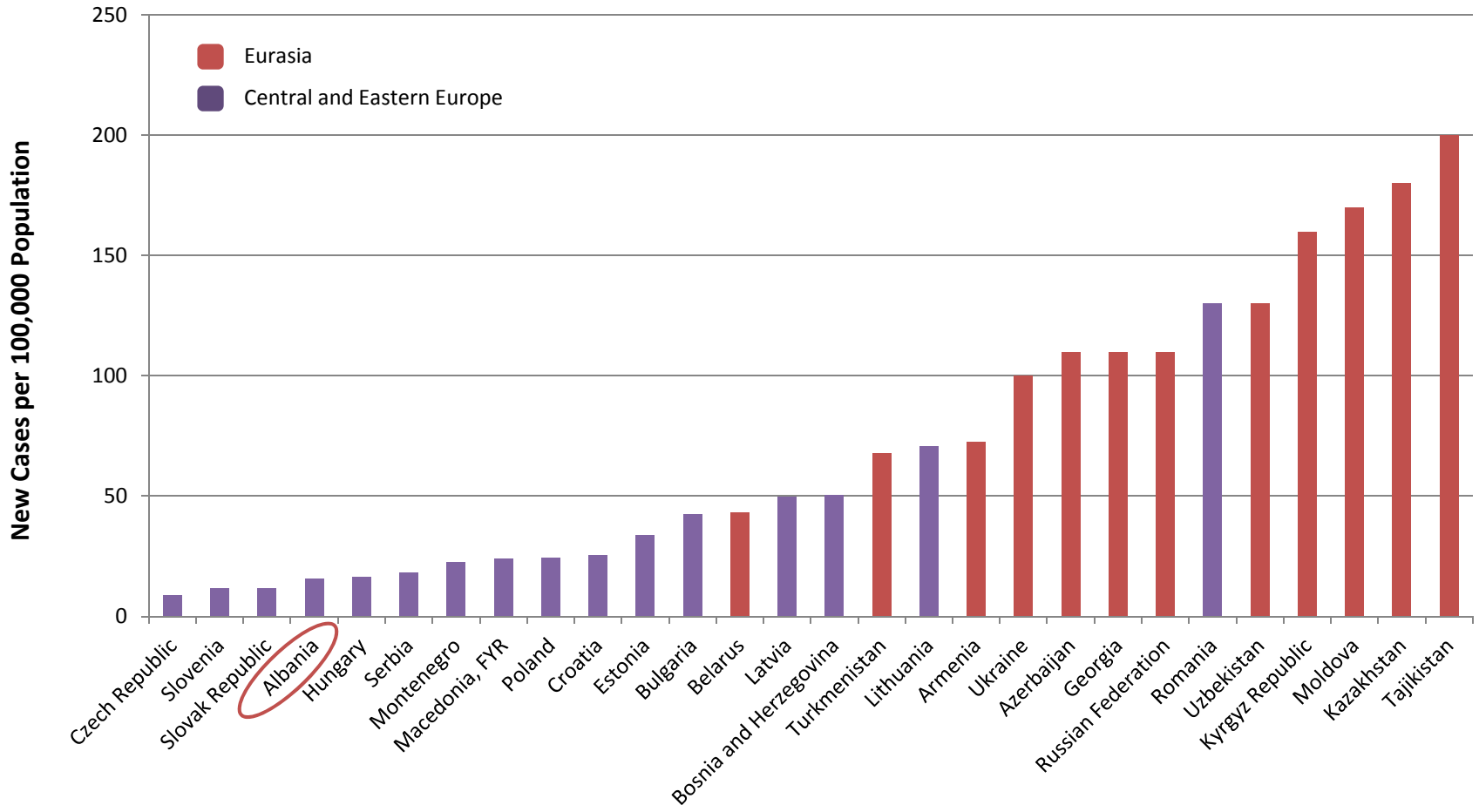
Life Expectancy at Birth



World Bank, *World Development Indicators* 2010.

Figure 35

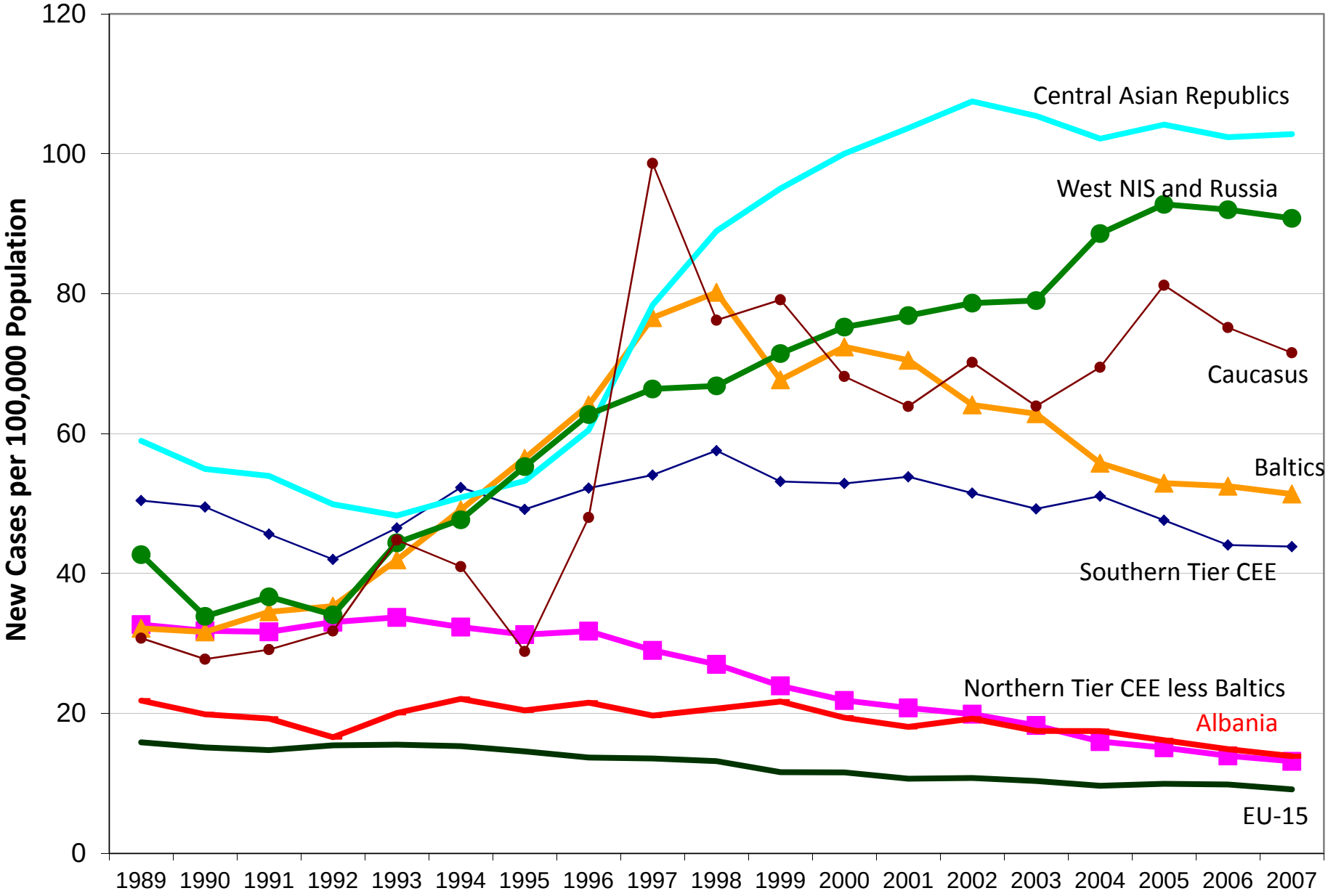
Tuberculosis Incidence 2008



World Health Organization 2008

Figure 36

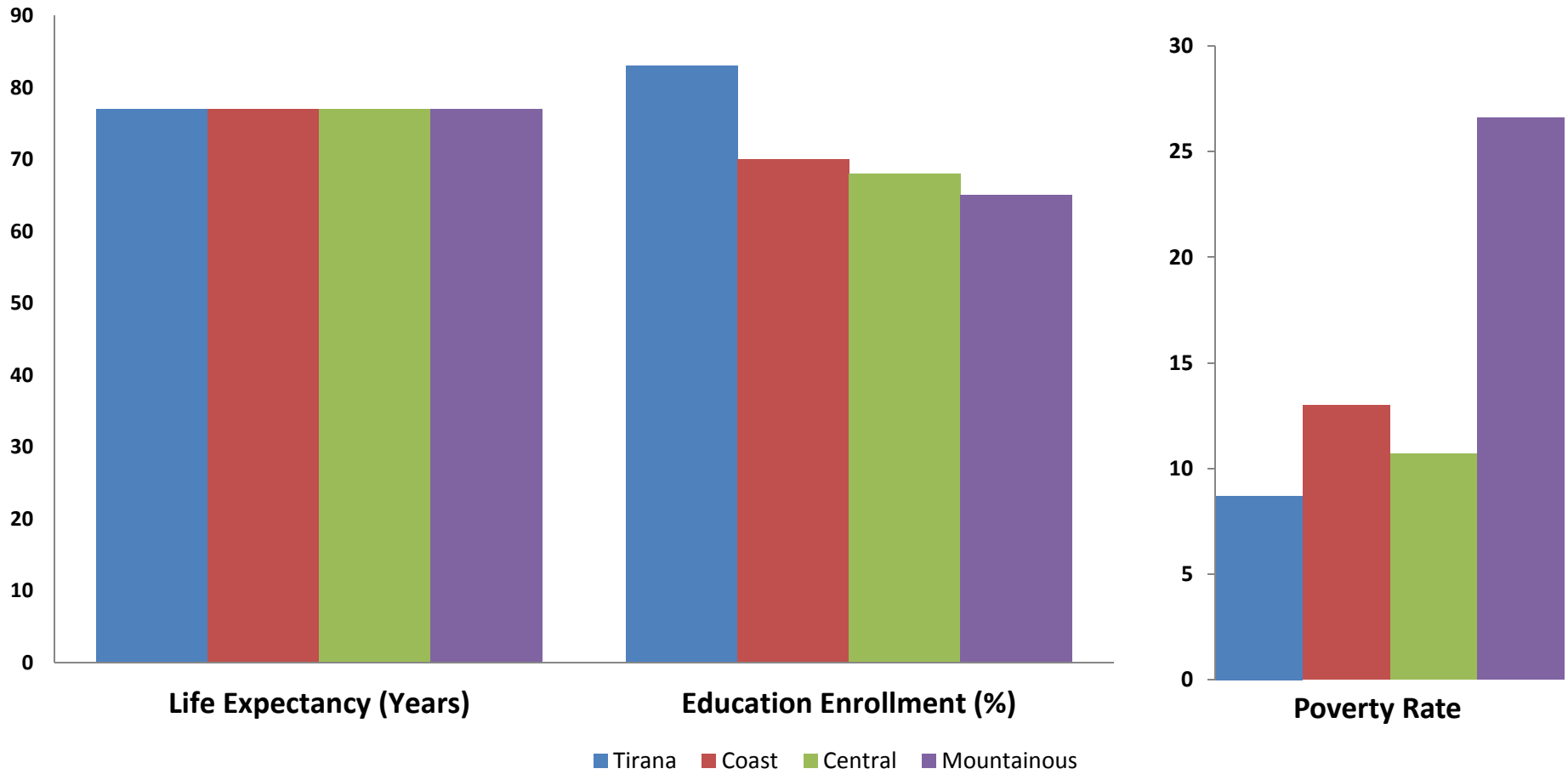
Tuberculosis Incidence



World Health Organization, *European Health For All Database* (January 2009).

Figure 37

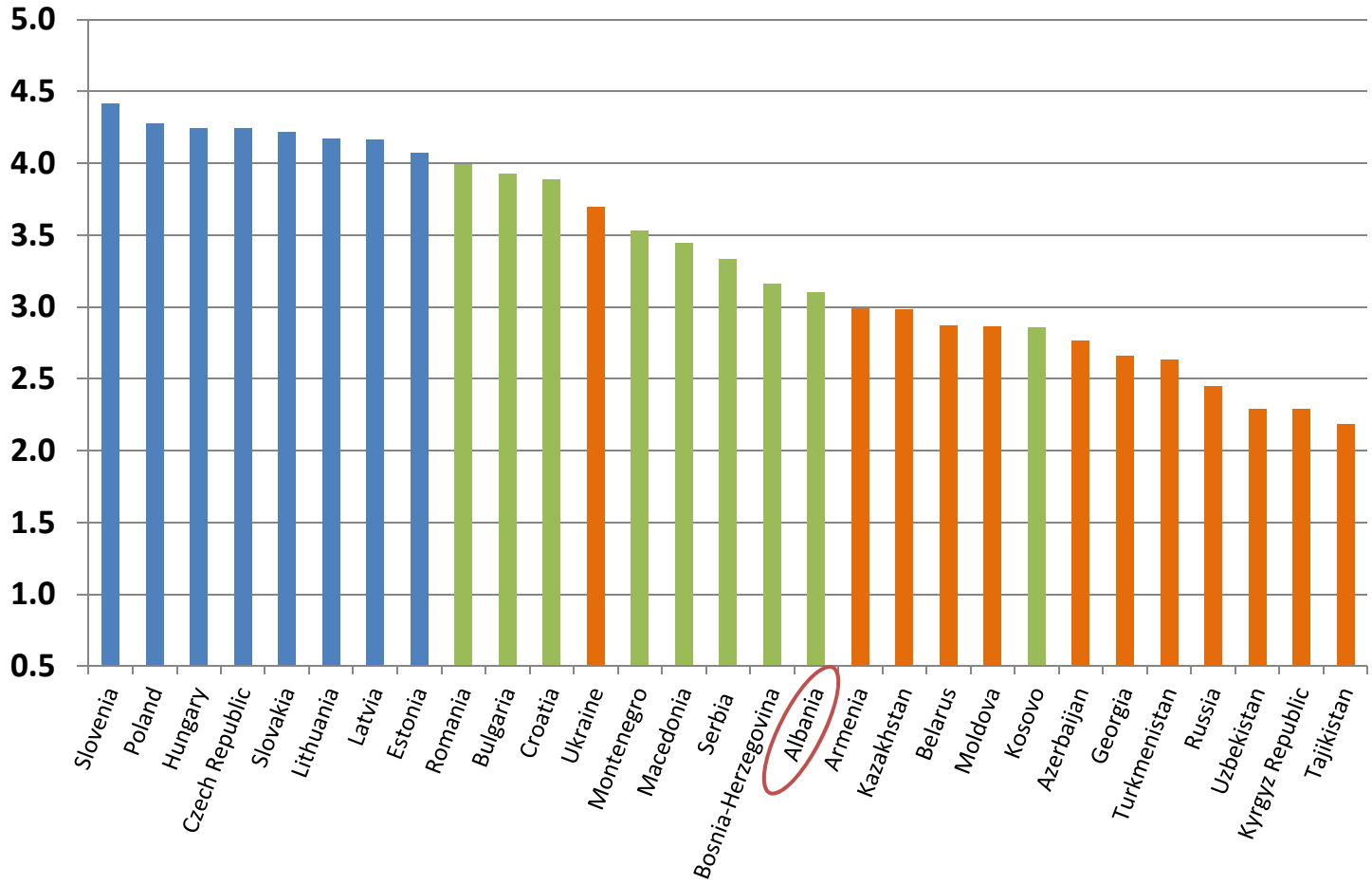
Regional Disparities in Albania



UN Human Development Report Albania (2010)

Figure 38

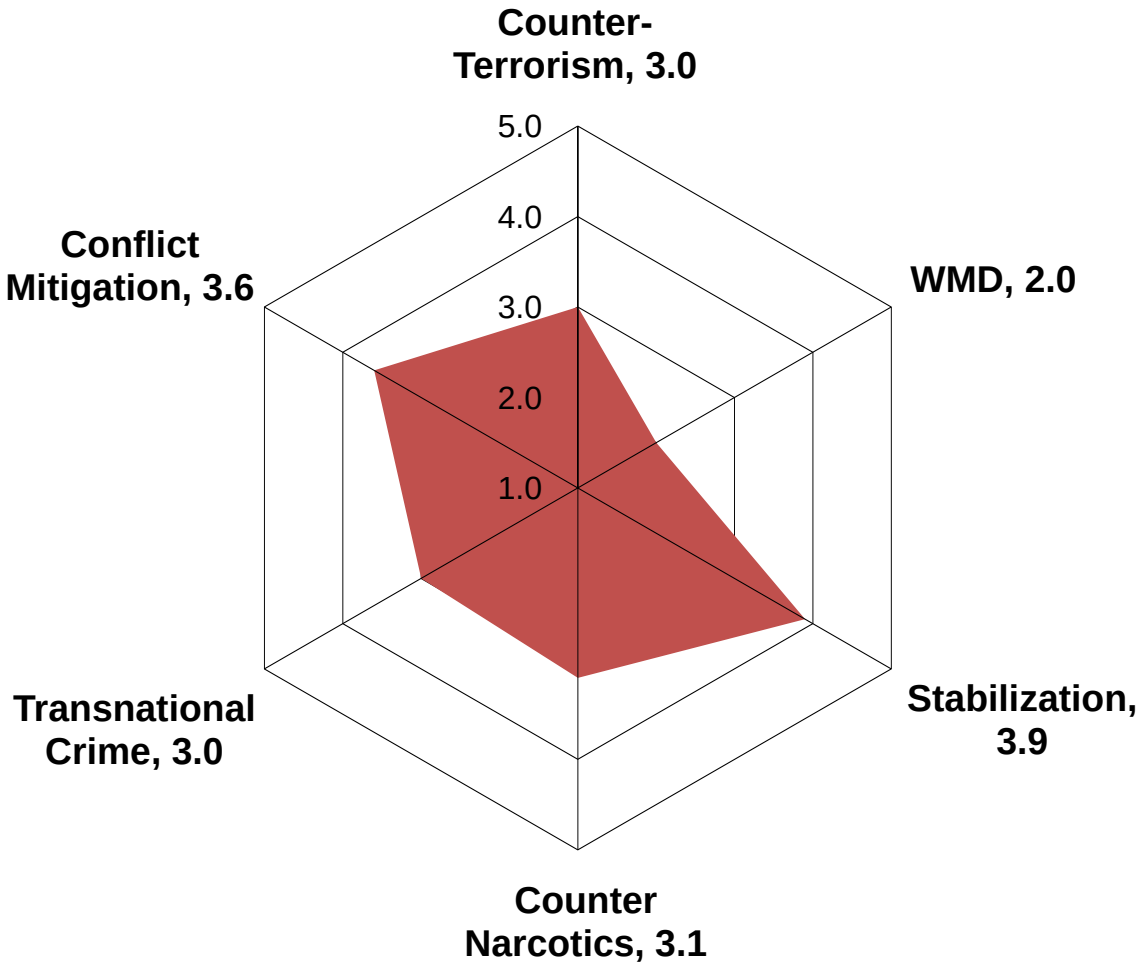
Peace and Security Score



US State Department; Foreign Policy Magazine and the Fund for Peace; World Bank; US Commerce Department; Binghamton University; UNICEF; A.T. Kearney/Foreign Policy Magazine; UNODC; USTR; George Mason University

Figure 39

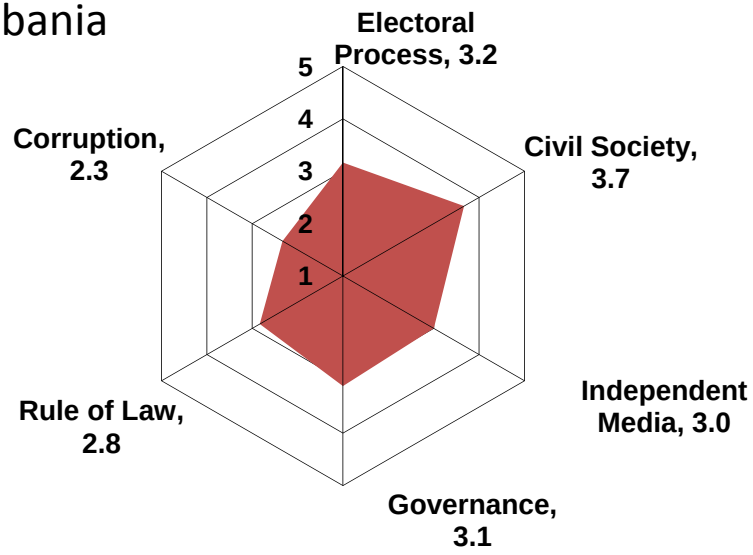
Peace and Security in Albania



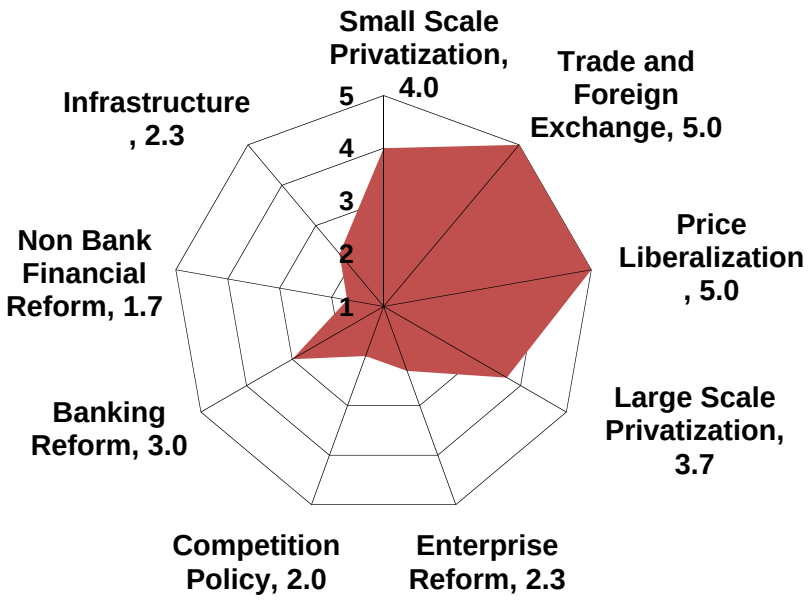
US State Department; Foreign Policy Magazine and the Fund for Peace; World Bank; US Commerce Department; Binghamton University; UNICEF; A.T. Kearney/Foreign Policy Magazine; UNODC; USTR; George Mason University

Figure 40: Albania

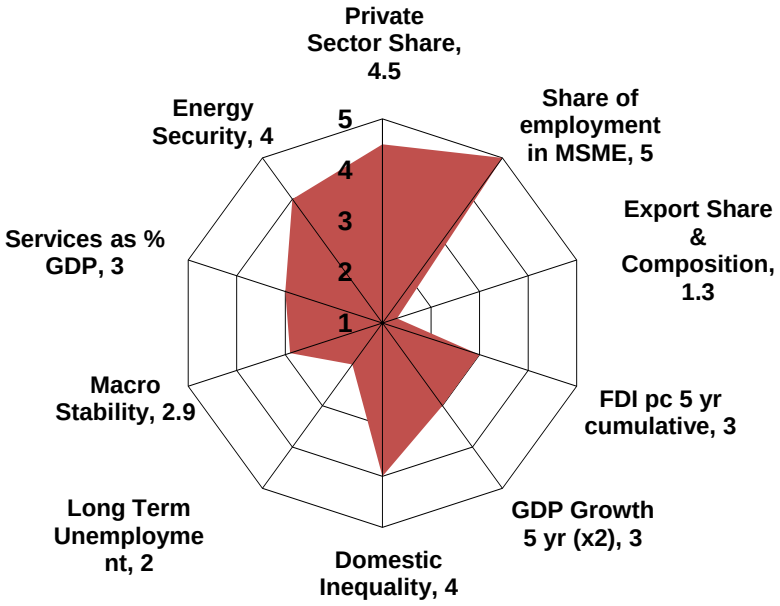
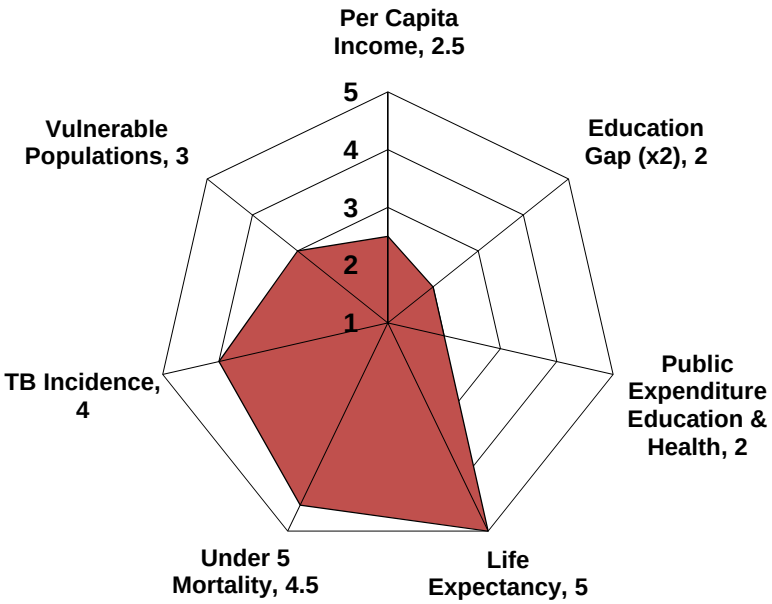
Democratic Reforms in 2009



Economic Reforms in 2010



Economic Performance in 2009-2010



Human Capital in 2009-2010