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# UNITED STATES SEED ACT ASSISTANCE STRATEGY

## FOR ALBANIA



**1993-1995**

Submitted by American Embassy Tirana  
Approved, July 30, 1993

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## THE DEVELOPMENT CONTEXT

After forty years of almost complete isolation, culminating in what may accurately be described as a state of political, economic and social collapse, the first fully democratic elections in Albania were held in March 1992. Almost simultaneously the new democratic government adopted a comprehensive program of macroeconomic stabilization and structural reform, a program which may be the most radical to be undertaken in Central and Eastern Europe. Although the nature of its transition is similar to its neighbors in the southern and northern tiers, Albania is facing a challenge of a different magnitude. It is attempting reform from an economic base far less developed, its centrally planned economy was far more rigid, its isolation was far more complete, and its population suffered full-scale suppression of human rights.

In spite of these constraints and the severe economic and social hardships of the adjustment process on virtually all segments of the society, the commitment to reform by both the government and Albanian population appears strong and firm. To be sustained, however, it must be nurtured with significant allocations of external resource flows and financing. Likewise there is also a need for some immediate, tangible benefits to demonstrate that economic and social recovery and progress are possible.

## U.S. ASSISTANCE IN PERSPECTIVE

Albania's painful transition from a centrally planned to a free market economy has only been underway since the democratic elections in March 1992. Real output has fallen approximately 50 percent since 1990 (although there are recent signs that the decline in output has been arrested). Per capita annual income is under \$400. Input supply and transport bottlenecks associated with collapse of the central planning system and dilapidated infrastructure have led to a 70 percent cumulative decline in industrial output and weak export earnings over the past three years. This severe shrinkage in production has triggered a 40 percent unemployment rate in the industrial workforce. Agriculture has replaced industry as the largest sectoral contributor to GNP (50 percent).

Agricultural output declined about 30 percent in 1990-91, crippled by the collapse of input supply and marketing channels and disruption associated with the spontaneous mass privatization and fragmentation of land plots. The dramatic drop in yields of key staple crops has resulted in food shortages in towns and cities, a gap which U.S. and EC food aid

has been critical in covering. Agricultural production recovered strongly in 1992, however, reflecting the positive impact of pricing and land ownership reforms on production. We now anticipate that food aid gradually will be phased out over the next several years as agricultural production continues to increase and input and output distribution channels are established.

Economic prospects remain clouded by on-going conflicts in former Yugoslavia which are restraining foreign investment inflows and creating the specter of a massive influx of refugees, especially from the Serbian province of Kosovo, where ethnic Albanians comprise a majority.

U.S. assistance, totalling almost \$90 million since initiation of the A.I.D. program in late 1991 (including about \$35 million in food aid), will have the greatest impact over the next three years if it continues to be focused on economic restructuring of the agricultural sector. Complementary and concurrent efforts to help Albania develop a strong market economy should also continue and expand, building the financial institutions and legal framework necessary for markets to function and to provide the fiscal base for macroeconomic stability. Market response to the range of fiscal reforms and ancillary economic incentives can be reinforced through access to credit for the emerging small and medium enterprise sector and through privatization of land, housing and state-owned enterprises. Fostering Albania's young democratic institutions is also important in order to convince the Albanian electorate that: the reform process, though painful, will lead to a better way of life; popular participation in local, regional and national government is now possible and indeed critical; those who govern should be accountable for their performance; and human rights are now respected.

#### **ROLE OF OTHER MAJOR DONORS AND LENDERS**

The U.S. Government coordinates its activities with other major donors and lenders to maximize the impact and value of total resource and financial flows to Albania and to avoid duplication of effort. In terms of estimated aid commitments over the 1991-94 period, the USG is the second largest bilateral donor (following Italy, whose contribution to date has been largely food aid). The leading multilateral donors and lenders are the World Bank (\$322 million), the European Community (\$312 million) and the European Bank for Reconstruction and Development (EBRD, \$212 million).

World Bank lending is focused on (a) analysis and advice on the macroeconomic reform program and, in the process, building institutional capacity in economic management and (b) provision of critical inputs to the primary sectors of the economy: agriculture, power

and transport. Over the next several years IDA credits will be directed towards restructuring the agricultural and industrial sectors, improving basic public services (especially health and education), and rehabilitating infrastructure. Recognizing also the need to mitigate the adverse effects of economic restructuring on the population, the Bank will implement a multicomponent poverty reduction strategy (reform of the entitlement system, micro-credit through a rural development fund, and labor-intensive public works).

EC PHARE's commitments are focused on food aid (\$169 million), as well as balance of payments support, provision of critical agricultural inputs (in collaboration with the USG and the World Bank), industrial revitalization, and humanitarian aid through European private voluntary organizations.

The EBRD strategy for 1993-94 is focusing on rehabilitating the telecommunications and energy infrastructure and supporting privatization of the chromium, on-shore petroleum and tourism industries. Advisory assistance is also being provided to the banking sector in order to create a more favorable climate for direct foreign investment.

### U.S. ASSISTANCE STRATEGY

The goal of U.S. assistance policy in Albania is to support the historic political and economic transformation which is now underway. This transformation seeks to restructure the economy based on the principles of a free market and a democratic system of governance. Over the next three years, and no doubt extending over the medium-term (five years) and even long-term (6-10 years), the U.S. assistance strategy to help Albania move towards achieving this goal gives highest priority to the following objectives:

- promoting agricultural development;
- developing a market economy;
- fostering democratic institutions; and
- at least within the three-year timeframe of this strategy, improving the quality of life through the provision of humanitarian assistance.

The rationale for selecting these development objectives is based on their importance to USG foreign policy interests in Albania and the region, their priority in the Government of Albania's economic and political strategy, and the USG's experience and comparative

advantage in these areas. The objectives are also interrelated and mutually reinforcing. Agriculture represents the primary sector which can/will respond to market economic reforms. The commitment to implement the full range of these reforms, however, requires a political will and public consensus which must be sustained in a healthy democratic climate and political system. In turn, the effects of the reforms are exerting, and will continue to exert, enormous strains on Albanian society, especially in terms of real economic hardships. It is therefore appropriate and integral to USG economic and political policy in Albania that the USG also extend a "helping hand" to the economically and socially disadvantaged segments of the population.

Within the context of Albania's starting point and acknowledging the difficulty of the road ahead to reform, the USG policy decision was taken in spring 1992 to initiate a bilateral development assistance (DA) program. This decision reflects a longer term commitment to seeing this poorest country in Europe through the transition to a restructured and dynamic economy and a strong and viable democracy. Given Albania's development needs across virtually all sectors, however, it will indeed be challenging to concentrate limited resources where they can have the greatest development impact. This strategy therefore presents program objectives which are focused and realistic.

It is assumed that the program will continue to access resources from regional projects under Support for Eastern European Democracy (SEED) legislation, supplemented by DA funding. Initial allocations of DA funding, up to US\$ 25 million, are programmed for implementation over a period of six years of the "Strengthening Agricultural Restructuring in Albania" project. Given the "special case" of Albania, however, it is foreseen that a broader portfolio of DA-funded projects will develop over the medium- and long-term.

The discussion below highlights the principal activities which support the four primary objectives of the U.S. Assistance strategy. Although it is anticipated that the activities will be undertaken within the 1993-1995 timeframe of the strategy, several will lay the groundwork for activities beyond this period. The optic, then, extends well beyond the short term.

## **I. PROMOTING AGRICULTURAL DEVELOPMENT**

The strategy for promoting agricultural development is to encourage broad-based, environmentally sound, market-oriented growth in the agricultural sector. Activities include policy reform, privatization, market and agribusiness development, and training on the sectoral dynamics of a market-based economy.

In collaboration with the World Bank, the EC and other bilateral donors, U.S. assistance will primarily consist of long- and short-term technical advisory assistance and training.

#### A. Policy Reform

The collapse of the centrally planned economy, which dictated cropping patterns, administered prices and provided inputs and markets, created a vacuum with little to take its place. The breakdown of the previous system has also put severe strains on the environment. A rapid, environmentally sound restructuring of the agricultural sector is crucial to the economic recovery of Albania. Albanian policy-makers, however, have little experience with market economies and the development of environmentally sound policies and practices.

#### **U.S. Assistance Will:**

- provide advice to the Ministry of Agriculture and Food (MOAF) in such areas as price liberalization, land use and land markets, export and investment promotion, development of environmentally sound policies and practices, formulation/implementation of an agribusiness strategy, and a methodology for privatization of state agro-industries;
- strengthen the capability of the MOAF to perform data collection and analyses for decision-making and evaluating effects of policy reforms, as well as to generate and disseminate market information;
- assist in development of an appropriate research and extension program which takes advantage of technologies which Albanians previously have not had access to, and is reoriented toward crops in which Albania has a comparative advantage nationally and internationally and will therefore likely be those which farmers will choose to produce;
- conduct an environmental assessment in order to identify possible areas for intervention such as erosion and pollution control, forest management and reforestation; and
- leverage policy reform, on an interim basis, and in coordination with other donors, continue to provide food assistance until normal supply conditions can be reestablished.

## B. Privatization

A major contributor to the serious drop in agricultural production has been a breakdown of the input delivery system. Most input and output systems have been, or are scheduled to be, privatized. In order to make them viable, strong support to this privatization effort will be required. Based on the success of the fertilizer import and distribution program, efforts will focus on privatization of the domestic fertilizer industry.

### **U.S. Assistance Will:**

- provide engineering services, spare parts, equipment and supplies to the Fier nitrogen fertilizer factory to make it commercially viable. Privatization of the factory will be a condition of this support; and
- continue to support a network of private agricultural input supply dealers by providing advice on credit, product diversification, dealership associations, connections with U.S. and other donors providing agricultural inputs and with national fertilizer factories, and procurement of inputs on the international market.

## C. Market and Agribusiness Development

In the collapse of the previous regime, state-owned agricultural cooperatives were quickly dismantled and former members took possession of parcels averaging 1.5 hectares. For agriculture to be profitable, however, farmers need economically viable areas to cultivate. As many of the small landholdings in rural areas prove to be nonviable and consolidation into larger units begins, migration to cities will occur if off-farm employment opportunities are not available. This will further exacerbate an already-serious urban unemployment problem. Agribusiness can provide both off-farm employment and markets for production. With low labor costs and proximity to European markets, good potential exists for both domestic and export production.

### **U.S. Assistance Will:**

- aid in setting up a cost-effective and accessible property registration system which will support development of a land market for consolidation of smallholdings. This will be accomplished in collaboration with the EC, the World Bank and other donors;
- promote development of agribusiness by providing advice on privatization of state-

owned agricultural enterprises, preparation of feasibility studies and provision of technical assistance to encourage investors and/or to assist newly privatized enterprises;

- assist in the establishment and strengthening of private farmer associations (PFAs) by providing advice on organization and registration, obtaining credit, use and improvement of storage facilities, agricultural practices, marketing, and training in accounting and business practices;
- provide entrepreneurial training to PFAs, individuals and firms;
- develop linkages among agribusiness firms, trade associations, PFAs and cooperatives in Albania and the U.S.; and
- make available a credit line to support the development of small and medium agribusinesses.

#### D. Training

In order to fully take advantage of Albania's shift to a free market economy and to encourage Albania's youth to remain in agriculture, changes must be made in the educational system to train the agricultural leaders and farmers of tomorrow. In addition to instruction in technical areas, they must also be trained in the skills that competition in a market economy implies.

#### **U.S. Assistance Will:**

- strengthen the Agricultural University of Tirana (AUT) with particular emphasis on the agricultural economics department by providing assistance in curriculum development, upgrading library and laboratory facilities, improving linkages with the MOAF in economic policy and agronomic/livestock research, and offering short- and long-term training of AUT faculty; and
- in collaboration with the EC, Germany and private foundations, support the revamping of agricultural high schools (initially two on a pilot basis) with advisory assistance, training and supplies.

## **II. DEVELOPING A MARKET ECONOMY**

This objective will focus on the dimensions of the transition to a market economy,

offering to Albanians in the public and private sector the analytical tools with which to devise their own approaches and base their own decisions. Activities include macroeconomic policy reform in the public sector, privatization, trade and investment, and a heavy emphasis on training to meet the demand for skilled employment in a vigorous market economy.

Constraints are multiple and will be reduced and then removed: inadequate legal, regulatory and administrative structures; weak financial markets and an unhealthy banking system; lack of management and marketing skills in the private and public sectors; and limited labor mobility due to collapse of the industrial sector and unavailable, inadequate housing.

#### A. Macroeconomic Policy Reform in the Public Sector

Efforts must continue to draft legislation and implement regulations which enable and encourage domestic and foreign marketing transactions, development of input supply and marketing channels and the protect Albania's resources base.

Largely using resident technical expertise to provide on-the-job training, complemented by short-term advisors, and working closely with the World Bank and International Monetary Fund,

#### **U.S. Assistance Will:**

- provide sound policy advice to the Ministry of Finance on issues related to macroeconomic stabilization and economic structural reform, including price liberalization, debt reduction, tax policy and administration, privatization, entitlements and subsidies, interest rates, etc.;
- enhance the institutional capacity of Albania's central government administration and banking system to develop and implement economic and financial policies based on thorough analysis of options; and
- assist Albanian authorities in efforts to integrate the Albanian economy and its public institutions with the "outside world" and international economic and financial institutions. This includes continuing to encourage the GOA to open up the financial sector to foreign participation, as it has done with the Banca di Roma and the Arab Islamic Bank.

#### B. Privatization

Sustained market development will require restructuring potentially profitable state

enterprises and dismantling those which are not economically viable. It will also require access to credit and assisting a new entrepreneurial class to acquire business skills and experience. Privatization of housing stock and development of a real estate market will also help improve labor mobility, ensuring that workers will be available where employment opportunities are created.

**U.S. Assistance Will:**

- in collaboration with the EBRD, complete the privatization of the chromium industry;
- support restructuring and privatizing other enterprises and industries where the U.S. has a comparative advantage and the potential for U.S. exports and investment;
- provide access to credit for capital investments to commercially viable small- and medium-sized enterprises (SME's) and, concurrently, provide resident business services and training in marketing, management, accounting, formulating business plans and loan applications, etc.; and
- provide technical expertise in developing the legal, regulatory and institutional environment for privatization of existing housing stock and revitalization of the housing industry.

**C. Trade and Investment Promotion**

Potential foreign investors are coming to Albania for a "look-see" but, to date, are often discouraged by, and uneasy about, recent and pending legislation related to privatization and banking; a baffling bureaucracy; and the lack of adequate infrastructure (power, water, communications, roads, accommodations, etc.).

**U.S. Assistance Will:**

- establish the capacity in the public sector to deal in the international marketplace with a view towards developing trade relationships and encouraging direct foreign investments in Albania; and
- assist in creating a climate conducive to foreign investments, including transparency in government decision-making and operations and appreciation for business ethics.

## D. Training

As the free market economy develops, so will the demand for technically trained, efficient and motivated employees. Although generally highly educated and intellectually curious, the workforce in general has become demoralized from decades of depersonalization and alienation under the centrally planned economy. The youth are uneasy about the future and when possible emigrate to seek work and the opportunity for a better standard of living. This brain drain of both white- and blue-collar workers will continue unchecked unless opportunities for training and subsequent employment open up in Albania.

### **U.S. Assistance Will:**

- continue to provide job training in specific skills (small business management, computers, english, secretarial, tourism services, auto mechanics, etc.) to those who have been disadvantaged by political persecution under the former regime;
- provide job skills training specifically targeted to employment prospects as they emerge as a result of privatization, SME development and foreign investments in light industry (agribusiness, tourism, etc.). This would be targeted to vocational training for adults in an effort to reduce the staggering rate of the urban unemployed and would be undertaken in close collaboration with the World Bank, the EC and bilateral donors; and
- provide training in market economics and management to senior- and mid-level officials in the public sector and existing and new entrepreneurs in the private sector.

## **III. FOSTERING DEMOCRATIC INSTITUTIONS**

Albania is indeed a new democracy, and its history, even predating forty years of communism and five hundred years in the Ottoman empire, is characterized by subjugation of its people. The most basic concepts underpinning democracy - popular representation and participation in governance, diversity in ideas and sources of information, the rule of law and respect for human rights - have been introduced in Albania, but support in their interpretation and practice is very much needed.

## A. Popular Representation and Participation in Governance

The 140-member Albanian Parliament is representative of the electorate, but members are unsure about how to represent their constituency. Parliamentarians' role vis-a-vis the government is also not clearly defined and understood. For example, in drafting, reviewing and enacting new legislation, the lines of responsibility between the parliamentary committee structure and various ministries are often blurred. Members often do not solicit, much less represent, the interests and views of the people in home districts. Constituents themselves often don't know how to effectively make their views known to those who represent them.

### **U.S. Assistance Will:**

- strengthen the capability of the Albanian Parliament to function effectively and efficiently as the representative body of Albanian society, including assistance to better define and fulfill its role and responsibilities.
- work directly with citizens and citizen groups to strengthen their ability to be active, effective participants in the political process.

## B. Access to Information and Ideas

While in principle Albania is now open to a diversity of information and ideas, the institutional base for making this a reality -- particularly the media and the education system -- is still weak. Free, independent newspapers and broadcasting have yet to be established on firm foundations. While the print media may not be in a position to effectively absorb further A.I.D. assistance, the broadcast media could use help in developing more independence from its major financial sponsor -- the Government. In terms of education, reform of the school system has hardly begun -- in most schools, Marxist teachers, books, and course content remain entrenched. In addition, there is virtually no Western-level training available in the social science fields essential to the building of Albania's first democratic institutions and a free market economy. Other donors, particularly the World Bank, are taking the lead in the education sector, but there remains a role for A.I.D. assistance.

### **U.S. Assistance Will:**

- support university-level education in the social science fields (particularly law, economics, business, political science, public administration, sociology/social

work, and journalism) to expose a new generation of leaders in education, business, the media, and public service to modern social science concepts.

- Support the teaching of English and the translation of educational materials into Albanian, as a means of increasing Albanians' access to new information and ideas.
- assist the broadcast media, which reaches large segments of the Albanian population, in becoming more independent in its programming and editorial policies.

### C. Rule of Law and Respect for Human Rights

#### **U.S. Assistance Will:**

- continue assistance in legal and judicial reform, concurrently addressing such political issues as taxation, land privatization and restitution; and
- assist in defining the role(s), responsibilities and functioning of the federal government, especially in the administration of justice and protection of human rights (the court system, criminal code, administrative law, family law, citizenship, etc.).

### IV. IMPROVING THE QUALITY OF LIFE

Albania is the poorest country in Europe in terms of not only basic statistics related to production levels, GNP, per capita income, etc., but also in terms of access to basic foodstuffs, basic social services (especially adequate health and education systems) and public utilities (especially water and electricity). In the latter cases, access may be limited and/or nonexistent. Remittances from abroad in cash and kind (clothing, medicines, etc.) provide critically important relief, but not all Albanians are lucky enough to have a supplemental source of support and income. It is also documented that Albanian women are discriminated against (e.g., last hired and first fired) and disadvantaged (e.g., little or no access to family planning and childcare services, no property rights unless head of household, etc.).

#### **U.S. Assistance Will:**

- in coordination and collaboration with the World Bank and other donors, support implementation of the Ministry of Health's health sector strategy; of

particular interest is examining options to manage and administer the University Health Center in Tirana through a partnership with a U.S. medical center;

- favorably consider requests for emergency food assistance targeted to those rural and urban populations which are most nutritionally at-risk (especially infants, children and mothers);
- recognizing that (a) the Ministry of Health's budget is allocated primarily to meeting health personnel costs and (b) the domestic pharmaceutical industry requires significant investment to again function, favorably consider providing emergency supplies of medicines and medical equipment to support the sustained provision of the most rudimentary curative and preventive health services;
- implement a Women in Development strategy for Albania to address issues such as the legal status of women, women's health, access to financial services and credit, etc. within the context and framework of the program portfolio of projects and activities; and
- support the efforts of U.S. and Albanian private voluntary organizations to design and implement activities directed to improving the quality of life of specific beneficiary groups (e.g., the blind and sight-impaired, street children, etc.).

## POLITICAL ANNEX

Albania, the last Balkan nation to free itself from Ottoman rule, has a long and brutal history of foreign domination. Most recently it was invaded by the Italian Fascists in 1939, who together with the Germans occupied it until the close of WWII. This history was exploited by the Communist dictatorship under Enver Hoxha to justify repressive and isolationist policies which over a period of 45 years from 1946 to 1991 all but destroyed the country's political and economic institutions.

After Hoxha's death in 1985, Albania began a slow and grudging opening up to the West under President Ramiz Alia. In December 1990, student protests in Tirana forced the regime to legalize opposition parties, the largest of which, the Democratic Party, was formed a few days after the demonstrations. (At present, there are five political parties represented in the parliament -- Democratic, Socialist, Unity for Human Rights, Social Democratic, and Republican -- as well as numerous smaller parties which do not have parliamentary representation.)

In February 1991, the government agreed to hold multi-party parliamentary elections on March 31. The elections resulted in a victory for the Party of Labor (Communists), but irregularities including the lack of access to mass media for the opposition tainted the victory and led to further civil unrest including a general strike later in the spring. In June 1991, the Democratic Party was invited to participate in a coalition government of "national stability" under Prime Minister Ylli Bufi. Alia retained his position as President. In December 1991, the Democrats, followed by other political parties, decided to pull out of the government and seek immediate elections. Alia agreed to Presidential as well as parliamentary elections in March 1992.

In the March 1992 elections, a coalition of non-communist parties headed by the Democratic Party and its popular leader, Dr. Prof. Sali Berisha, swept to a convincing victory, and soon thereafter formed a government under Prime Minister Aleksander Meksi. In April 1992, the parliament with a two-thirds vote named Berisha to replace Alia as the President of the Republic of Albania.

The government under Prime Minister Meksi has worked hard to address the legacy of almost a half century of brutal, totalitarian rule. The parliament, despite its lack of experience, staff and equipment, has passed over one hundred pieces of legislation. The central Ministries, which had roles and capabilities secondary to the Communist party machinery, have begun to exert more influence and take a more active implementation posture. The Meksi government moved aggressively to replace functionaries from the

previous system with professional technicians, but soon found that the task of finding competent and trained people was not as easy as expected. To this day many positions have gone unfilled, and officials at their jobs have been overwhelmed by the extraordinary workload of introducing a market economy and democracy from scratch.

Meanwhile, the Democratic Party, which had been an extremely broad-based, anti-communist political and social movement, began to experience internal problems. Various factions disagreed with one another about personalities and about the pace and scope of the breathtaking reforms underway. After a mixed showing in the July 1992 municipal elections, the PD went through several personnel changes which resulted in the removal from the party of several of the better known figures who had represented the PD in the 1991 Government of National Stability.

The removal of these persons was considered by some political observers to signal an authoritarian trend within the Democratic Party. This characterization is vigorously refuted by others who cite the inevitable difficulties of holding together such a broadly based political organization which had been established to defeat a well-disciplined communist force. The problems and disputes have been exacerbated by the way in which political players deal with each other, accusing opponents with corruption on the basis of scant information.

Albania has a long way to go before it can be said to have the requisite institutions that would make it a modern democracy. Nonetheless, during the past year, enormous strides have been made in all fields, which augur well for this transitional country to become a full democracy.

## ECONOMIC ANNEX

**Overview:** The Albanian economy made significant strides in its transition from a centrally planned to a free market economy in 1992. There are strong indications that the free fall in output which began in 1990 has been arrested. Real output fell only by about 8% in 1992, after a cumulative decline of almost 40% during the preceding 2 years. In fact real GDP grew by an estimated 2% during the last 6 months of 1992. After a significant 2-year production decline associated with the collapse of input supply and marketing channels (as well as by the disruption associated with the spontaneous mass privatization and fragmentation of land plots), the agricultural sector appears to be responding positively to pricing and land ownership reforms. Agricultural output expanded by approximately 13% in 1992, as the production of fruits, vegetables, milk and meat returned to pre-crisis levels. By year's-end approx. 75% of arable land was in private hands, and 43% of private holdings were titled.

Industrial output, however, continues to decline. Input supply and transport bottlenecks associated with a dilapidated infrastructural base, and collapse of the central planning system have resulted in a two-thirds reduction in industrial production since 1990, weak export earnings capacity and an unemployment rate of about 40% among the industrial workforce. With the severe shrinkage in industrial production agriculture now represents the largest sectoral contributor to GDP (50%); while the share of industry has dropped to about 25%. Annual exports in convertible currency (mostly mining and primary energy products) fell by about 12% in 1992, reflecting the continuing decline in the output of state owned enterprises. The economy has been supported via large-scale donor commodity assistance and unexpectedly large private remittances that stabilized import capacity over the past year. During the 1992-93 agricultural year, food aid represented about 20% of GDP.

**Fiscal Restructuring:** The collapse in public enterprise output led to a severe shrinkage in the government revenue base during the 1990-91 period, with the fiscal deficit reaching 42% of GDP during the first half of 1992. Through a reduction in consumer price subsidies and deep cuts in real expenditure levels, the fiscal deficit was reduced to 22% of GDP by year's-end. The introduction of modernized taxation policies and the overhaul of the tax administration system remain fiscal reform priorities; as do the introduction of a rational public investment prioritization system, and streamlining of income maintenance programs (which currently represent about 15% of GDP).

**Monetary/Exchange Rate Policy:** Since mid-1992 the Central Bank has kept monetary expansion under firm control, by limiting the expansion of credit to the public enterprise sector and enforcing bank-specific credit ceilings. Largely in response to tight monetary

conditions, a large volume of inter-enterprise arrears began building up within the banking system during the latter half of 1992. In response the GOA has introduced major payments system reforms designed to prevent a further expansion in inter-enterprise arrears (including a new payment order system whereby banks can reject any order not backed by sufficient funds and a new law on supplier credits). The reforms appear to have succeeded in stemming the buildup in arrears over the past several months.

The exchange rate was floated in August 1992 and, after a rapid appreciation of about 30%, has remained reasonably stable over the past six months (reflecting the improvement in underlying fiscal and monetary management policies). Inflation started off at 10-15% monthly during the first few months of 1992, but was moderated to the 4-5% monthly level during the latter stages of the year, for an annual rate of roughly 300%. The rate continued to decelerate over the first quarter of 1993 (falling to 0.9% in March 1993), and the annual rate for 1993 is currently estimated at just 45%.

**Structural Adjustment Policies:** The GOA made significant progress in 1992 in implementing key market-oriented institutional reforms. Bankruptcy and company laws were passed, as well as a central bank law and a comprehensive banking law establishing a two-tiered banking system. A liberal foreign investment law was enacted (although one provision in the law permitting state regulation of investments which are determined to be detrimental to "public order...and morals" is dangerously open-ended). Legal reforms permitting land sales/rentals still require passage, as do regulatory reforms establishing modern civil and commercial codes. Most prices have been fully liberalized, and the handful of basic consumption and other 'essential' items which remain under control have been raised significantly during the past year.

Significant progress has been made in the privatization of small-scale service sector and trade activities. However little headway has been made in restructuring and privatizing larger-scale public enterprises. The GOA is currently developing an enterprise and financial sector restructuring strategy within the context of ongoing FESAL negotiations with the World Bank. A central component of the strategy would be the establishment of an enterprise restructuring agency which would manage the financial and management restructuring or (where necessary) liquidation of problem enterprises; and provide financial support to troubled enterprises through direct on-budget transfers.

Implementation of the strategy would be accompanied by a final inter-enterprise arrears clearing operation, and replacement of the nonperforming loan portfolio of commercial banks with interest-bearing government bonds (the commercial banks have been largely decapitalized as the result of the buildup of uncollectible loans to state enterprises). The rapid adoption of a systemic approach to the enterprise restructuring and bank

recapitalization process is necessary in order to permanently eliminate incentives for the funneling of cheap credit to large state-run operations. The GOA is attempting to promote greater competition in the banking sector via the establishment of joint ventures with foreign banks.

The current GOA faces a major external debt arrearage problem, having inherited some \$430 million in arrears (primarily commercial obligations) built up during the 1989-91 period as the country sought to shore up its declining reserve position. Resolution of this issue will be critical in facilitating the reopening of access to commercial credit.

### ANNEX III: OVERVIEW OF THE AGRICULTURAL SITUATION

During the 1980s, agriculture generated approximately 35 percent of GDP. After the collapse of industry, it now contributes around 50 percent of GDP and employs over 50 percent of the population. With most of the machinery in the industrial sector outdated or destroyed, and the infrastructure needed for development of tourism years away, agriculture represents the quickest and most logical path to economic recovery. Albania's land is fertile and the population is well educated. Albanian farmers are familiar with mechanization and use of fertilizer and other inputs. These were important elements of the state farm and collective cooperative systems. With proper economic incentives and the infrastructure to deliver credit and inputs and to market production, a rapid supply response in the agricultural sector can be achieved.

However, in order for this to happen a number of serious problems have to be overcome. The collapse of the former economy, which planned cropping patterns, administered prices and provided inputs and markets, created a vacuum with little to take its place. State-owned agricultural cooperatives were quickly dismantled and former members took possession of parcels averaging 1.5 hectares. Reform of these former cooperative farms created approximately 1.2 million parcels divided among 300,000 families (most families received two or more parcels). These smallholdings cover over 75 percent of arable land and account for 40 percent of the national labor force. There is currently no legal mechanism for consolidation of these small parcels, and the resulting small plots caused many new landowners to revert to subsistence farming. Farmers are concentrating on crops which are easily consumed, processed and stored on the farm, and for which prices have been liberalized. Many who are growing wheat, the main staple, save it for home consumption or store it in anticipation of higher prices. The fragmentation, combined with a lack of credit, inputs and a breakdown of the input and output delivery system, led to a 20-30 percent drop in agricultural production between 1989-91. Agricultural production did increase by an estimated 12-13 percent in 1992, but much of that production was either consumed by the farmers or stored in case of an emergency or in anticipation of higher prices.

State farms occupy 23 percent of all arable lands and some of the best agricultural land in Albania. In addition to poor management and uncertainty about their future, they suffer from many of the same problems as small farmers. While a few have managed to find partners for joint ventures, most are barely functioning. An October 1992 law authorized the distribution of state farm lands to workers. Implementation of this law will fragment some of Albania's most productive land.

In an attempt to overcome some of the difficulties facing small farmers, a number

have grouped together into private farmer associations (PFAs). These groups are organized in order to request credit, purchase farm supplies, consolidate production, purchase or rent equipment and to access markets. Given the lack of business experience, most of these are hardly operating. However, with proper support these PFAs can provide a cost-effective mechanism for reaching a large number of smallholders with extension and agribusiness services.

The breakdown of the previous system has also put severe strains on the environment. Deforestation is rapidly becoming a serious problem, as uncontrolled cutting has been aggravated by fuel shortages. Livestock owners are rapidly increasing the size of their herds to the detriment of pastures, which cover approximately 58 percent of Albania's arable land. Soil erosion is also a serious problem on Albania's steep slopes. There is almost no environmental institutional framework. Responsibility for environmental protection rests with a committee in the Ministry of Health and Environment which is weak and understaffed. The Ministry of Agriculture and Food (MOAF) is responsible for forestry, while the Ministry of Tourism is accountable for public parks. There are no laws or standards for fertilizer and pesticides, soil protection, or solid and hazardous waste disposal.

A rapid, environmentally sound restructuring of the agricultural sector is crucial to the economic recovery of Albania. Albanian policy makers have little experience with market economies and privatization and have requested assistance in these areas. The Agricultural University has also requested assistance to upgrade and revamp its curriculum towards a free market economy. Research by both the MOAF and university needs to take advantage of advances in technology, and to be reoriented toward crops in which Albania has a comparative advantage nationally and on the international market. Farmers need training in decision-making, marketing, storage and basic business practices. Infrastructure must be put in place to provide access to credit and other inputs and markets for production. Formal land ownership has to be secured and land markets created to allow for consolidation of smallholdings. The agro-industrial sector needs to be developed to provide off-farm employment as small plots are combined. The capacity to assure that environmentally acceptable practices are being instituted must also be put in place.

In close collaboration with other donors working in the agricultural sector, U.S. assistance will address these constraints by concentrating on activities which support policy reform, privatization, market and agribusiness development and training.

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