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# Albania

## Building Competitiveness in Albania

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## 1. APPAREL AND FOOTWEAR

*Despite ongoing strong export growth in recent years and accounting for around 50 percent of Albanian exports, the apparel and footwear sectors are still characterized by extreme reliance on re-exporting to Italy based on low labor costs assembly operations. There is limited evidence of upgrading with total value-added for the sector (24 percent) at the same rate as it was in 2000, relatively few firms moving beyond assembly operations to selling directly to foreign wholesalers, and no national private labels having been established. Upgrading has been limited for two reasons: First, exposure to foreign knowledge has been limited with FDI in the sectors decreasing and with limited spillovers to the local economy, while imports of capital equipment are low by regional standards. Second, the absorptive capacity of Albanian firms is hindered by their low technical capabilities (internal to the firm) and key aspects of the investment climate. This, in turn, implies there is scope for carefully targeted public interventions to promote the strengthening of the technological capacity of firms in the sector to enable them to upgrade faster.*

*Key policy actions to enhance technological upgrading and competitiveness in the footwear and apparel sectors:*

- (i) Ensure the reliability of electricity supply, perhaps through the establishment of industrial sites with adequate infrastructure that can also encourage stronger backward linkages and spillovers between large production firms and sub-contractors and suppliers.*
- (ii) Increase supply of skilled worker and technicians by including private sector in reform of vocational education system.*
- (iii) Address the key aspects of the business environment that hurt apparel and textile export disproportionately namely tax policy and implementation (i.e. VAT reimbursement for imports of equipment and inputs especially).*
- (iv) Support the development of financial instruments tailored to export-oriented firms that allow them to make long-term investments to upgrade (i.e. guarantees for working capital).*
- (v) Consider establishing a simplified, but carefully targeted and properly implemented incentive regime for the sector aimed at (a) Attracting technology-intensive FDI in light of the incentives offered in regional competitors; (b) promoting learning and technology upgrading by local firms (i.e. firm level training, reimbursement of capital imports)*

## 1. INTRODUCTION

1.1 **The apparel and footwear industries were two of the main industries of the Albanian economy prior to the onset of the transition in 1990.** Before 1990, the state-owned enterprises operating under a planned economy produced a fairly wide range of products of the value-added chain, such as fiber and leather and even final products for domestic consumers. After 1990, the state-owned enterprises were privatized and all enterprises are now private, with activities concentrated on production

under the EU outward processing regime of clothes and footwear uppers, which comprised almost 50 percent of Albania's exports in 2007. By contrast, domestic consumption of garments and footwear are being met primarily by imports.

**1.2 Labor-intensive apparel or garments are more widely produced in Albania and exported than textiles that are relatively more capital-intensive.** The textile industry is generally understood to cover fiber production, spinning, weaving, dyeing and fabric finishing. Chemical chips, fibers or yarns are the raw materials and the companies sell products like fibers, yarns, fabrics, non-wovens or home textiles. The apparel industry buys yarns, in the case of a knitwear manufacturer, or fabrics and sells readymade garments. Textiles and apparel are usually separate parts of the production network, with the exception of knitwear, where often, but not always, the same company knits the material and produces the readymade garments as well. The focus of this study is on apparel that accounted for 97.7 percent of Albania's total textile and apparel exports in 2007. Of total apparel production, in 2007, just under US\$ 294 mln were exported, accounting for 27.3 percent of total exports in the same year. In 1999, textile and apparel exports amounted to US\$ 98.4 mln, or 35.7 percent of total exports. During this period, average annual export growth since 1999 reached 15.3 percent.

**1.3 Footwear and leather exports have also grown significantly in recent years although linkages between footwear exporters and leather product exporters are very limited.** Footwear and other leather products are also frequently put together given the growth in the production of shoes with leather uppers in recent years from Albania and which are among the highest exports amongst the footwear sector. The leather industry, supported by the increasing number of bovines, has experienced a growing level of exports of semi-finished products but these are driven primarily by re-exported products organized and marketed by foreign investors and retailers and do not use local hides. Moreover, the production of these leather articles is still very low at close to US\$2million (total leather exports amounted to over US\$ 22.3 million in 2007 but 90 percent of these were unprocessed hides and skins), while total footwear exports during the same year amounted to more than \$229million. Thus, footwear remains one of the largest sectors economically in Albania, accounting for 10 percent of processing industrial output and 14 percent of total employment. Overall, this chapter will look more closely at the footwear sector, it should be noted that the issues addressed are in many respects similar to those of the processed leather sector.

**1.4 These sectors are important not only because of the high current share of exports, but also because they can strengthen the technological absorptive capacity of local firms and.** Sustained export growth of apparel and footwear products has been the foundation for sustained industrial development and economic growth in a number of emerging economies in Europe and Asia.\* The acquisition of technical know-how and equipment for light manufacturing facilitates industrial upgrading that drives the expansion of exports into more advanced market segments and more high-tech exports. To a greater or lesser extent, the process of industrial development has been based on a combination of FDI (or joint ventures of local companies) that brings not only financing but also training, technical know-how and equipment, and intense local investment learning and capacity strengthening supported by pro-active government policies.

**1.5 Despite the strong export growth recently, there are concerns that Albania's competitiveness in apparel and footwear is being eroded in the face of competition from Asia and decreasing FDI.** Particularly after the phasing out of quota restrictions under the Multi-Fiber Agreement in 2004, there are concerns that Albania's relatively high concentration both in export products and markets leave it highly vulnerable to Asian competition if Albanian firms do not upgrade processes and products faster. Furthermore, despite a reasonably strong foreign presence in the Albanian footwear and textile sectors, there have been few new investments in recent years and there are concerns that technology transfer to local firms are limited. The surge in foreign direct investments into the Albanian

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\* Bonacich et al. (1994); Gereffi (1999).

apparel and footwear sectors in the 1990s has not been continued, particularly after the 1997 crisis, despite the strong recent period of domestic macroeconomic and political stability in Albania and the relocation of several assembly plants from Eastern Europe to other low labor cost destinations. Moreover, case study interviews suggest that current foreign apparel and footwear investments in Albania may not be enabling technology and knowledge transfer as much as in other countries.

**1.6 The rest of this section will analyze the competitiveness of the apparel and footwear sectors and highlight the role of investment climate reforms in stimulating sustained export growth and attracting FDI in the future.** The rest of this section is split into three main parts: The following part highlights the key trends in Albanian exports and FDI in the apparel and footwear sectors over the last years and puts them in a regional perspective, finding there is substantial scope for strengthening Albania's competitiveness by increasing the levels of domestic and foreign investment, which will, in turn, facilitate technological upgrading. The next part of this section will summarize some lessons from the upgrading of the apparel and footwear sectors in Asia and Eastern Europe and describe the key mechanisms that facilitated technological upgrading and, by extension, export growth. The following part will identify the key aspects of the investment climate in Albania that may hinder domestic and foreign investment in technological upgrading and recommend reforms. Next is a discussion of the need for certain pro-active policy interventions beyond the investment climate, aimed at stimulating learning and the strengthening of the absorptive capacity of local firms. The final part concludes with policy recommendations.

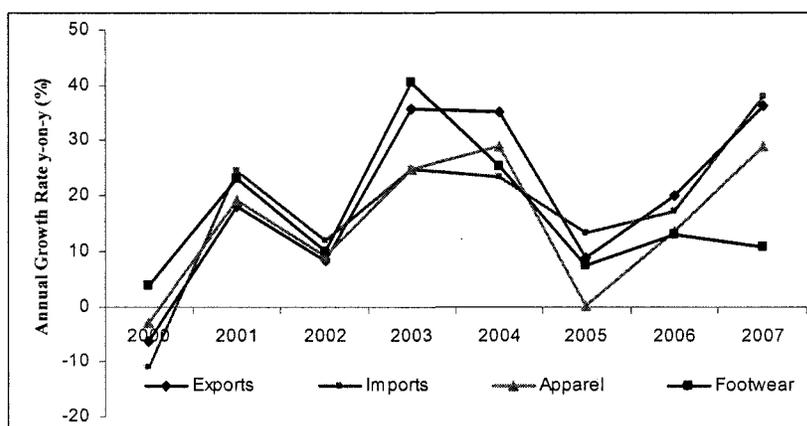
## **2. GLOBAL COMPETITIVENESS OF THE ALBANIAN APPAREL AND FOOTWEAR SECTORS**

### **Macro Trends in Global Trade and FDI**

**1.7 Albania has seen strong growth in apparel and footwear exports since 2000.** Figure 1-1 below shows the annual growth in total exports and imports in Albania, and then specifically the growth in apparel and footwear trade (exports and imports) during the period 2000-07. These trends make evident that Albania has seen substantial, if somewhat volatile, growth in exports and imports since 1999 and that that the trends in overall trade are closely mirrored by the trends in apparel and footwear trade. This reflects the reliance of Albania's export structure on these sectors, which together accounted for just less than 50 percent of total exports in 2007.

**1.8 EU trade preferences are an important cause for the surge in apparel and footwear exports since 1999.** Since 1992, Albania has been benefiting from the EU's General System of Preferences, with textile and footwear products specifically benefiting from this status, according to Regulation 3917/1992 of 21 Dec. 1992. Further liberalization of textile and apparel trade was granted with the Autonomous Trade Preferences, based on Regulation No. 1763 of 29 July 1999, while in 2000, with Regulation No. 2007, Asymmetric Regional Preferences were granted to Albania and other Balkan countries (Bosnia-Herzegovina, Croatia and Macedonia), which allowed for export with 0 percent customs duties on *Outward Processing Trade (OPT)*, namely apparel exports that were produced using materials that originated only from the EU or the beneficiary country. EU trade preferences may also have played an important role in boosting trade after 2000.

**Figure 1.1. Annual Growth in Trade, Apparel and Footwear Exports, 2000-07**

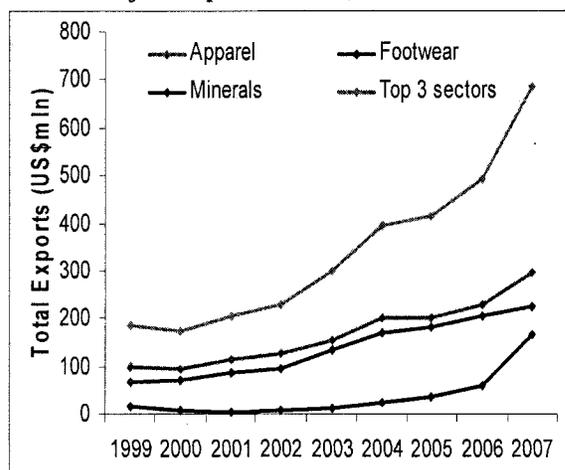


Source: Albanian Center for International Trade, 2008

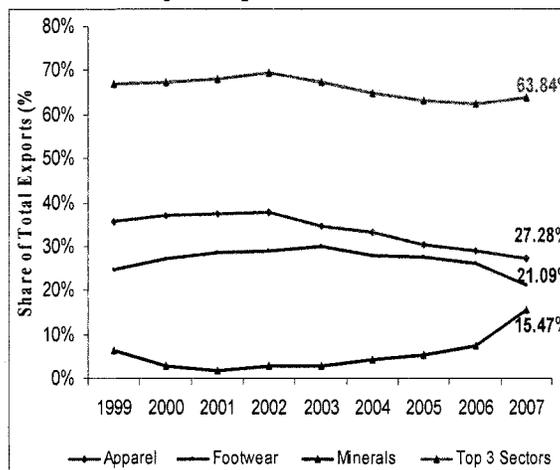
1.9 **In relation to the EU trade preferences, the vast majority of export flows from apparel and footwear are in fact re-exports.** Re-exports have accounted for over 90 percent of total exports in both sectors during this period, highlighting the importance of integration into global production networks for Albania's export competitiveness. Many of these OPT exporters (known locally as fasson), however, have not upgraded to sourcing inputs themselves, which would allow them to reap higher margins, and are still reliant on their foreign buyers. This has also meant there have been only weak spillovers from this surge in exports to the local economy in terms of backward linkages, despite the substantial growth (from a low base) in recent years of semi-finished leather exports from Albania. Thus, for the foreseeable future, strong growth in exports in footwear and apparel sectors will be associated, as over the last 8 years, with equivalent growth in imports.

1.10 **Together, footwear and apparel exports accounted for just under 50 percent of all merchandise exports in 2007.** The dominance of apparel and footwear in the Albanian export basket is shown in Figures 1.2 and 1.3 below that display the relative importance of the 3 largest export sectors in Albania, apparel, footwear and minerals. From 60.5 percent of total exports in 1999, the share of apparel and footwear reached a peak of 66.5 percent in 2002. By 2007, total exports of apparel and footwear from Albania had increased by 212.7 percent since 1999 and 136.2 percent since 2002 (with an average annual growth rate of 19.2 percent) to US\$519.8million. During the same period (1999-2007), total world apparel and footwear exports grew by around 75 percent from US\$200billion to just under US\$350 billion. Yet despite the strong growth in apparel and footwear exports from Albania, the share of total Albanian exports by value accounted for by these two sectors had fallen to 48.4 percent in 2007, reflecting increasing commodity prices in 2005-2007, which correspondingly increased the share of minerals exports.

**Figure 1.2. Evolution in Total Exports of 3 major Export sectors, 1999-2007**



**Figure 1.3. Evolution in share of Total Exports of 3 major Export sectors, 1999-2007**



Source: Albanian Centre for International Trade 2008

1.11 In recent years, the narrow concentration of Albania's export basket in apparel and footwear has been reduced because of the exceptional growth in mineral exports following soaring commodity prices but it is not clear that this diversification is sustainable. As can be confirmed in Figure 1, the growth rate of total exports (and imports) has exceeded the growth rates of apparel and footwear exports in the last three years with total exports reaching US\$1.08billion in 2007. Around 20 percent of the growth in the value of total exports between 1999-2007 and 30 percent of total exports growth between 2005-07 is related to a surge in mineral exports, such as metallurgy and metal processing. The share of total exports accounted for by minerals more than doubled from 6.3 percent in 1999 to 15 percent of total exports in 2007 and the average annual growth rate of mineral exports during this period has been 50.3 percent. While this diversification in exports is welcome, there is a concern about its long-term sustainability and whether the rise in mineral exports reflects a genuine improvement in Albania's global competitiveness in the sector given the rise in mineral exports and in foreign investor interest is largely related to the surge in global commodity prices.

1.12 The substantial growth in exports of footwear and apparel in Albania is impressive by regional standards. Table 1.1 below shows a breakdown of the average annual growth in exports at the Harmonized System 2-digit level. The average annual growth in Albania's exports in apparel and footwear over the period 1999-2006 in each category has been among the highest in South-eastern Europe and surpassed the regional average. Average annual growth over the period was particularly high for footwear at 20 percent and apparel that was knit or crochet (HS 61) at 18 percent. It should be noted that in 2006, 38.5 percent of total Albanian apparel exports were knit or crochet (HS 61) while 59.7 percent of total apparel exports were not knit or crochet (HS 62). In 2006 alone, the growth rates in each of these categories were somewhat slower, amounting to 10 percent in footwear and apparel not knit or crochet, and 13 percent for apparel articles knit or crochet.

**Table 1.1. Comparison of Average Annual Growth in Apparel and Footwear Exports, 1999-2006**

HS Product Category	Albania	Romania	Bulgaria	FYROM	Bosnia	Serbia	Croatia	Average
62 Articles of apparel, not knit	15	13	17	12	8		9	11.8
61 Articles of apparel knit or crochet	18	13	17	10	21	14	-1	12.3
64 Footwear and parts	20	15	11	12	12	34		16.8

Source: UN COMTRADE 2008

1.13 **However, the structure of Albania's export basket within these two sectors both in terms of products and geographic destination markets remains substantially more concentrated than those of its regional peers.** Albania's export product and geographic diversification can be assessed by considering the number of export products that amount to over US\$100,000 in trade; the share of total exports accounted for by its top 3 exports; and the top 3 destination markets. Table 1.2 benchmarks Albania's export diversification to Slovakia and Romania, two more advanced comparators in Eastern Europe, showing that Albania's export basket in apparel and footwear, particularly in the latter, is substantially more concentrated both in terms of products and. Albania exported 30 different types of knitted apparel products with a value over \$100,000 in 2006, less than one third of the number of products exported by Romania (99) and half the number of Slovakian products (73). Moreover, Albanian exports in this category had just 3 notable destination markets (Italy, Greece, Germany) contrary to 25 for Slovakia's exports and 36 for Romania's. Also problematic is that in 2002, Albania had 32 types of knitted apparel exports, suggesting that firms in these segments may not be introducing new products. Albania's exports of non-knitted apparel are less concentrated in terms of products with 53 different types in 2006, but this was still around half the variety of products exported in Romania. Furthermore, market concentration was still very high, with the same three main markets (99.7 percent) Albanian exporters while Romanian firms exported substantially to 41 different markets with the top 3 markets accounting for 75 percent of total exports.

**Table 1.2. Product and Geographic Concentration of Exports**

	Slovakia			Albania			Romania		
	Apparel knitted	Apparel not knitted	Footwear	Apparel knitted	Apparel not knitted	Footwear	Apparel knitted	Apparel not knitted	Footwear
Number of exported products	73	94	22	30	53	20	99	110	28
Share of top 3 exported products (%)	34.1	30.8	73.1	47.1	69.4	71.6	34.1	25	65.4
Number of export markets	25	29	37	3	5	4	36	41	37
Share of top 3 export markets (%)	76.3	66.4	69.2	99.7	99.7	99.9	75.2	75.6	83.4

*Source: UN COMTRADE, UNCTAD/WTO International Trade Centre*

1.14 **In fact, Italy is by far the largest destination of Albania's exports in these sectors.** Italy was the destination of around 75 percent of total apparel exports from Albania (73 percent of knitted apparel and 80 percent of non-knitted apparel articles) and almost all (99.5 percent) footwear exports between 2005-07. This extremely high concentration is related to the re-export nature of these flows, with Italian companies that have established access to final markets controlling input sourcing and product distribution and Albanian firms responsible only for assembly. In view of this, it is instructive to see where Albania ranks vis-à-vis its competitors that export to the Italian market. Albania is ranked 18th largest apparel exporter to Italy (1 percent of total Italian imports) and the regional competition is primarily from Turkey, Romania, Tunisia, Hungary and Bulgaria, while China, India and other low-cost Asian producers, such as Bangladesh, dominate the low value-added market segment. Albania is Italy's 9th largest source of footwear (3.8 percent of imports) where the main competitors are Romania (16 percent) and Tunisia (8.5 percent), while China, Viet Nam and India dominate the low value-added market segment.

1.15 **In summary, Albania's exports of apparel and footwear have been increasing strongly but the extremely high concentration in products and markets suggests firms are having difficulties upgrading and are excessively reliant on Italian buyers.** The narrow concentration of Albania's export basket is, to some degree, normal given that the Albanian producers only began integrating into the global economy after 1990 and were thus starting from a low base. However, experience in East Asia (i.e. Korea, Taiwan) and Western Europe (Portugal, Spain) shows that firms move up the value-chain from being responsible for the assembly of finished products for foreign buyers to having their own brand label within twenty years. Albania today does not seem to have firms at the cusp of producing their own brand labels. In fact, during case study interviews, a number of firms expressed concern about their almost

complete reliance on foreign buyers for markets, inputs and design, which breeds uncertainty that discourages investment in learning and upgrading. The next section uses the *global production network* framework to define upgrading in the context of the apparel and footwear sectors.

## **Global Production Networks and Upgrading in the Apparel and Footwear Sectors**

1.16 **The apparel and footwear sectors are the most common starting point for industrial development for developing economies.** The garment and footwear industries, due to the low investment cost per worker and minimum management skills required, are often among the first industries in any developing economy. Box 1 describes the main terminology in global apparel and footwear trading. For new firms, given their limited knowledge of the industry and connections to the input and customer markets, the entry point into the industry is usually as a seller of cheap assembly services for global production networks (also known as global value chains) led usually by a large MNC. The only means of competition is price and, in more fashionable apparel and foot wear, speed to the market if the location is near to a large consumer market. Subsequently, new firms move into Cut –Make (CM) type operations which means that, although they still do not buy inputs and only sells production capacity, they are given the responsibility of cutting the inputs of fabric supplied by the customers. The next level is usually Cut-Make-Trim (CMT) where the producer buys only the basic trimmings, but all materials, as well as detailed product specifications, are supplied by the customer. Firms in these three types of operations only need manufacturing skills and production machinery, while product designs, technical specifications, as well as manufacturing instructions are provided by the customers.

### **Box 1.1. Terminology**

**Assembly:** The manufacturer sells only manufacturing services only, assembling pre-cut components of garments or footwear imported from foreign buyers.

**CM (Cut-Make):** The manufacturer sells cutting and manufacturing services only and temporary imports all materials, which are owned by the customer.

**CMT (Cut-Make-Trim):** The same as CM except the manufacturer buys some of the accessories like sewing thread, buttons, etc.

**Full Package:** The manufacturer buys all materials according to the customer's specifications and at delivery invoices the full value of the product. Beyond the textile/garment sectors, this manufacturing model is known as Original Equipment Manufacturing (OEM)

**Private Label:** The manufacturer designs collections independently or jointly with the customer. The full-value products are delivered under customer's trademark. Beyond the textile/garment industry, this is more widely known as Original Design Manufacturing (ODM) where the manufacturer not only makes a product, but also designs and owns the intellectual property or they license it, but sells the product under the brand name of the customer

**Own Label:** The firm is selling the product it manufactures under its own brand name. Beyond the textile/garment industry, this is more widely known as Original Brand Manufacturing (OBM).

1.17 **CM and CMT are effectively a process of “technological learning”.** Firms entering global production networks as assembly or CM/CMT operators learn better sewing techniques in compliance with quality standards, as well as becoming familiar with the machinery and type of fabrics needed for quality production. In addition, foreign buyers are usually actively involved in purchase of machinery, training of engineers, technicians, and, in some cases, they also provide advice on production, management and financing. In most cases, a technician from the buyer company resides with the producer

company for several months until production of the ordered pieces is completed, with the aim of monitoring quality, as well as teaching how to perform particular tasks or use particular machinery.

**1.18 The next level of firms in global production networks are full-package subcontracting firms.** Full-package or OEM firms are usually branded manufacturers or wholesalers that manage the logistics and purchases of all inputs needed for the production of the final product but they receive the specification of the type of inputs, product design, as well as styling from the final buyer -a retail firm. OEM firms either assemble the inputs into the final product themselves, or, if the domestic labor costs are too high, outsource to CM/CMT firms. Thus, OEM firms are effectively the intermediary between assembly operators and retailers. OEM firms need to have adequate financing, in addition to the know-how for sourcing materials, which includes logistics, strong links with suppliers, and up to-date knowledge of inputs (leather, fabric etc.) and latest fashion information. This know-how means that OEM producers offer more value to their customers, allowing them to increase their margins and, if they can approach the retail customers directly, these margins can be increased further by omitting the intermediary wholesalers.

**1.19 The final level of value-adding in global production networks prior to a direct selling to consumers is Private Label where the producer searches materials, designs collections and presents customers product development ideas.** The final decision on designs and products are made by the customers and products are supplied under customers' labels. This is the highest level of value adding before Own Label sales, i.e. the producer designs collections and sells them under their own labels. The time span for climbing these steps is long for any company and especially for the fast fashion sensitive garment and footwear sectors.

**1.20 Industrial upgrading refers to the process of moving up these production networks by undertaking investments in technological and marketing knowledge.** Following Kaplinsky and Readmann (2001), upgrading can be broken down into four separate types (see A): product upgrading, process upgrading, functional upgrading, and organizational and managerial upgrading. *Process upgrading* refers to increasing the efficiency of internal processes by re-organizing the production system or introducing superior technology. *Product upgrading* refers to introducing new products or improving old products. It might include moving into more sophisticated product lines. *Functional upgrading* refers to increasing value-added by changing the mix of activities conducted within the firm (for example, taking responsibility for, or outsourcing accounting, logistics and quality functions) or moving the locus of activities to different links in the value chain (for example from manufacturing to design). *Organizational and managerial upgrading* refers to improving the efficiency and effectiveness of production and non-production activities by acquiring new organizational and managerial methods, such as teamwork, involvement of workers, application of ISO, etc.

**1.21 In the long-term, as labor costs in their local environment rise, firms in light manufacturing have to upgrade functionally from export-oriented assembly to private label in order to survive.** Industrial upgrading can be conceptualized as a series of role shifts involved in moving from export-oriented assembly to more integrated forms of manufacturing and marketing associated with the original equipment manufacturing (OEM) and original brand name manufacturing (OBM) export roles, respectively.<sup>†</sup> The key to success in East Asia's buyer-driven chains was to move from the mere assembly of imported inputs (traditionally associated with export processing zones) to a more domestically integrated and higher value-added form of exporting such as full-package supply or OEM (original equipment manufacturing) production. Subsequently, Japan and some firms in the East Asian NIEs pushed beyond the OEM export role to original brand name manufacturing (OBM) by joining their production expertise with the design and sale of their own branded merchandise in domestic and overseas markets.

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<sup>†</sup> Gereffi (1999)

1.22 **Moving up global production networks requires lead firms building strong linkages with retailers and marketers.** From a global commodity chains perspective, East Asia's transition from assembly to full-package supply derives in large measure from the ability to establish close linkages among a diverse array of lead firms in global supply chains. *Lead firms are the primary sources of material inputs, technology transfer, and knowledge in these organizational networks.* In the apparel and footwear commodity chain, different types of lead firms use different networks and source in different parts of the world. Retailers and marketers tend to rely on full-package sourcing networks, in which they buy ready-made apparel primarily from Asia, where manufacturers in places like Hong Kong, Taiwan and South Korea have historically specialized in this kind of production. As wage levels in those countries have gone up, East Asian manufacturers have tended to transition into the critical coordinating role in the full-package production process whereby they develop multilayered global sourcing networks where low-wage assembly can be done in other parts of Asia, Africa and Latin America and they play the. Branded manufacturers, by contrast, tend to create production networks that focus on apparel assembly using imported inputs with EU firms relying on North Africa and Eastern Europe.

1.23 **Successful upgrading by apparel and footwear firms requires access to foreign knowledge and investment in learning and technical capacity building.** The garment industries in Hong Kong, Korea, Taiwan and Portugal took around two decades in order to upgrade to primarily Private Label producers, and only a few companies have succeeded with Own Label collections. The incentives for upgrading were provided by rising domestic labor costs, which had the effect of making CM/CMT production uncompetitive, thus forcing firms to invest in upgrading to full-package and outsourcing assembly operations to other countries where labor costs were lower. The transition of many garment suppliers in *Eastern Europe* has been relatively slow, with a large share of them still restricted primarily to CM or CMT operations. Recent examples of successful upgrading in Eastern Europe are Poland and the Baltic States, where the apparel industry made large investments in upgrading with several firms employing designers in the late 1990s and establishing own collections for their domestic markets, while also offering FOB and private label services to big-brand foreign customers. At the same time, numerous Joint Ventures and fully foreign owned firms were established bringing in further know how and triggering new and well-organized spin-off companies.

1.24 **At the same time, the learning potential of CM or CMT operators also depends crucially on the governance of the production network by the lead firms.** Retail firms can source products directly from various CM/CMT producers but many prefer to use intermediaries, such as wholesalers or branded manufacturers, who have specialized know-how and organization for input sourcing. This means that a CM/CMT supplier very often does not have any interaction with the final consumer market, and thus is heavily reliant on the intermediary, who is looking for the lowest price and, in many cases, does not have the incentives or the capacity to transfer the most advanced knowledge and technology to the CM/CMT producer. Certainly, a number of Albanian firms, during case study interviews, complained that their foreign clients did not transfer any knowledge beyond the initial sending of the technician for equipment installation and training and, subsequently, specific product specifications. The majority of firms that did benefit from additional knowledge transfer from their foreign clients, particularly with regards to process improvement brought about by a temporary consultant, had to pay for it.

## Albanian Firms in Global Apparel and Footwear Production Networks

1.25 **Albania is a low cost supplier in the global production networks for mid and high level quality apparel and footwear.** After 1990, Albanian apparel and footwear CM/CMT producers joined

**Table 1.3 Labor cost comparisons in Apparel US\$ 2007**

	Total Labor Cost per Operator Hour	% of which are direct wages
Albania	1.85	79
Slovakia	3.53	69.3
Czech Republic	4.9	79.6
Lithuania	3.7	66.3
Bulgaria	1.55	72.6
China (Coastal)	0.85	59.4
China Inland	0.55	62.9
Vietnam	0.46	78.4
India	0.69	66.4
Tunisia	2.01	77.2
Turkey	2.96	74.0
Bangladesh	0.28	90.0

Source: *Werner International, 2007*

global supply chains mainly for the mid segments of the apparel and footwear markets, based on Albania's geographic proximity to Europe and extremely low labor cost (see Table 1.3) that is critical as labor accounts for around 70-80 percent of total costs. Most of the foreign firms using Albanian CM operators are Italian manufacturers, importers or wholesalers that sell the products to retailers and thus include their own margins into the production network. This squeezes the margins of Albanian CM firms, reduces their retained earnings and, by extension, capacity to invest in upgrading. This creates further problems as labor costs increase and CM firms are not able invest in new equipment that can increase factory efficiency, further undermining their competitiveness.

1.26 **Even the largest firms in Albania have remained CM/CMT producers reliant on Italian clients.** The relatively large share of CM/CMT producers (known locally as *fasson*) amongst medium and large sized firms in Albania shown in Table 1.4 suggests that in the last 15 years Albanian firms have been facing difficulties growing and upgrading. Just under two-thirds of the firms in the Albanian apparel sector are either small in size (fewer than 20 employees) or micro-enterprises (under 5 employees), which alone account for around 40 percent of all firms in the sector. The case studies conducted in the context of this report confirmed the general pattern, All domestic companies interviewed were CM/CMT manufacturers or sub-contractors for such manufacturers. Only one of the largest Albanian footwear company is able to sell a small share of its products directly to a foreign retailer but does so under the umbrella of its foreign client that receives a trademark commission.

**Table 1.4. CM/CT producers in Albania, 2004**

Type of Producer	Size of Enterprise (employees)						Total
	1-4	5-9	10-19	20-49	50-	>250	
Number of enterprises	134	40	25	47	63	6	314
CM/CMT producers	0	6	9	29	48	2	94

Source: INSTAT

1.27 **Although Albanian firms have gradually begun exporting higher value-added products in the footwear sector, they are still predominantly a low value-added producer.** Footwear exports have been shifting from intermediate or semi-finished products, such as footwear parts, towards finished products over the last ten years. Comparing Albania to other large footwear producers in the region displays clearly the evolution of the sophistication of the shoe "supply chain" in Albania compared to similar countries (Table 1.5). While in 1997, 87 percent of Albania's footwear exports were semi-finished products such as footwear parts, this share had fallen to under 58 percent by 2006. However, this was by far the highest share amongst regional producers - for example, Romania as the largest EU exporter to

Italy, has seen its share of footwear parts fall to 25 percent of total exports from 40 percent in 1997. In summary, Albania's export growth is impressive but is still dominated by low-value added products or parts of products. The evolution of exports away from parts is encouraging sign of the organizational learning of Albanian enterprises that is necessary to upgrade and remain globally competitive in the medium-term but Albania still has the highest share of semi-finished products in the region, suggesting that technology transfer and learning within the global supply chains that Albanian firms participate in could be improved.

**Table 1.5. Share of Footwear Exports that are parts, 1997-2006**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Albania	87.0	89.3	89.8	94.4	90.4	92.4	87.4	77.8	68.9	57.8
Italy	11.0	12.0	12.7	13.3	13.7	14.2	14.4	14.0	14.1	14.2
Romania	39.8	38.4	36.7	35.4	34.1	34.8	33.6	29.8	26.0	25.3
FYROM	18.9	12.1	7.3	11.5	15.4	20.4	33.2	32.8	36.3	37.2

Source: UN COMTRADE

1.28 **The value-added of Albanian garment and footwear exports is low by regional standards and has not been increasing over recent years.** A method to estimate the value-added of Albanian garment and footwear exports that enables comparisons with regional competitors is to employ EU trade data of outward processing trade. For example, in 2004, the value of OPT clothing exports from Albania was US \$197million, while the value of the imports of materials used to produce these exports were valued at US \$159 million. The value of materials imported for use in outward processing rose by 107 percent between 2000 and 2004, whereas the value of exports rose by 103 percent. Hence, the value added of apparel exports in 2004 amounted to just 24 percent of the value of the exports while the equivalent figure in 2000 was 26 percent. For comparison, the value-added of OPT exports from Moldova in 2004 was 37 percent. Calculations using enterprise survey data also support the conclusion that Albanian apparel exports are of low value-added by regional standards. Table 1.6 shows that value-added per employee and as a share of exports in Albania is the lowest in the region even though exports per employee is average by regional standards.

**Table 1.6. Comparison of Value-added of Apparel Sector in West Balkans, most recent year**

	Albania (2005)	Bosnia (2006)	Croatia (2004)	FYROM (2005)	Serbia (2004)
Value-added (mln)	33	53	346	137	145
Employment	10480	6971	21937	40384	24047
Exports (mln)	200.6	176	538	509	445
Value-added/per employee (US\$)	3149	7603	15772	3392	6030
Value-added (% exports)	16	30	64	27	33
Exports per employee (US\$)	19144	25247	24525	12604	18505

Source: National Statistical Institutes of above mentioned countries.

1.29 **The footwear and apparel sectors are the most dynamic in Albania in terms of introducing new products but product quality upgrading is limited.** While CM/CMT trade is beneficial in the short-term by creating industrial jobs and foreign currency earning, it seems that learning benefits for workers and managers have been very limited and that many firms are simply not in a position to upgrade in the value-chain. According to the 2007 Investment Climate Survey (ICS), just under half (48 percent) of garment and footwear firms introduced a new product between 2004-07, the highest share amongst all manufacturing sub-sectors. By contrast, the share of firms that upgraded existing products in these two sectors (35 percent) was lower than in the other main subsectors like food (42 percent), metal product fabrication (51 percent) and other manufacturing (61 percent). Given their export-orientation, and the need to meet supply orders of foreign lead firms, it is not surprising that the apparel and footwear sectors are the most innovative in terms of new products. However, case studies suggest that Albanian CM/CMT

firms produce new designs as specified by foreign buyers' but there is very little evidence, as shown above, that they are upgrading the quality of their products, or designing new products themselves, either of which would enable them to reap higher profits.

1.30 **Moreover, investment in cutting-edge technology by apparel and footwear firms in Albania is low by regional standards, leading to lower productivity.** According to the 2007 ICS, the share of garment and footwear firms in Albania that had purchased new technology in the last three years (46 percent) was slightly higher than the average across the entire manufacturing sector (41 percent). However, there is strong evidence that the equipment employed by most firms in the apparel and footwear sectors in Albania is still far from the cutting-edge, and the investment rates are low by regional standards, leading to lower productivity. According to the *OECD Regional Capability Survey* in 2008, only 27 percent of firms in Albania considered lack of investment in technology to be one of their three biggest challenges, contrary to 38 percent in the West Balkans. Moreover, the share of apparel firms in Albania employing different types of cutting-edge technology for reducing lead times is very limited, and, in some respects, low relative to other economies in the region. For example, just one third of apparel firms in Albania use Uniform Product Code (UPC) symbol standards to manage inventory levels that are customary in Western Europe, which is about half the average share in the West Balkans. Moreover, no firm in Albania is implementing Modular Production Systems (MPS) to improve plant throughput time and very few employ automated technology. This is manifested in terms of lower productivity: Total costs of production per standard allowed minute (SAM) in Albania amount to €0.11, *higher than many countries in the West Balkans, while productivity is just 42 percent of the UK level, even though labor costs are the lowest in Europe.*

1.31 **Case study interviews suggest that a variety of proximate causes for the limited level of technology upgrading by firms in Albania.** Many firm managers during case study interviews conducted in preparation of this study claimed they were only able to replace Communist-era machinery gradually due to *financial constraints* but also because *workers could not use automated technology*. Even the largest footwear firm in Albania that used automated equipment suggested that 90 percent of equipment needed upgrading but that it was too expensive. Foreign firms with no financial constraints claimed that they did not bring their highest quality machinery to Albania for fear that it would be *destroyed by the unpredictable power cuts*. In addition, *many managers of apparel firms are not aware of the added value of technology upgrading* and are still in the CMT mentality, undertaking investment in equipment mainly on the suggestion of their customers. Case study interviews of firms in the Albania apparel sector conducted by the OECD similarly conclude that limited managerial capacity is hindering improvement in equipment and processes.<sup>‡</sup>

1.32 **The key determinants of technological diffusion and upgrading in developing countries are exposure to advanced foreign knowledge, and the absorptive capacity of local firms.** Technology diffusion to developing countries like Albania depends on two key factors: (i) the extent to which firms are exposed to foreign knowledge, particularly in terms of FDI, imports of capital goods and high-tech exports but also through communication with the Diaspora; and (ii) the capacity of local firms to absorb advanced new technologies. The next two sections will present evidence to show that, first, Albanian firms are less exposed to foreign knowledge than they could be, and secondly, that their absorptive capacity could be strengthened substantially by specific reforms of the investment climate and selective cost-effective public interventions to support firm learning and strengthening of their internal technical and managerial capabilities.

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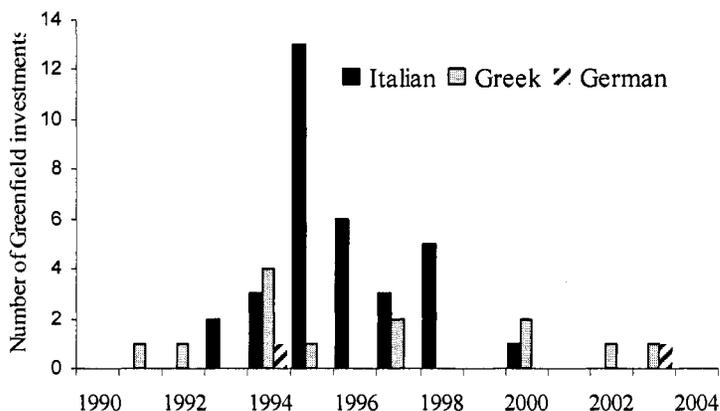
<sup>‡</sup> OECD (2008).

## Determinants of Technological Upgrading

### Foreign Direct Investment (FDI)

1.33 FDI plays an important role in Albania's apparel and footwear sectors, but Greenfield investment has slowed significantly in recent years. The stock of foreign investment in the apparel sector in 2004 accounted for €112 million or about 11 per cent of total FDI stock in the manufacturing

Figure 1.4. Foreign Direct Investment in Apparel Sector, 1990-2004



Source: INSTAT

the entry of FDI into the garment sector since 1990, with a spike in investment in 1995 but very few new Greenfield investment projects since 1998. By contrast, there have been consistent FDI inflows in the apparel sector in other regional economies, with €12million going to Croatia and €5million to Serbia in 2007, and flows of €3.7million to FYROM in 2006.

1.34 **Low labor costs in Albania by regional standards remain a key comparative advantage in the short to medium-term for attracting FDI but there are concerns about labor quality.** In the mid segment of the global market for apparel and footwear that Albania and other countries in Eastern Europe service, labor costs account for around 50-60 percent of total costs of production. Hence, the low cost of labor for manufacturing in Albania at all levels relative to regional competitors (see Table 1.7), but particularly for the semi-skilled and unskilled cohorts, is still an important source of comparative advantage for attracting FDI. Wages in the textile and apparel industries in 2005 were the lowest in the Western Balkans outside Kosovo at US\$ 178 per month. However, wages have risen relatively rapidly, growing at an annual rate of 15 percent between 1997 and 2005 implying some supply bottlenecks. Moreover, over the medium to long-term, Albanian workers need to compete not only on low cost but also on quality and currently according to some foreign investors in Albania there is a shortage of skilled workers required for the maintenance of equipment and process upgrading. Matching the reforms in the Vocational Education and Training System to these areas of current labor demand that are underserved is very important for Albania's competitiveness.

§ National Bank of Albania.

**Table 1.7. Total annual labor cost to employer in Manufacturing, US\$ (2005)**

	Management	Professional	Technical	Skilled	Unskilled
Albania	17695	10617	7882	4665	2896
Serbia & Monten	13881	12353	7537	6630	4980
Bosnia-Herzegovina	25111	15889	14049	8548	6095
Macedonia	34652	18763	14252	7526	5384
Croatia	41352	26155	19763	13370	9041
Slovak	28647	NA	15241	6965	5001
Czech Republic	28611	NA	17128	12675	8887
Hungary	49622	NA	23843	11673	10170

Source: MIGA, World Bank Enterprise Benchmark Program, 2005

**1.35 Albania's long-term comparative advantage in these two sectors lies in its proximity to the EU market.** Albania's geographic proximity to the EU facilitates trade with these markets and satisfies one of the essential requirements of European customers: fast and flexible just-in-time delivery. Many of Albania's direct competitors in the attraction of FDI are countries in Eastern Europe (Poland, Romania, Croatia, Serbia, FYR Macedonia and, increasingly, the former Soviet bloc like Moldova and Ukraine) as well as Tunisia and Morocco that compete by enhancing their ability to respond to short-notice orders from the European market. A number of Italian investors in Albania mentioned during case study interviews that the frequency and short time of ferry crossings between Italy and Albania was a crucial factor in deciding to invest in Albania, while other studies have confirmed this with Greek and Italian FDI (UNDP 2005). According to OECD calculations, the cost of shipping products from Albania to Italy is equal to 1.43 percent of the value of the imports, in line with the average in the West Balkans of 1.48 percent but substantially lower than the 11.8 percent required to ship from China.\*\*

**1.36 Bureaucratic requirements, trade logistics and infrastructure in Albania are more cumbersome than in other countries in the region and lead to longer delivery times.** Proximity to the EU market is shared by a number of countries in the region that have seen higher FDI inflows than Albania in recent years. This may be partially related to the fact that delivery times to import from other countries in the region area lower than in Albania as shown in Table 1.8 below where it takes 21 days to export and 22 days to import products, relative to the average of 17 days on average in the region. A deeper comparison between Albania and Romania (the best practice in the region) shows that the biggest differences are in the time needed to complete documents (11 days as opposed to 6 days) and the inland transportation and handing (5 days relative to 2 days). Cutting excessive red tape and improving trade logistics and infrastructure, especially at Albania's four ports, can substantially reduce reducing transaction costs and delivery times, attracting more FDI and facilitating access to neighboring countries.

**Table 1.8. Time and Cost to Trade Across Borders in the West Balkans, 2008**

Doing Business 2009: Trading Across Borders Indicator

	Global Rank	Documents for export (number)	Time for export (days)	Cost to export (US\$ per container)	Documents for import (number)	Time for import (days)	Cost to import (US\$ per container)
Albania	77	7	21	770	9	22	775
Bulgaria	102	5	23	1,626	7	21	1,776
Bosnia	55	6	16	1,070	7	16	1,035
Croatia	97	7	20	1,281	8	16	1,141
Macedonia, FYR	64	6	17	1,315	6	15	1,325
Romania	40	5	12	1,275	6	13	1,175
Serbia	62	6	12	1,398	6	14	1,559
Average	..	6	17	1248	7	17	1255

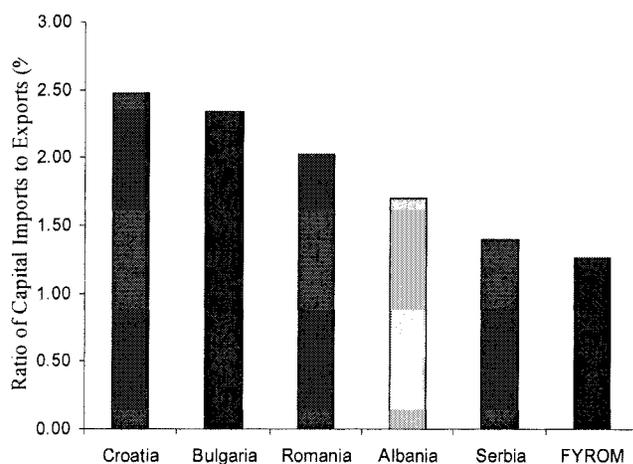
Source: Doing Business 2009.

\*\* OECD (2008).

### *Trade: Imports of Capital Goods and Learning by Exporting*

1.37 **The capital intensity of footwear and apparel exports in Albania is low by regional standards.** Imports of advanced foreign equipment and machinery is a major source of technology transfer to the developing world, bringing substantive productivity gains that, according to case study

**Figure 1.5. Capital Goods Imports as a share of total footwear and apparel exports, 2000-06**

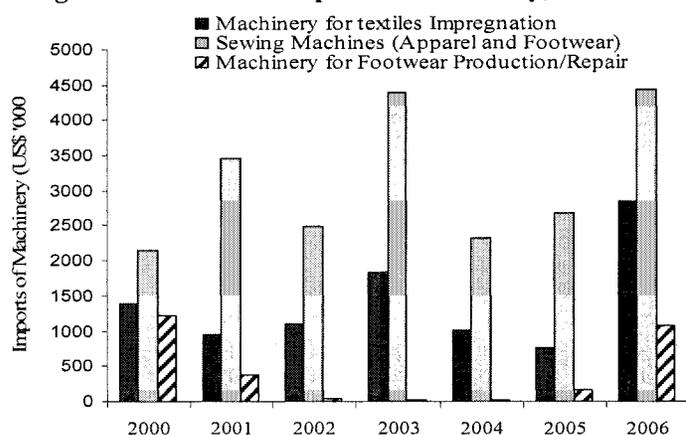


Source: UN COMTRADE

in Albania was confirmed during case study interviews where many firms mentioned that they wanted to upgrade but could not access financing and thus had to wait to accumulate sufficient retained earnings. Even foreign firms in Albania said they did not bring their most sophisticated equipment to Albania because the frequent electricity outages could damage them. As a result, there are only a few computerized product design and cutting facilities in the country that are standard in Western Europe and amongst advanced firms in Eastern Europe.

1.38 **Capital goods imports have however been increasing in the last two years and technology consulting services are being set up in Albania but VAT on imports of machinery is a disincentive for some firms.** Figure 1.6 shows the growth in capital imports over the last two years, which has been very low for footwear equipment in particular. While garment production is based around the use of basic sewing equipment, a limited but growing number of firms are investing in pattern cutting equipment enabling cutting to be carried out locally from free issue cloth. According to case study evidence, a small number of foreign firms are employing guide machines for the integration of several production processes. Two firms employ a hanging system to improve workflow and reduce work in progress, and at least three firms are using computer based planning systems to monitor and control stocks and production. Given this technological upgrading, a number of technical consulting firms, including two Italian companies, have been established in Albania to service growing demand. Rainbow Industries, an Italian subsidiary in Tirana that offers a two-stage cleaning process, a morbidity phase to soften the fabric followed by a stone wash enzymatic process, was set up in January 2005 and has an output of 2-3,000 pieces a day. Firms delivering equipment supply and servicing have also been growing, including

**Figure 1.6. Albanian imports of machinery, 2000-2006**



Source: UN COMTRADE

investment. Furthermore, many companies complained of inconsistent and delayed VAT reimbursement.

**1.39 Firms can also acquire more advanced technical knowledge and equipment through exporting higher value-added products.** Participation in technology-intensive export markets has also been identified as a channel through which technology is diffused within developing countries with potentially very large spillover benefits. Many case studies find that exporting firms in developing countries benefit from implicit and explicit technological transfers in the process of interacting with foreign buyers who often have higher quality standards than local customers. In addition, foreign buyers may help with process improvements and provide information about new opportunities in terms of products and export markets. Technology transfer through exporting may be most prevalent in global production networks with clear vertical supply chains (Gereffi 1999; Hobday 1995)

### Technological Absorptive Capacity of Firms

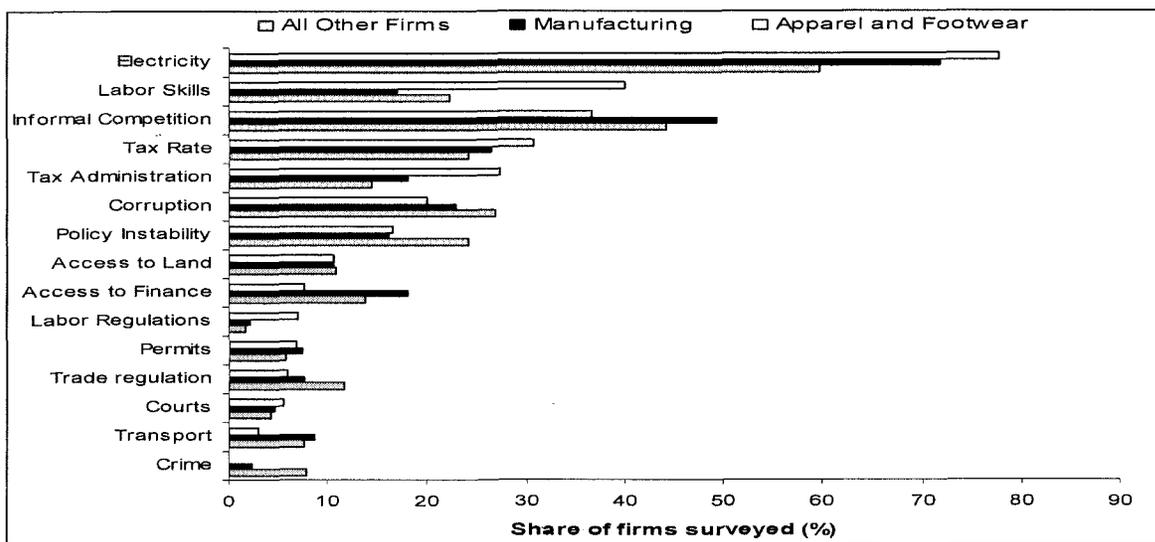
**1.40 The extent to which exposure to advanced technology translates into broad diffusion across the economy and technological upgrading depends on the absorptive capacity of an economy's firms.** Exposure to advanced technologies, knowledge and their applications via trade, FDI and global production networks is necessary for technological upgrading but the extent to which this technology and knowledge is diffused in the local economy is determined by the technological absorptive capacity of its enterprises. The absorptive capacity of a firm in turn is determined by 3 main groups of factors, the first being internal to the firm, in particular (i) the technological capabilities (literacy) of its labor force and management; and the other two being external, notably (ii) the investment climate or broader environment in which firms operate that affects their incentives to invest and innovate (including the business environment, access to finance, governance, infrastructure services etc); and (iii) the quality infrastructure and other public policies to address market failures and provide public goods. This section will focus on (i) the role the investment climate plays in determining the absorptive capacity of firms and (ii) mechanisms that could strengthen the technical capabilities of firms themselves.

Adriatex, an Italian subsidiary of Vermatex. However, a number of firms in Albania still mentioned during case study interviews that while they had the financing to buy new equipment, they wanted to delay the investment because of the high rate of (standard) VAT of 20 percent. While exporters under the OPT regime with 100 percent exports only pay VAT on 1 percent of the import value, for exporters who also sell a small part of their products to local customers, or for small firms that are sub-contractors for larger OPT producers, the lack of a capital goods tax exemption discourages

### Investment Climate Constraints on Absorptive Capacity

1.41 **Electricity supply, labor skills, the business environment (most notably tax rates and administration) and access to finance for investment are the most important investment climate obstacles to upgrading.** Figure 1.7 below shows the share of enterprises in the apparel and footwear sectors that cited each investment climate variable as one of its top three most important obstacles to investment, and compares them with the equivalent share of all other firms in the survey sample, and all other manufacturing firms citing each variable. The poor provision of electricity is by far the most cited top three obstacles to growth (77.6 percent) followed by inadequate skills of the labor force (40.1 percent), informal competition (36.7 percent), tax rates (30.7 percent) and administration (24.7 percent). There are some noticeable differences between the top obstacles cited by enterprises in the apparel and footwear sectors and those cited by all other firms in the survey sample, and those cited by firms in other manufacturing sectors.

**Figure 1.7. Share of enterprises citing Investment Climate Variable as one of top 3 obstacles (%)**



Source: Albania Investment Climate Survey, 2007

1.42 **Electricity seems to be a substantially more prominent concern for apparel and footwear enterprises (77.6 percent) than for the rest of the sample (59.8 percent).** Similarly, almost double as many apparel and footwear enterprises cited labor skills (40.1 percent) and tax administration (27.4 percent) as the rest of the sample (22.2 percent and 14.4 percent respectively). By contrast, a lower share of apparel and footwear enterprises cite informal competition as an obstacle (36.7 percent) than the share of all other firms (44.3 percent) and the share of manufacturing (49.3 percent), likely because most apparel and footwear enterprises are exporters and thus compete with foreign companies. Interestingly, access to finance was frequently mentioned as the second highest obstacle to investment and upgrading by firms in case study interviews whereas in the enterprise surveys it was only mentioned by 8 percent of respondents as one of their three biggest obstacles. The rest of this sub-section focuses on the main constraints specific to apparel and footwear enterprises identified by the surveys and case studies that impede their capacity to upgrade technologically.

### *Infrastructure*

1.43 **Electricity supply is by far the biggest obstacle to upgrading and growth for even the largest firms.** While the energy sector is still publicly owned and the price of electricity is relatively low by international standards, the unreliable supply of electricity is a major obstacle for all businesses in Albania and for the attraction of FDI. For more than three quarters (77.6 percent) of textile and apparel firms interviewed, electricity supply was one of their top three obstacles. Only for the firms that were located in industrial zones or were large enough to organize their own grid, electricity was not a concern. Unreliable supply of electricity affected the productivity and competitiveness of firms in a variety of ways.

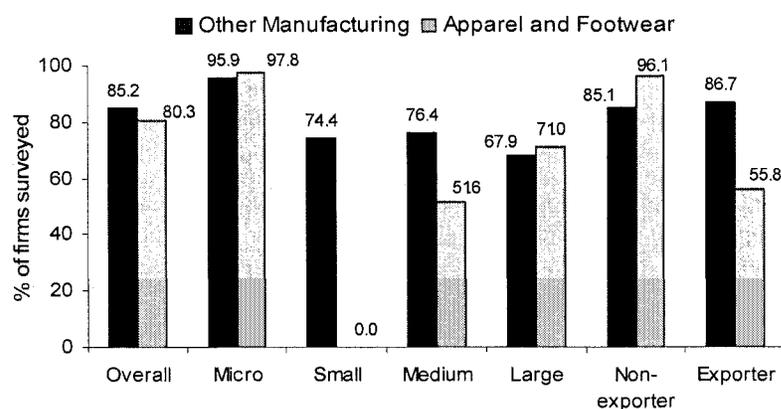
1.44 **Unreliable electricity supply reduces firm competitiveness by raising costs, and reducing incentives to invest in high quality equipment.** Unreliable public electricity supply means that production costs are higher for many companies as they have had to buy fuel-run generators that they may have to use for 4-5 hours a day. This affects the competitiveness of Albanian firms in at least three ways. Depending on the company, the use of generators increases total energy costs by between 30-200 percent, reducing profits and by extension financial resources for productive investments in equipment upgrading and capacity expansion. An additional side effect is that firms with only access to residential electricity lines can only practically have one shift (7am-3pm) and thus are less able to meet large export orders, reducing their flexibility vis-à-vis their foreign clients, with the effect of reducing their competitiveness against other firms in the region. This may also diminish productivity gains from expanded economies of scale. Finally, unreliable electricity supply has a negative impact on the technological sophistication of even foreign firms in Albania many of whom decide not to install advanced *computerized equipment because it would be damaged by power outages*. This further reduces the potential for positive spillovers to local firms.

1.45 **The sector could benefit from the establishment of more industrial sites with reliable electricity connections.** The two largest footwear companies interviewed in case studies established a direct connection to the transmission grid and thus experience cuts in supply very rarely. However, this option is not available to most other firms, and even these large firms are affected indirectly if they subcontract work to smaller companies. The only other companies that did not face concerns regarding electricity were those located in industrial zones but more of these are required, particularly in order to attract foreign investment. Furthermore, the establishment of such industrial zones could provide the foundation for the strengthening of backward linkages, with supplier firms located close to foreign investors and large exporters, thus stimulating agglomeration spillovers. Currently, according to two firms interviewed for case studies, poor transportation links internally in Albania restrict incentives for large firms to invest in training local firms from which to source inputs.

### *Labor-force Issues*

1.46 **The shortage of skilled and semi-skilled labor seems to be a more important constraint for firms in the apparel and footwear sectors than other manufacturing sectors and discourages investment.** More than half the enterprises in the apparel or footwear sectors (52.7 percent) surveyed cited a shortage of adequately educated labor to be a major or very severe constraint on their growth, which was almost double (28 percent) the share of enterprises in other manufacturing sectors that cited the same problem. At the same time, apparel and footwear enterprises seem to have a lower share of skilled workers of their permanent production workforce relative to other manufacturing sectors both overall and across different firm characteristics (see Figure 1.8). The shortage of educated labor is related to migration and the weak vocational education system and retraining schemes that do not seem to provide enough semi-skilled workers and equipment technicians. While more advanced technology could raise labor productivity to a degree, it cannot compensate for long-term skill shortages. Moreover, a few firms in case study interviews cited the high expense of technicians (related to labor supply deficit) as a reason why they will not upgrade equipment.

**Figure 1.8. Share of Permanent Production Workforce that is skilled (%) by firm characteristic**



Source: Albania Investment Climate Survey 2007

**1.47 Few firms invest in training for their workers.** To address the shortage of semi-skilled and skilled labor, some companies interviewed for case studies offer ongoing on-the-job training and requalification but this option is usually restricted to large companies with guaranteed export orders that can afford higher wages and have lower turnover of employees. Most companies in the apparel and footwear sectors, however, particularly the small firms and micro-enterprises, say they are not in a position to offer higher wages as this would threaten their competitiveness that hinges on keeping labor costs low.

**1.48 Since they pay low wages, many firms also face high turnover that creates further costs.** High turnover of semi-skilled workers in particular further hurts firms' competitiveness in at least two ways. First, the firm has to deal with the formal requirements connected with hiring new workers and, secondly, new workers have to be trained to perform their specific task in the production process, implying that, with a large proportion of new workers at any given time, average plant productivity is hurt. Some firms in order to compensate for the high turnover, incur the additional cost of being systematically overstaffed by 15-20 percent relative to their needs, in order to minimize the search costs for new workers. The high turnover of the workforce also has the side effect of reducing the incentive of firms to train new workers in more skilled tasks, because of the likelihood that workers will part after receiving training, this implying that the firm will not be able to recoup its training costs.

**1.49 Firms in the apparel and footwear sectors seem to be trapped in a low equilibrium with low margins, poorly educated workers, and high labor turnover.** Many firms in Albania in the apparel and footwear sectors seem to be in a low equilibrium of low margins, requiring low wages for poorly educated workers, which encourages high turnover by workers that subsequently discourages firm to train their workers, and further hurts firm competitiveness. Helping firms break out of this spiral requires deep reform of the public vocational and higher educational training system,<sup>††</sup> as well as promotion of private training providers to reduce the skills mismatch and increase the supply of technicians and skilled workers. Better designed and implemented public support programs to encourage firms to provide in-firm training to their workers would also be beneficial. Benefits could also be reaped by relaxing some aspects

<sup>††</sup> In the medium to long-term, it is vital to increase the share of enrollment of scientists, engineers and professional staff who are required in the textile and apparel sectors but even more so in other more technologically and knowledge intensive export-oriented manufacturing and even service (IT) sub-sectors that Albania should move into in the medium-term as its comparative advantage in low-cost unskilled labor erodes.

of labor regulation relating to newly employed workers. One such measure could be exemption from pay social insurance contributions until after a statutory 6 month trial period. The increase in the minimum wage by more than 20 percent over the last three years has further exacerbated this situation for small firms, particularly outside Tirana, since labor accounts for 70-75 percent of total costs.

### *Regulatory Environment*

**1.50 Uncertainty over tax policy and implementation and concerns about informal practices by public officials were the most cited major obstacles by firms in the two sectors.** Just under half of firms in the apparel and footwear sectors (48.9 percent) surveyed within the 2007 Investment Climate Survey found tax rates to be a major obstacle, versus just 30 percent of other manufacturing firms. Similarly, almost double the share of firms (39 percent) in the apparel and footwear sectors mentioned tax administration as a major obstacle than the share of firms in other manufacturing sectors (16 percent). This reflects the substantially higher share of exporters who find tax administration to be problematic (41 percent) than non-exporters (18 percent), which represents a major impediment for export competitiveness. Finally, slightly more than a third of firms in the apparel and footwear sector (36.9 percent) found corruption to be a major obstacle, (although the share of other manufacturing was higher at 42 percent) and was the fifth most cited obstacle.

**1.51 Frequent changes in policies and inconsistent implementation of special support for apparel and footwear exporters discourage long-term investment and make the economy less attractive for high quality FDI.** For example, a scheme for reimbursing the fuel cost of generators for exporters in apparel and footwear was recently called off, while VAT reimbursement for exporters is notoriously time-intensive and unpredictable. To promote export competitiveness, it is important that the financial incentives for exporters are clear, properly enforced and support long-term investment. A number of managers interviewed in the course of case studies consider the Government's new fiscal package that simplifies the tax code to be critical for Albania's competitiveness, but have concerns that it will be implemented properly by tax officials, especially outside Tirana, where public capacity is more inconsistent. This unpredictable business environment may also be discouraging top quality foreign investors in the sector who have many other good options for relocation including Tunisia, South-eastern Europe and, increasingly, Moldova and Ukraine.

**1.52 Small and young companies suffer disproportionately from the unfriendly aspects of the business environment.** The regulatory environment is a relatively less important constraint for large firms because they are better equipped to deal with the delays and costs associated with excessive regulatory bureaucracy and taxes. For example, in the apparel and footwear sector, 58 percent of small firms cited tax rates as a major obstacle versus 52 percent of large firms. Moreover, small firms that service large exporters do not benefit from the financial incentives for exporters. For example, while exporters are eligible for VAT reimbursement, their outsourcing satellites, each of which specializes in one production process, is not eligible as they are considered to be producing for the domestic market. This implies that any fiscal package promoting exports in the apparel and footwear sector should be applied at the cluster level so that small sub-contractors can also benefit and be encouraged to invest and expand.

### *Access to Finance*

**1.53 Access to financial services for enterprises in the apparel and footwear sector especially small ones, remains difficult despite the expansion of the sector, and constrains their ability to finance investment and upgrading.** Access to long term finance and a lack of sophistication of available financial instruments severely limit firms' ability to borrow to finance working capital and investment needs with important consequences for the ability of Albanian firms to upgrade their productive capacity. Analysis of enterprise survey data and case study evidence shows that access to finance has significant negative effect on the average firm's productivity and propensity to export. However, access to finance

seems to be a particularly important constraint on upgrading for firms producing apparel and footwear – 23 percent of firms cited finance as a major obstacle versus 17 percent of other manufacturing firms – because the sector is seen as cyclical and risky.

1.54 **First, relatively small and young apparel and footwear producers have difficulty accessing finance from the formal private sector because the sector is viewed as risky.** Banks are generally conservative and unwilling to lend to relatively small, young enterprises in the apparel and footwear sectors that are seen as cyclical, high risk business. For such organizations, one of the few options is to borrow from donor subsidized financial institutions (such as ProCreditBank specializing in small loans to businesses in developing countries) although interest rates are still quite high (22-25 percent).

1.55 **Even for large firms in these sectors, accessing credit for working capital is problematic with short repayment periods and high interest rates because banks do not accept export orders as collateral.** Most companies interviewed in the course of case studies had a working capital loan but some complained that the interest rates were still high and the time to pay was too short, especially since they are dependant on payments by foreign firms. The fact that banks do not accept export orders as collateral is highly problematic because it means that owners have to put up their personal property as collateral. This dampens incentives not only of small business owners, but also of large firms because export orders collateral cannot be used for larger investments like the establishment of a new production line. Even firms with invoices from established international brand names cannot access working capital with these documents.

1.56 **Poor credit infrastructure also severely constrains firms' capacity to make necessary long-term investments, which would be needed to absorb the knowledge that is embodied in more sophisticated machinery and equipment.** A specific constraint is that most banks do not accept the purchased machinery/equipment as collateral, implying that owners have pledge their personal property (worth 100-150 percent of the credit value) in order to borrow, which, of course, dampens the incentives of entrepreneurs to upgrade their production capacity. At the same time, other types of credit financing such as leasing were limited to the largest firms (leasing accounts for 0.05 percent of total credit financing). *This obstacle becomes especially relevant for companies that have tried to upgrade by sourcing inputs and selling directly to retailers.* The lack of these instruments slows the process of moving up the production network as the owners wait to make the *necessary investments until they make enough profits*. Moreover, even the largest Albanian firms in the apparel and textile sector that with sufficient creditworthiness to obtain a loan would manage to obtain loans often opt to upgrade equipment on a more gradual, piecemeal basis, deterred by onerous debt servicing requirements.

1.57 **The limited range of credit instruments also constrains exporters in Albania.** Specialised instruments that are offered in Eastern Europe but not in Albania include insurance of export credits against non-payment or cancellation of order, either for short and medium-long term and for political or commercial reasons, export-related bonds such as bid, performance, advance payment, retention bonds, insurance for adverse exchange rate movements, credit information or professional receivable management services.

### 3. CONCLUSIONS AND POLICY RECOMMENDATIONS

1.58 **Despite consistently strong export growth in recent years, the apparel and footwear sectors are still dominated by firms that rely excessively on re-exporting low-value added products with limited evidence of upgrading.** Value added in the sectors have remained at similar levels to 2000, with relatively few firms moving beyond assembly operations to selling directly to foreign wholesalers, and no national private labels having been established. Upgrading has been limited for two reasons: First, exposure to foreign knowledge has been limited with FDI in the sectors decreasing and with limited spillovers to the local economy, while imports of capital equipment are low by regional standards.

Second, the absorptive capacity of Albanian firms is hindered by their low technical capabilities (internal to the firm) and key aspects of the investment climate. This, in turn, implies there is scope for carefully targeted public interventions to promote the strengthening of the technological capacity of firms in the sector to enable them to upgrade faster.

**1.59 A number of policy actions can be employed to stimulate technological upgrading and competitiveness in the footwear and apparel sectors.**

1.60 First, improving the reliability of electricity supply is vital in order to strengthen firms' incentives to upgrade to automated equipment. In the short to medium-term, the establishment of industrial sites with adequate infrastructure that can also encourage stronger backward linkages and spillovers between large production firms and sub-contractors and suppliers, may be appropriate.

1.61 Secondly, the supply of skilled workers and technicians that can use automated equipment needs to be increased by reforming the vocational education system, with private sector participation.

1.62 Thirdly, the key aspects of the business environment, especially those that hurt apparel and footwear exporters disproportionately such as unpredictable tax policy and implementation (i.e. VAT reimbursement for imports of equipment and inputs in particular) need to be addressed.

1.63 Fourth, the Government could facilitate the development by commercial banks of financial instruments tailored to allow export-oriented firms to make long-term investments to upgrade (i.e. guarantees for working capital) and inform firm managers of all existing sources of financing (local and international).

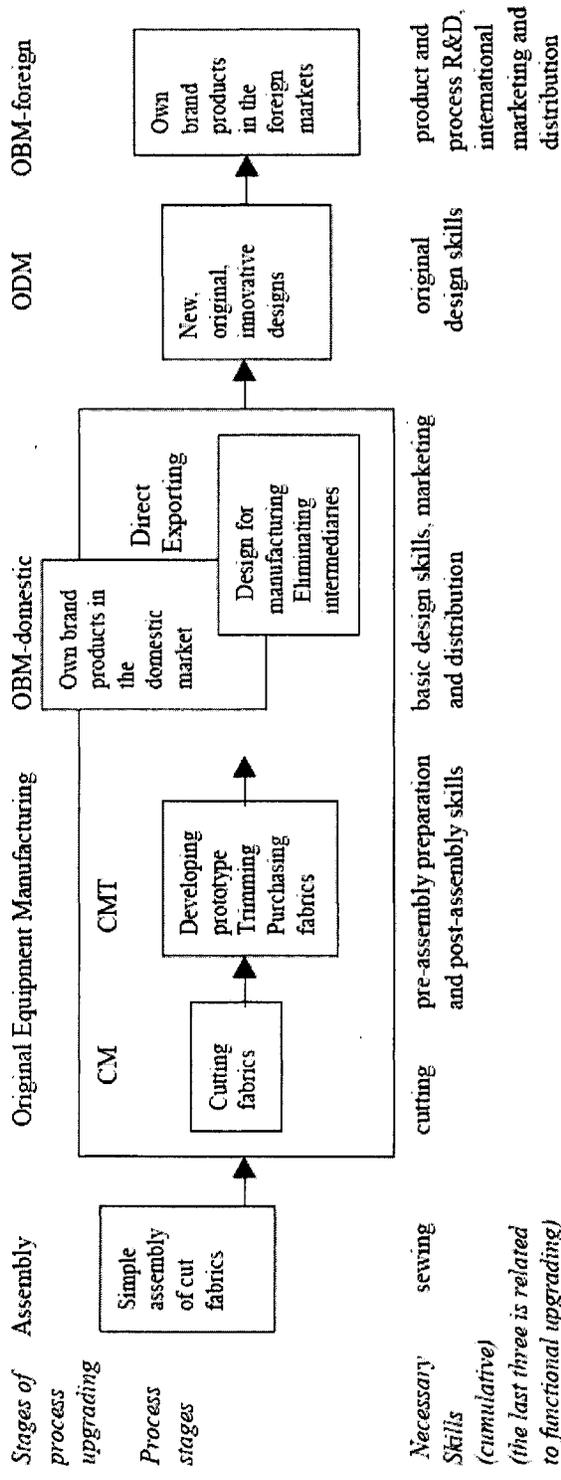
1.64 Fifth, a simplified, strictly targeted and effectively implemented temporary incentive regime aimed at attracting technology-intensive FDI to the apparel and footwear sectors could be considered following a careful analysis of the advantages and disadvantages of the incentives offered by other countries in the region.

1.65 Finally, the Government could promote (although implementation should be undertaken by the private sector) the training of apparel and footwear firm managers on sector-specific technology, processes and tools employed to reduce delivery times, increase productivity and better forecast demand. In addition, a matching grants scheme could be developed (again partially financed by the Government but implemented by a non-government entity as is the practice in other EU countries) to facilitate viable life-long learning and upgrading (i.e. firm-level training for workers, reimbursement of capital imports) by firms that face financial constraints.

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**ANNEX. DIAGRAMMATIC REPRESENTATION OF TECHNOLOGICAL UPGRADING IN THE APPAREL SECTOR**



Source: Adapted from D. Yoruk (2001)

## 2. TOURISM

*Tourism is one of the main channels through which Albania can achieve sustainable long term growth by integrating into the global economy. Tourism has become an integral and increasingly important part of the economies of the countries in Central and Eastern Europe, generating employment, foreign exchange revenue and new businesses. For Albania, increased tourism activity is inevitable given its proximity to markets and other well developed tourist destinations, as well as its natural and cultural asset endowments.*

*The current paradigm for tourism in Albania is that the primary market for the existing supply capacity and trends in the tourism sector is domestic and at best regional. This market dominates tourism consumption in Albania and is dictating a supply response that is oriented towards those consumers' limited needs (simple and cheap accommodation). While loyal and probably consistent, this market, and the supply response it triggers, will not drive innovation and change and it will not encourage improved standards and better skills necessary to reach out to international markets. This is a limited market that can only serve to perpetuate isolationism. For Albania to improve its tourism offer, penetrate international markets, and grow the sector, it will be essential to stimulate increased levels of foreign interest and investment and, by doing so, increase integration in the global tourism market.*

*Significant challenges – a consequence of transition from state to private management and centralization and monopoly to decentralization and competition – face Albania in its efforts to use tourism to promote international integration. Among these, the following are considered priority areas to address:*

- *Gaps in a suitable infrastructure platform for tourism activities and enterprises (particularly accommodation, roads and electricity);*
- *A paucity of trained personnel in tourism service provision;*
- *Weak promotion efforts that hinder market penetration;*
- *Insufficient FDI in tourism that could drive both increased market penetration and improved service standards and training;*
- *Weak regulation and environmental standards that are a threat to tourism endowments and overall destination attractiveness;*
- *Insufficient public-private policy dialogue and insufficient intra-government cooperation on tourism related issues such as land allocation, investment promotion, data collection and infrastructure development;*
- *Insufficient policy and political focus on tourism specific issues.*

*Given the current situation, the following are recommended priority actions to promote sustainable tourism growth in Albania over the short to medium term:*

- (i) **Target tourism FDI promotion** in resort development and tour operations, and aim at 5-7 investments over the next 3-5 years.
- (ii) **Invest in improving the quality of existing Albanian involvement** in the private sector (mainly service delivery) and the public sector (asset management and presentation).
- (iii) **Target recognized niche markets** (such as cultural tourism, adventure tourism, walking and trekking, bird watching) and organize and package the existing domestic product for an international independent traveler market.
- (iv) **Instigate a tourism destination planning culture** in the public sector and improve public institutional capacity and cooperation in tourism planning, regulation, promotion and data collection.
- (v) **Invest in (public and private sector) extensive tourism services training.**
- (vi) **Improve public-private dialogue and cooperation** in the areas of information dissemination, marketing and promotion, industry standards and regulation, human resource development, infrastructure provision, and destination planning and zoning.
- (vii) **Target the development of an international airport in the south** as an alternative entry point for charter flights and low cost carriers that is closer to primary tourism assets.

## 1. INTRODUCTION: A “NEW MEDITERRANEAN FRONTIER”?

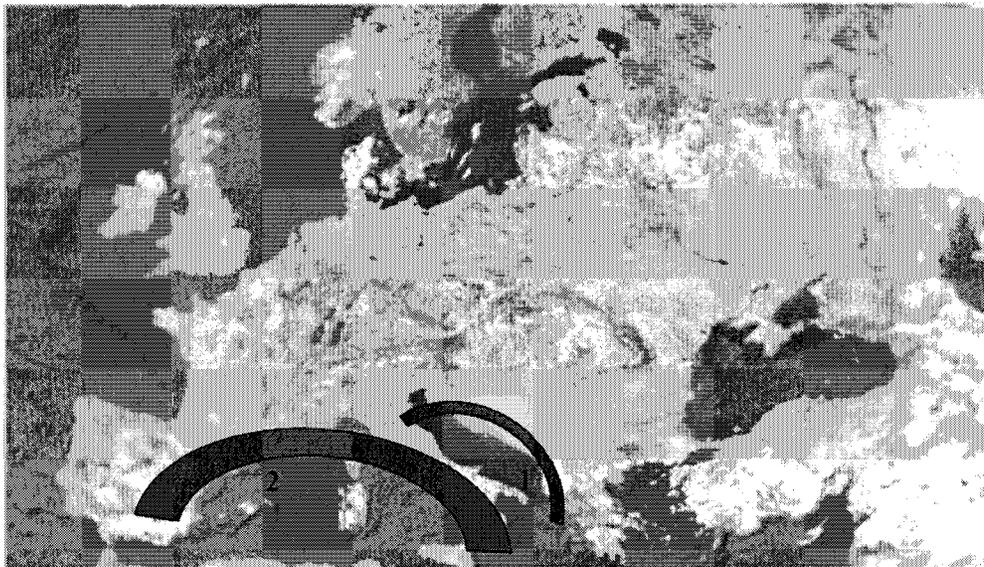
2.1. **Albania is located in a region of increasing international interest as a travel destination.** While there are currently just over 1 million international visitors entering Albania, few of these are foreign tourists but rather business people, returning residents, officials and over 40 percent who are Albanians resident outside the country coming home to visit friends and family (an estimated 1.5 million Albanians live outside the country). However, analysis of UN World Tourism Organization (UNWTO) forecasts and data provided by other industry associations<sup>7</sup> suggests that, as a tourist destination, the Eastern Mediterranean region is expected to grow at above average rates over the next two decades as stability returns and as the Russian outbound market expands<sup>8</sup>. In particular, the Western Balkans states of Albania, Montenegro and Croatia all share a piece of the Adriatic coastline being coined by the travel and tourism industry as “the new Mediterranean frontier”<sup>9</sup>.

<sup>7</sup> 2006, World Travel and Tourism Council, Annual Report

<sup>8</sup> 2007, UN World Tourism Organization; Tourism Market Intelligence Report, Europe

<sup>9</sup> Headline in World Travel Market “Daily News” November 8<sup>th</sup>, 2007.

**Figure 2.1. New Mediterranean Frontier (1) and Traditional Mediterranean (2)**



2.2. **UNWTO forecasts arrivals to Central/Eastern Europe are expected to grow rapidly and that by 2020 nearly one in three visitors to Europe will choose a Central or Eastern European destination.** Contributing factors are cited as favorable location relative to source markets (Figure 2.1) and competitively priced products; exactly the same circumstances as Spain and Greece 30 years ago. This opens new opportunities for the expansion of the tourism sector in Albania.

2.3. **Albania has a comparative advantage in several areas,** suggesting that the development of an internationally competitive tourism industry is possible:

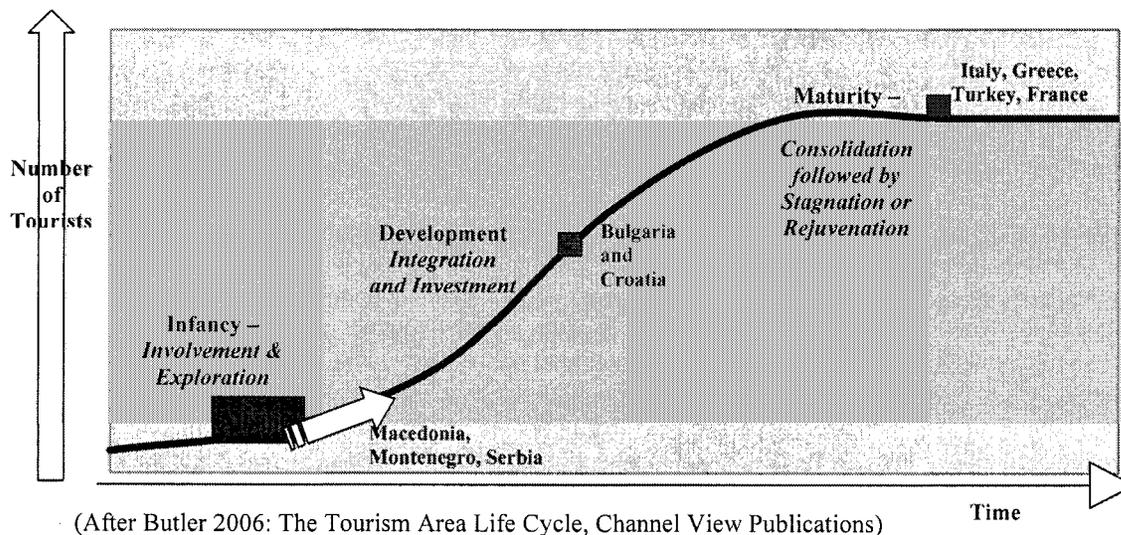
- Albania has a strong *underlying product* which is potentially saleable on the European and World travel market;
- Albania is close to many other countries which act as major *“pull” destinations* in the region including Italy, Greece, Croatia, Bulgaria, Turkey, Hungary, Cyprus;
- There are large numbers of *travelers in surrounding countries* and this is already having an impact on destinations like Butrint National Park and Saranda that receive day visitors by ferry from Corfu;
- Albania’s warm *climate* and high number of sunny days (second to Spain among European countries);
- There is a high *“curiosity” factor* following Albania’s closure for most of the past century;
- International air *access* is relatively good and improving as is road and maritime access;
- *Visa requirements* are not onerous.

2.4. **Albania is seemingly well placed to take advantage of the tide of tourists flowing into the region.** However, local and foreign investment in response to this opportunity appears stalled, especially when compared to the growth occurring in neighboring countries. By assessing and analyzing tourism competitiveness factors this study highlights binding constraints and suggests remedial actions.

## 2. ASSESSING TOURISM COMPETITIVENESS IN ALBANIA

2.5. **Albania's tourism sector is still in its infancy.** Hypothetically all tourism destinations follow a product life cycle concept (Figure 2.2)<sup>10</sup> whereby sales proceed slowly at first as the destination gains market appeal and investor confidence (infancy), then experience rapid growth and investment (development), then stabilize (maturity) and subsequently decline or rejuvenate. If, as suggested by the travel trade, Croatia, Bulgaria, Albania, Macedonia, Montenegro are a new tourism frontier, then Spain (58 million visitors), Portugal (12.5 million visitors), France (79 million visitors), Italy (41 million visitors), Greece, Turkey (see below), Morocco (7 million visitors), Tunisia and Egypt (8 million visitors each) are the established, or "mature", destinations of the Mediterranean. Much can be learned from the path these destinations took to "maturity" in planning for Albania's growth.

**Figure 2.2. Albania's Conceptual Evolution as a Tourist Destination**



2.6. Albania's tourism industry exhibits classic characteristics of infancy:

- relatively small numbers of foreign visitors (it is still being "explored"),
- few visitor specific services (tourists are not catered to),
- most services are provided by locally owned and operated enterprises (not much integration),
- there is a strong seasonal dimension, limited advertising and non-specific marketing, and
- there is not much physical change in the destination as a result of planning and tourism development.

2.7. **Inadequate infrastructure, training, promotion, regulation and political commitment are the main obstacles for the development of tourism in Albania.** Whilst

<sup>10</sup> R.K. Butler 2006: The Tourism Area Life Cycle, Channel View Publications

support for tourism development is stated as a key priority by Albanian policymakers<sup>11</sup>, tourism operators (both domestic and international) interviewed during the preparation of this case study lament gaps, *inter alia*, a suitable infrastructure platform (particularly accommodation, roads and electricity), a paucity of trained personnel in tourism service provision, weak promotion efforts, weak regulation and environmental standards, and an absence of political will to support the recently launched 2007 National Tourism Policy and Strategy.

**2.8. Albania's history of isolation and poor image are fundamental causes of tourism underdevelopment.** While Albania has had a tradition of domestic and regional (from Eastern Europe) visitation, its venture into international tourism has only been possible since the fall of the communist regime in 1991. Subsequent events external to the tourism sector - such as the collapse of the Pyramid Schemes in 1997, Albania's long held reputation for unchecked organized crime, the periods of hostilities in neighboring Kosovo and the subsequent NATO intervention in 1999 - have all contributed to an image deficit and have hindered Albania's growth towards increased international tourism from the "west". Driven mainly by thriving tourism in neighboring countries, Albania is only now starting to reach out to international markets, as operators in these markets are in turn making tentative steps towards exploring Albania as a destination. However, the growth trajectory of tourism in Albania over the coming decade will be determined by government policies and planning, as well as by the extent to which the government values and invests in these.

**2.9. Transition from "infancy" to "maturity" requires that the Albanian tourism sector become competitive across a range of demand- and supply-side dimensions.** This section of the study focuses on competitiveness factors as interpreted through the overall performance of the sector and observed business characteristics of sector players such as hotels and tour operators interviewed during the 2007 Investment Climate Survey (ICS) and the follow-up work for this study. Desk research and interviews with the public sector informed the analysis of the background policy and regulatory environment. The study uses this information to analyze different dimensions of tourism competitiveness, demand conditions, and supply conditions including, *inter alia*, infrastructure, supporting industries, sector policies and strategies, political support, as well as social, cultural and environmental conditions.

## **Demand Characteristics**

### ***Tourist Arrivals and Receipts***

**2.10. Tourism arrivals have increased eight-fold since the start of transition.** In the pre-transition era, Albania was virtually closed to international tourism, and the few tourist arrivals were strictly controlled and directed by the State thorough Albtourism. Albeit from a low base, tourist arrivals have grown since 1992 when the recorded figure was 130,000. Tourist arrivals for 2007 were just over 1 million and tourism foreign exchange receipts<sup>12</sup> were nearly US\$900

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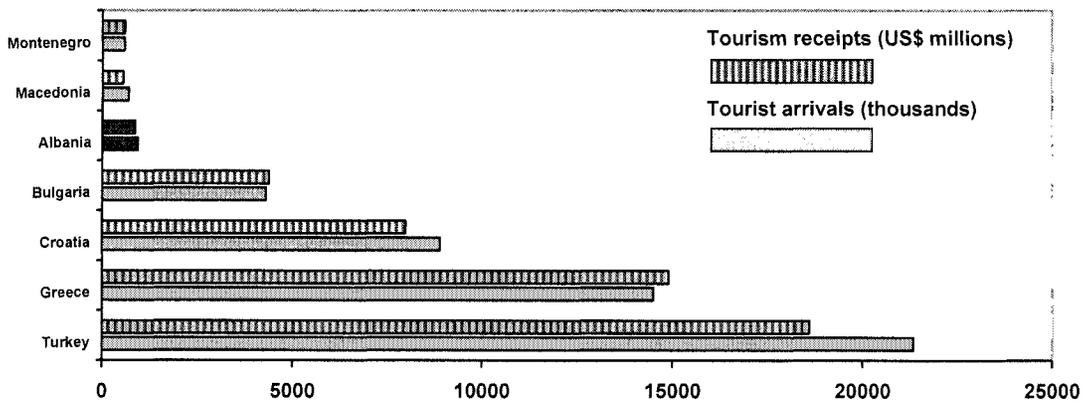
<sup>11</sup> In a recent interview with the BBC (Feb.11 2008) the Albanian Minister for Tourism, Culture, Youth and Sport, is quoted as saying that he is "convinced that following the example of Bulgaria, European integration can be supported through tourism ... We aim to reach over a million tourists this year; our country has over 470 kilometers of preserved coastline ideal for tourism investment, as well as first rate cultural sites. The number of visitors to our UNESCO registered World Heritage site in Butrint National Park and the Apollonia shrine has tripled in the last five years.

<sup>12</sup> Figures taken from Ministry of Interior estimates and Bank of Albania Balance of Payments estimates in UNDP "Summary of Albanian Tourism Statistical Data", December 2007, Marco Bordini.

million. These figures seem to indicate that Albania's tourism sector is performing well, but comparative data for the region show it could be doing better.

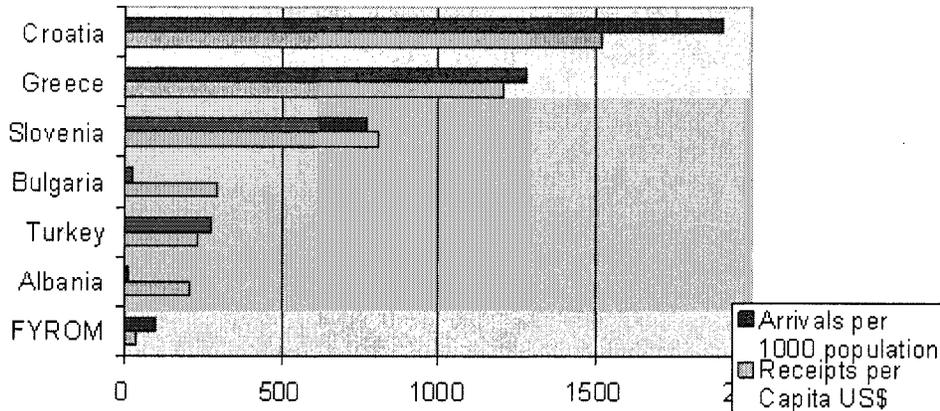
2.11. **Tourism arrivals and receipts still lag behind other countries in the region.** Figures 2.3 and 2.4 show the comparative data for tourism arrivals and earnings for a range of countries in the region<sup>13</sup>. Of the frontier countries, Croatia and Bulgaria are showing signs of catching up to the rest of the Mediterranean, while Albania, lags both in terms of number of arrivals and value of tourism receipts per capita. From a tourism perspective, the size of a country, either by land area or population, does not correlate with tourism performance as measured by numbers of visitors (for instance most islands in the Caribbean attract 5-10 times more tourists than the resident population). More important as an indicator of performance, is the composition of the overall tourist visitors and their characteristics in terms of purpose of visit, seasonality, length of stay and expenditure in the destination and unfortunately this data is not routinely collected by the government (as it is for most countries through immigration cards).

**Figure 2.3. International Tourist Arrivals and Receipts (2006)**



\*Source: UN World Tourism Organization statistical tables and Albania Ministry of Interior data.

**Figure 2.4. International Tourist Arrivals and Receipts per Capita**



<sup>13</sup> Albania does not collect entry cards at ports of entry and there is therefore no reliable data on the country of origin or purpose of visit of tourists. The total number reported by the Ministry of Interior is accurate for total visitors but only differentiates for "Albanians" and "foreigners".

a) Purpose of visit

2.12. **Most tourism arrivals are from neighboring countries and Albanians residing abroad.** While the figure of 1 million tourists for Albania is significant, over 70 percent are from Kosovo, Macedonia, Italy and Montenegro, most of whom have family ties to Albania. Less than 10 percent of visitors are from traditional European source markets such as the UK, Germany and France. Meanwhile there has been no market research in any of the current source markets to assess travel characteristics and expenditure patterns of current tourists. In addition, the absence of regularly collected immigration data makes it difficult to establish visitation trends and, therefore, difficult to plan for marketing and promotion activities. Based on existing sources of data, it is not possible to put together a segmented demand profile of Albania's tourism. However, the various reports and tourist trade interviews suggest that, out of nearly a million recorded visitors in 2006, roughly 800,000 visitors were returning Albanians visiting friends and family or coming home for holidays, 70,000 were business visitors staying mainly in Tirana, 100,000 were day visitors to Saranda and Butrint, a further 70-80,000 were foreign tourists visiting Albania through a tour operator or as independent travelers (these are the genuine leisure tourists), and the balance were transit visitors passing through the country. The figure for genuine leisure tourists is disappointing when compared to other regional destinations (all information collected from websites indicated):

Albania: **70-80,000** (Albania National Tourism Organization <http://www.albaniantourism.com/> tag-line<sup>14</sup> "*A new Mediterranean love*")

Croatia : **3.8 million** (Croatian National Tourism Board <http://www.croatia.hr/>) tag-line "*The Mediterranean as it once was*"

Bulgaria: **1.25 million** (Bulgaria State Travel Agency <http://www.bulgariatravel.org>)

Montenegro: **190,000** (Ministry of Tourism <http://www.visit-montenegro.com/ministry>)

Macedonia: **216,000** (Ministry of Tourism <http://www.exploringmacedonia.com/> )

Greece: **7.2 million** (Greek National Tourist Organization <http://www.visitgreece.gr/>) tag-line "*The true Mediterranean experience*"

2.13. **Clearly, even allowing for errors in calculating the Albanian share of leisure tourists, Albania is not performing as well as its neighboring countries.** In particular the low numbers of international tourists are an indicator of both weak demand and poor product offering.

b) Seasonality

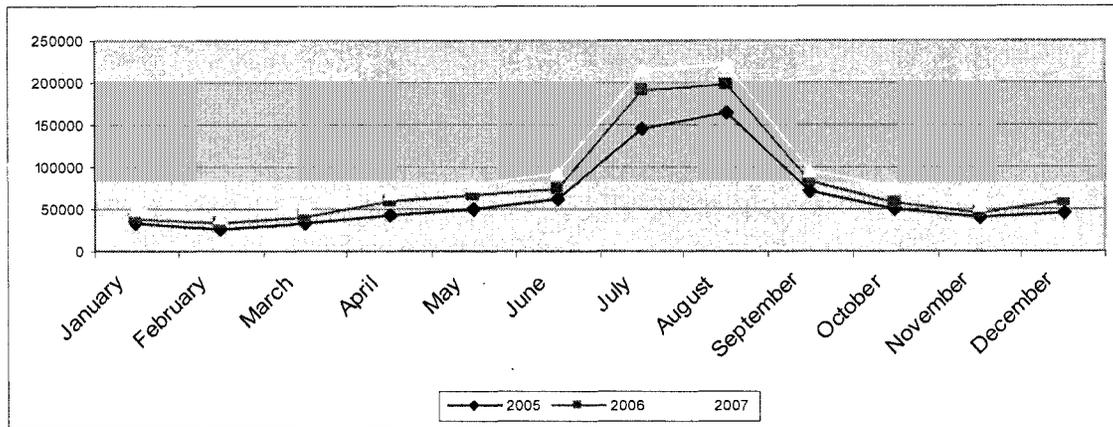
2.14. **Albania also exhibits significant seasonal variation in its visitor traffic, with almost three times the number of visitors in the summer months of July and August compared to the rest of the year.** This is a challenging characteristic to overcome for tourism sector players

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<sup>14</sup> The "tag-line" is the phrase that the country is marketing itself under – it indicates how the country is positioning itself in the market place.

and, in Albania's case, it appears largely driven by Albanians living abroad returning for summer holidays with friends and relatives (Figure 2.5).

**Figure 2.5. Seasonal Variation in Tourism Visitors by Month 2005-2007**



Source: Albania National Tourism Organization

#### *c) Length of stay*

2.15. **Length of stay in Albania is shorter than in neighboring countries.** There is little reliable data available on the length of stay of tourists to Albania. Nevertheless, all destinations aspire to keep tourists for as long as they can and it is likely, with the exception of the segment visiting friends and relatives for summer holidays, that the length of stay in Albania is shorter than regional competition. Current tourism promotions for Albania characterize it as a “secondary” destination and an “add-on” to primary destinations like Greece and Croatia. While this persists, length of stay for tourists is always going to be limited.

#### *d) Expenditure*

2.16. **Average expenditure figures may overstate the actual expenditure patterns of foreign visitors.** As with all countries, tourists visit for different reasons (business and conferences, leisure, education, pilgrimage, visits to friends and family etc.) and have different expenditure patterns. Business visitors tend to stay for shorter periods and have different accommodation needs to leisure visitors. Others are just day-trippers, for instance it is known that approximately 80,000 visitors crossed by ferry for the day to southern Albania from Corfu and Greece in 2006; these tourists spend up to 10 times less than the average of US\$900 or so per person. Currently the figure of US\$ 861 million (roughly US\$900 per person) in foreign exchange receipts from tourism (as calculated by the Bank of Albania) is based on the average expenditure of a sample of hotel guests in Tirana and extrapolated to the total number of recorded visitors; the flawed assumption being that hotel guests in Tirana are a proxy for all visitors. An ongoing tourist survey<sup>15</sup> is showing that more than 40 percent of visitors passing through Tirana

<sup>15</sup> December 2007, Andrew Seidl, Consultant, Colorado State University, Mid-term Report of a tourist survey at Mother Teresa International Airport.

International Airport (678,098 in 2006; approximately 328,000 of which are inbound passengers) are staying with friends and family; they too are not spending the assumed average per person. It is therefore critical to segment the tourism traffic in order to understand, not only the economic impacts attributable, but also market shares of specific segments as this aids development and promotion strategies.

### ***Market Presence***

2.17. **Tourism promotion efforts are insufficient.** Traditionally, tourism products are commercially promoted in tourism markets through a combination of three channels; (i) a national promotion agency financed partly or wholly by government that takes responsibility for promoting the whole destination, (ii) tour operators and travel agencies that wholesale or retail packages (bundled together products including transport, accommodation and activities) to the destination, and (iii) individual hotels or resorts that sell direct to consumers. The performance of each of these is examined and analyzed.

#### National promotion

2.18. A review of the publications and website produced by the National Tourism Organization as well as the range of material available from the public sector suggests the following:

- **“information” material is detailed and accurate but is untargeted** - it is concentrated on *imparting information* to the general public rather than *conveying a specific experience* to a targeted customer;
- **all material lacks a “marketing” bias reflecting an absence of market research**, and a limited understanding of key product features and buyer behavior;
- **there is no *product definition* that allows consumers to differentiate Albania** from other destinations in the region and there is no “activity based” promotion;
- ***quality of locally produced material is poor*** – imprecise translations, variable photographic quality, unprofessional layout and design;

2.19. **Shortcomings lie with both the public and the private sector.** These observations suggest that knowledge of markets and marketing is limited at the public sector institutional levels, where the most likely constraints are a lack of market research and the weak professional skills. Other constraints may be the ability of the private sector to engage in meaningful dialogue with the public sector to better target their promotional material. There may also be deficiencies in the capacity of the private sector to innovate and develop tourism (such as the creation of activity based products) that are reflected in the material being produced and promoted by the public sector.

#### Tour operators and travel agents

2.20. **Albania as a destination is absent in source market countries.** The absence of product being sold by both source market and destination country tour operators – who are critical sales intermediaries in the supply chain – is contributing to Albania’s weak market performance. There are two kinds of tour operators important to a tourism delivery system; tour operators in the

destination country and tour operators in the source market country. They perform different roles according to their position in the value chain. Tour operators in source market countries are higher up the value chain and package product that includes transport to the destination country, activities and transport around the destination country (typically, the service provided by tour operators in the destination country) and hotel accommodation in the destination country. It is very significant that “destination Albania” is mostly absent from the brochures of European tour operators<sup>16</sup>. For instance, the largest adventure tourism wholesaler (<http://www.exodus.co.uk/regions/europe>) in Europe – a product that might be suited to Albania’s scenery – does not feature trips to Albania at all. It is also significant that only two destination country tour operators feature prominently in internet searches; contrasted with over 50 for Croatia for instance. The small number of international tours that are coming to Albania, for example, Abercrombie and Kent’s Marco Polo Club and Birdquest Ornithological Tours, are set-departures<sup>17</sup>, expensive and all personally guided, typically in order to cocoon their clients from the local conditions. These types of tours are characteristic of destinations that are being market tested – again alluding to the infancy of Albania.

#### Individual hotels and resorts

2.21. **Individual hotels and resorts that attempt to market themselves directly abroad are virtually absent.** The number of hotels or resorts that are positioning themselves in markets outside Albania to sell direct to consumers is market presence is almost non-existent. Only one website, <http://www.albania-hotel.com/terms.html>, features hotels in Albania in any systematic way and this is a domestic service provider. Few hotels appear directly on the internet whilst a survey of the main internet distribution channels for hotels in Europe was reviewed with the following results:

**Table 2.1. Number of hotels featured on expedia.com and hotels.com**

	<a href="http://www.expedia.com">www.expedia.com</a>	<a href="http://www.hotels.com">www.hotels.com</a>
<b>Greece, Italy, France,</b>	<b>5000+</b>	<b>5000+</b>
<b>Croatia</b>	<b>128</b>	<b>85</b>
<b>Bulgaria</b>	<b>213</b>	<b>179</b>
<b>Montenegro</b>	<b>18</b>	<b>6</b>
<b>Albania</b>	<b>3</b>	<b>2</b>

2.22. **Albania does not have a network of Tourist Information Centers to co-ordinate marketing to potential foreign visitors.** Albania has very little tourism specific market presence and therefore a poor foundation for attracting tourists. This is reflected in both the public sector and the private sector weak promotion and information about Albania’s products. The recent inclusions of Albania by internationally published and distributed guidebooks like Lonely Planet and In Your Pocket improve the quality of information and ultimately make the country more accessible to independent travelers. Currently, apart from a seasonal kiosk in Saranda’s port building, Albania has no Tourist Information Centers. In other countries information centers are revenue earning through the provision of services such as selling hotel bookings and tours and packages. Several operators reported that the Tourism Ministry’s promotion department publishes

<sup>16</sup> The promotion material of Thompson Travel UK, TUI, Club Med, Airtours, and Nouvelles Frontiers, the five largest tour operators in Europe was surveyed and Albania featured only as an add-on 2-3 day trip to the region. Destinations like Croatia and Bulgaria were offered multiple times as stand alone packages.

<sup>17</sup> “Set departures” are tours with limited numbers (usually no more than 16) that have set departure dates. Operators advertise and try to fill the spots months in advance.

brochures and booklets, but these are only distributed at tourism trade fairs abroad, leaving the brave tourists that actually come and visit Albania with empty hands and quite a few questions. Providing details of hotels, restaurants and sights is left to private companies. It is clear that municipalities across Albania have no experience with providing information to foreign tourists, nor do they seem capable or willing to organize themselves to provide this service.

### Supply Characteristics: Access and Transport Services

2.23. **Infrastructure and transport services are paramount for developing tourism in Albania.** Transport services are usually provided by the private sector and closely linked to dynamics of supply and demand. The fact that transport service providers in Albania are lagging behind the region is further indication of its infancy as a destination and the fact that demand for transport services remains weak.

2.24. **Internal transport is likely to remain a major limitation for tourism** in the foreseeable future except perhaps for road transport along key highways where upgrading/reconstruction is already planned or committed. In the WEF Travel and Tourism Competitiveness Report, Albania’s tourism infrastructure is rated in the bottom two in the region (See Table 2.2). The government recognizes this and is investing heavily in improvements. However, for tourism, the availability of efficient and cost effective transport infrastructure and services is a critical competitive factor and Albania falls short. Even small advances in infrastructure could lead to fast tourism development, for example investments in large tourist resorts that may be able to increase the turnover of the tourist industry by several times, in only a few years, as happened in Bulgaria in the late 1990s. This could also mean more travel in the region, for example from Kosovo, which with its 2 million ethnic Albanians and no access to the sea, has great potential for development of Albanian tourism.

**Table 2.2. Tourism Infrastructure**

	Rank /130	Score
Moldova	91	2.44
Albania	86	2.53
Macedonia	61	3.55
Bosnia	59	3.61
Serbia	52	3.91
Turkey	50	4
Montenegro	31	4.81
Bulgaria	22	5.42
Slovenia	20	5.93
Croatia	10	6.63
Greece	9	6.67

*Source: WEF's Travel and Tourism Competitiveness*

2.25. **Air access to Albania is behind the rest of the region.** As a “short haul”<sup>18</sup> travel destination (i.e. easy access) from the main European generating markets Albania faces stiff competition from more established destinations in neighboring countries. Air access is moderate (14 airlines to and from 22 European cities), and it is telling that currently none of the high volume low cost carriers ([www.easyjet.com](http://www.easyjet.com), [www.ryanair.com](http://www.ryanair.com), [www.skyeurope.com](http://www.skyeurope.com),

<sup>18</sup> As distinguished from “long haul” destinations, which are typically more than 5 hours by air from source markets.

www.germanwings.com, www.whizzair.com) are flying to Albania. Comparison with competing regional destinations such as Zagreb (26 airlines to and from 68 European cities), Dubrovnik (32 airlines to and from 76 cities) Varna (32 airlines to and from 65 cities) and Sofia (45 airlines to and from 90 cities, including Asia and Africa) shows that air access to Albania is behind the rest of the region.

**2.26. Air transportation costs constitute a significant burden on tourism development.** The fact that the popular low cost carriers are not featuring Albania is impacting its competitiveness with other destinations, as is the fact that Tirana does not connect directly to any other continent besides Europe. Without a detailed value chain analysis it is difficult to tell how significant the air travel component would be in an overall trip to Albania. However, preliminary research carried out during the preparation of this study indicate that the cost of air tickets from London, Frankfurt and Amsterdam (all strong European source markets in the regions) comprise between 60-68 percent of the expenditure of a one-week holiday to Albania as offered by small tour operators in those countries. This is almost double the proportion of travel to Zagreb and Dubrovnik.

**2.27. Albania's tourism competitiveness and market appeal is hampered by the absence of a second or third airport close to tourism assets.** There is currently no effective domestic air transport network in Albania although there is a network of military airports which could be mobilized for private purposes. Also, there is no commercial air access to the south where the largest potential exists. Tirana International Airport is Albania's only international airport and thus plays an important role connecting the country to worldwide markets. The airport has received significant investment over the past five years with a further public-private investment in a modernization program totaling EUR 46.9m planned for 2008/09. The recently agreed contract with Lockheed Martin (the first major U.S. commercial investment in Albania) to develop the country's air traffic management infrastructure will modernize and improve communications and navigation equipment, link surveillance capabilities with the nearby airports of Skopje, Brindisi, and Kerkira, expand airspace structure, and enhance the tower building at the Tirana International Airport. The improvements will bring the airport, currently without radar capabilities, into compliance with *Eurocontrol* safety standards. The radar environment would also permit a significantly larger volume of over-flight traffic and encourage airlines to fly via Albania due to fuel savings and shorter flight times. This is a landmark transaction in Albania and sends a clear and positive message about the state of development of the commercial, political and legal environment for public-private partnerships in Albania. Its innovative structure makes it a showcase for private-sector investment in medium-sized airport operations in the region.

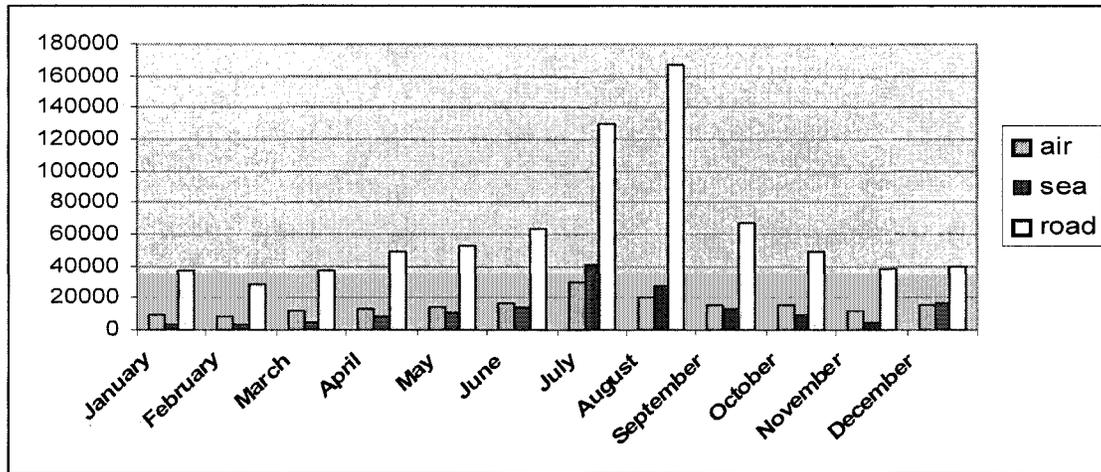
**2.28. Albania is serviced by well developed ferry services connecting its main ports with Italy and Greece, however, transport services from ports inland are generally poor.** Despite a number of existing ferry connections with Italy and Greece (see Table 2.3), as an entry point for tourism, seaports are relatively underutilized. In addition the absence of quality marinas and associated marina services (such as those found throughout the Mediterranean) also hampers potential tourist access and lowers the potential economic impacts from this important regional source of tourists and revenues.

**Table 2.3. Sea Links with Italy and Greece**

<b>Durres:</b>	from/to the Italian ports of Ancona, Bari, Brindisi and Trieste
<b>Vlora:</b>	from/to the Italian port of Brindisi
<b>Shengjin:</b>	from/to the Italian port of Bari
<b>Saranda:</b>	from/to the Greek Island of Corfu

2.29. **Most foreign visitors enter Albania by road.** Currently there are six main road entry points into Albania; from Greece at Kakavia south of Gjirokastra and Kapshtica near Bilishti, from Kosovo at Morina near Kukes, from Montenegro at Hani-Hotit near Shkodra, from FYR Macedonia at Qaf-Thane and Tushemisht on Lake Ohrid. As Figure 2.6 shows, these access points are the main entry for the current volumes of tourists – over 70 percent of all visitors to Albania come by road and it clear that mode of transport will continue to dominate tourist access to Albania until other services improve.

**Figure 2.6. Visitors by Mode of Transport (2007 data)**

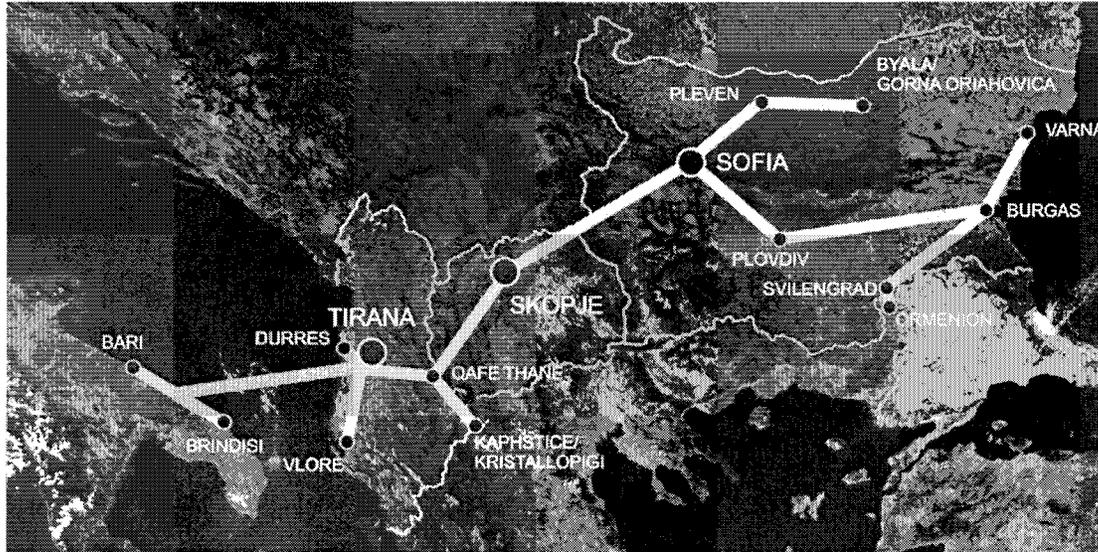


Source: Albania National Tourism Organization

2.30. **The road network is an obstacle to the development of tourist areas, while the rail network is almost non-existent.** Despite the high levels of public investment, Albania is still weakly endowed in infrastructure compared to other lower middle income emerging economies, both in terms of scope and quality. According to the Global Competitiveness Report, users find the quality of Albania's infrastructure to be commensurate with several African countries, worse than CIS countries, and much worse than other Lower Middle-Income Countries. The state of the road network is improving all the time but roads connecting tourist areas of the country are in poor condition limiting easy travel within the country. Travel times are long and journeys are uncomfortable - e.g. a trip from Tirana to Saranda takes 7-8 hours with limited traveler support (fuel availability, food service, rest stops, etc.).

2.31. New investments are being made at a rapid rate and the development of the Corridor VIII as a multi-modal transport system providing about 1270 km of railways and 960 km of roads between the Adriatic/Ionian Seas and the Black Sea is expected to generate opportunities for many travel services along the routes (see Figure 2.7 below). With increased and improved access, tourism destinations in Albania along Corridor VIII are also expected to benefit.

Figure 2.7. Corridor VIII Conceptual Plans



Source: Corridor VIII Secretariat

2.32. Despite the bottlenecks connected with transportation, non-stringent visa requirements represent an advantage for the Albania tourism sector. No visas are required for citizens from EC and EFTA countries as well as several other countries including USA, Canada, Japan, Singapore, Saudi Arabia, Malta, Qatar, Bahrain, Austria, New Zealand, and South Korea. Visitors from other countries can obtain visas on arrival; however, the absence of concessions for day visitors makes excursion travel expensive, but it is difficult, without a tourist survey, to assess whether this additional cost is a factor in influencing excursion travel.

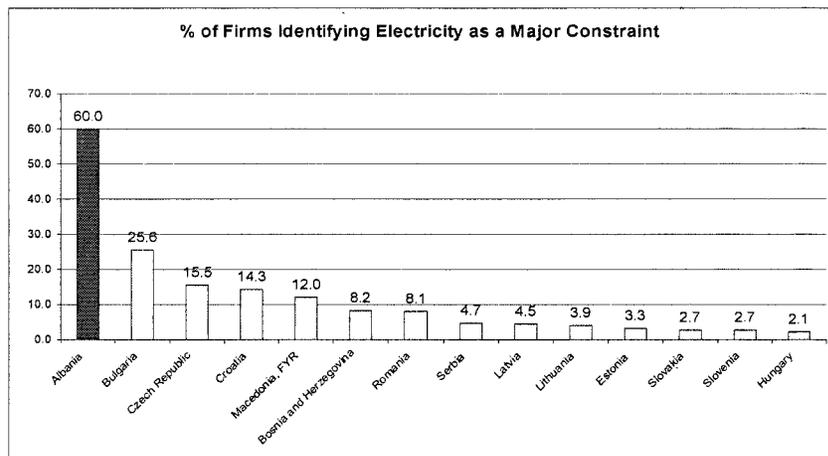
### 3. AN OVERVIEW OF CONSTRAINTS ON TOURISM DEVELOPMENT

2.33. **The main constraints to tourism development in Albania are both general and sector-specific.** Firms operating in the tourism sector (hotels, restaurants, tour operators, etc.) face constraints that are common to the enterprise sector in Albania. Bottlenecks to the expansion of the sector are often connected to deficient infrastructure services, such as energy, telecoms and waste disposal. More specifically for the sector, bottlenecks may also be related to poor training of tourism personnel and inadequate accommodation capacity.

#### Infrastructure

2.34. **Energy is a more frequent constraint for doing business in Albania than in neighboring countries.** Figure 2.8 shows that 60 percent of Albanian firms cite unreliable access to electricity as a major obstacle, by far the highest proportion in the region. This compares very unfavorably with other potential competitors in the tourism sector, such as Bulgaria and Croatia, where only 26 percent and 14 percent of respondents, respectively, cite access to energy as a major obstacle to doing business.

**Figure 2.8. Electricity as a Constraint for Doing Business**



Note: Data refer to the 2007 ICS for Albania, Bulgaria and Croatia and the 2005 BEEPS for other countries.

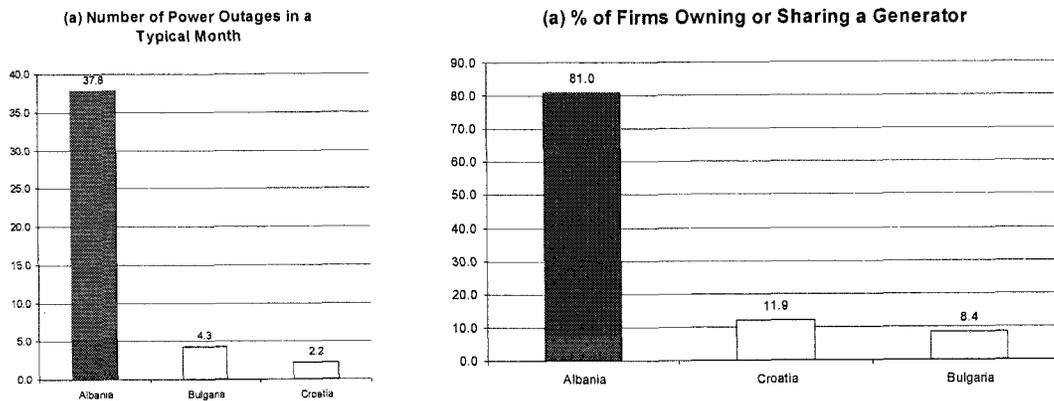
2.35. **Unreliable energy supply appears to be even more common for firms in the tourism sector.** Hotels and restaurants interviewed in the course of the 2007 Albania ICS cite access to reliable energy supply as a major obstacle more frequently than for firms in other sectors (Figure 2.9).

**Figure 2.9. Electricity as a Constraint for Doing Business: Sectoral Comparison**



2.36. **The frequency of – and costs associated with – power outages are a significant competitive disadvantage.** Since current tariffs are far below cost recovery levels, electricity prices remain low in nominal terms. Nonetheless, Albania’s electricity supply capacity is limited and whilst supply in the main centers is reliable, irregular power supplies (blackouts and brownouts) are common in tourist areas like Saranda, Durrës, and Vlorë. This puts Albania at a competitive disadvantage as a tourist destination relative to competitors in the region. For instance, Figure 2.10a shows that Albanian firms experience 38 power outages in a typical month, substantially more than firms in Bulgaria (4 power outages per month) and Croatia (2 power outages per month). This substantially adds to the cost of doing business for Albanian tourism operators, as reflected by the fact that 81 percent of Albanian firms use fuel-run generators (which substantially add to energy costs) to continue working, compared to only 12 percent and 8 percent of Croatian and Bulgarian firms (Figure 2.10b).

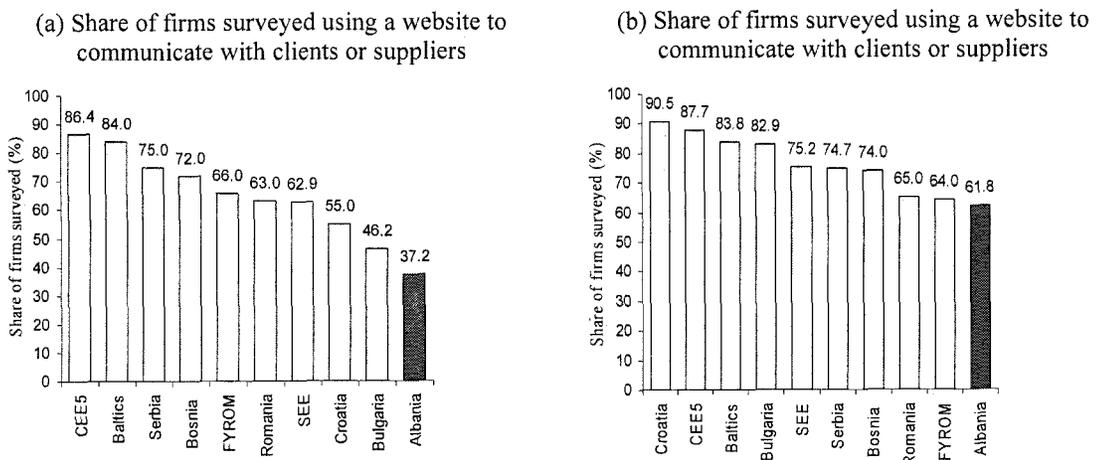
**Figure 2.10. Reliability of Power Supply**



Source: 2007 ICS for Albania, Bulgaria and Croatia.

**2.37. Albania has the lowest rate of ICT usage in Europe.** Firm-level surveys from 2007 in Albania suggest that the share of firms that are using modern Information and Communication Technology (ICT), for their business operations In Albania was the lowest in Eastern Europe. Figure 2.11 below demonstrate that just 37 percent of firms in Albania surveyed in 2007 had a website, compared to 46 percent of Bulgarian firms and 55 percent of Croatian firms. Similarly, around 62 percent of enterprises in Albania used email to communicate with clients and suppliers, compared to 83 percent in Bulgaria and 91 percent in Croatia. Whereas these results refer to the enterprise sector as a whole, they can be easily extended to firms operating in the tourism sector. Given the importance ICT use to publicize and market Albania as a tourism destination, lagging ICT performance in Albania has significant implications for the potential of Albanian tourism operators to compete in international source markets with better equipped competitors from countries in the region, such as Bulgaria and Croatia. In particular, the ability to take advantage of growth in online reservations and promotions will not be captured.

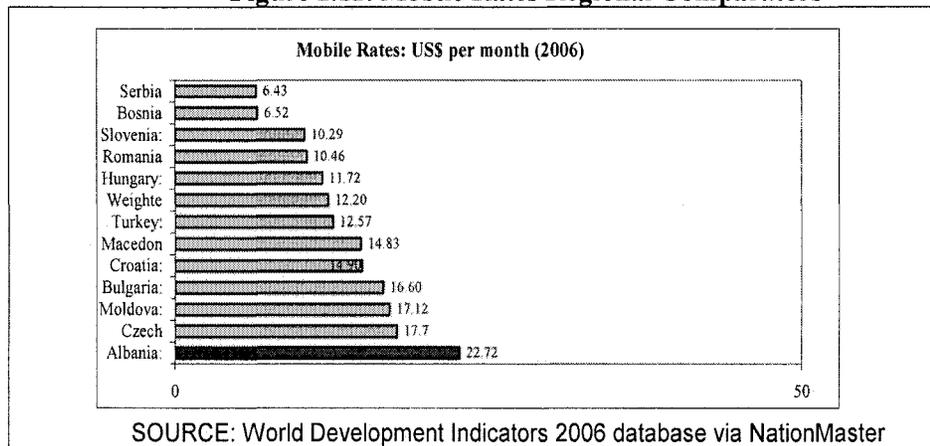
**Figure 2.11. E-mail and Web use**



Source: Albania, Croatia and Bulgaria ICS 2007, for all other economies, BEEPS 2005

2.38. **There are several shortcomings in Albania’s telecommunications, which concern prices and accessibility of service.** Telecommunication services in Albania compare unfavorably with other countries. In 2005, the last year for which data are available, mobile phones penetration rates were among the lowest in the region, with less than half the population covered. According to WDI 2006 data, mobile-phone tariffs are also among the highest in the region at an average of US\$23 a month (Figure 2.12). The price of an internet connection, at over US\$16 per month is also very high by regional standards, standing at more than double the value in Bulgaria.

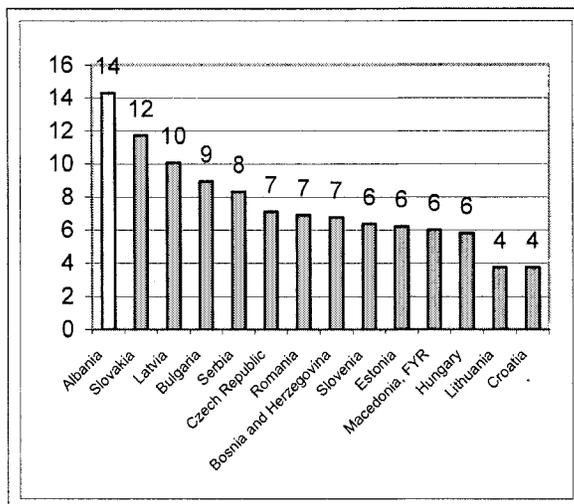
**Figure 2.12. Mobile Rates Regional Comparators**



2.39. **Reliability of water supplies compares unfavorably with other countries and water reticulation systems need upgrading in most urban centers.** Sewerage and waste disposal are a larger concern as these services are not adequately supplied by the public sector in most urban areas.<sup>19</sup> In fact, the duration of the average interruption in water supplies in Albania is 14 hours, far higher than comparators in the region, including Bulgaria (9 hours) and Croatia (4 hours). This obviously poses difficulties to the operation of the hospitality industry across the country (See Figure 2.13).

<sup>19</sup> A former deputy prime minister, Bashkim Kopliku, wrote an article condemning present national and local governments for the lack of sewerage and solid waste disposal management in his article “The Two Most Urgent Issues for Tourism,” Bashkim Kopliku, “Dy Problemet me Urgjente Per Turizmin,” *Gazeta Shqiptare*, 06/13/2008.

**Figure 2.13. Average Duration of Insufficient/Lack of Water Supply, Hours**



Source: Albania, Croatia and Bulgaria ICS 2007, for all other economies, BEEPS 2005

### Training and Skills

2.40. **Training and skills are certainly deficient in Albania but they are not perceived as obstacles by tourism operators interviewed in the ICS** (see Figure 9 above). Nonetheless, case study interviews with tourism operators conducted in preparation of this study, as well as anecdotal evidence from consumers and experts, suggest that the hospitality industry suffers from a deficit in adequate training and skills. In particular, case study interviews suggested that official training schemes in the tourism professions are inadequate and often firms have to shoulder the totality of the cost of training personnel, including hotels and restaurants staff, tour guides etc. An adequate skill levels is essential to make Albania's tourism assets attractive to potential customers, especially from more sophisticated source markets.

### Accommodation

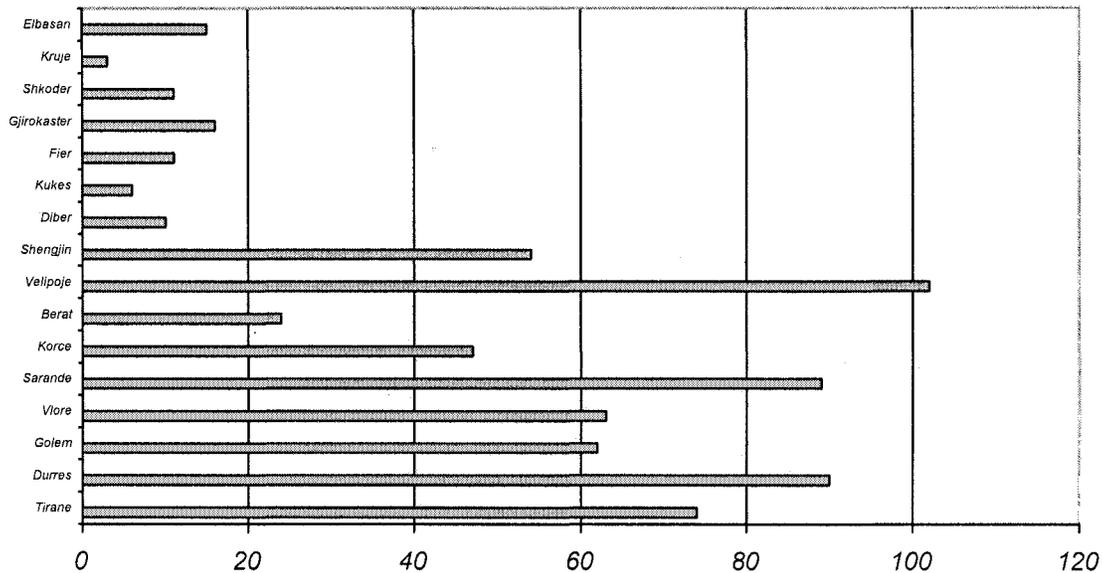
2.41. **Accommodation capacity is inadequate.** With about 670 hotels providing a lodging capacity of about 20,000 rooms, Albania nominally has ample room capacity to absorb additional tourism demand (up to 7.3 million bed nights). However, most rooms are in small locally owned hotels and guesthouses and outdated government facilities throughout the country. Over 80 percent of registered hotels have less than 20 rooms and only 7 percent have more than 40 rooms. Only 30 hotels have been officially classified (by star rating) and of these only 3 are classified as 5 star. These characteristics are not conducive to supplying and international tourism market.

2.42. **There is a range of hotels in Tirana which could support additional tourist numbers but only two hotels in Tirana are managed by international companies;** Rogner International and Sheraton. There is no evidence of international management or operational standards outside "branded" hotels in Tirana. Most beds are contained in "pension-style" properties or some other form of "self-contained" complexes. Many facilities can be described as operating in the "family tourism" market, i.e. operated as family businesses where rooms are offered in private houses catering to the domestic and independent tourist markets.

2.43. There are two ways to look at the low consumer prices for accommodation. On the one hand it makes the destination price competitive on the other it is a suboptimal use of valuable resources. There is a clear need to build larger international standard resorts in the key resort

areas of the country. For example, the average Albanian hotel realized per room revenues of some EUR 7,500<sup>20</sup> while the international standard for 3-star facilities is roughly EUR 20,000<sup>21</sup>. Productivity from the available inventory of rooms is low. Accommodation proprietors are better described as property managers rather than hospitality managers.

**Figure 2.14. Distribution of Hotels in Albania**



Mini-survey conducted by World Bank staff, May 2008

**2.44. The current distribution of hotels around the country is not targeted for tourism development.** Most hotels are found in Tirana, Velipoje, Vlore, Dures, Golem and Saranda. Investment in hotels that is occurring around Albania is often in prime holiday locations such as in Saranda and Dures where there is an additional risk that low quality investments with non-existent environmental safeguards and well below international operational standards will jeopardize future potential. From various reports and observations it is clear that the current product offer is not of a high enough quality to attract the attention of international buyers and distributors in Western Europe. For instance, it is telling that there are no international hotel or resort investments outside Tirana. Again, this situation is indicative of the stage of evolution of the destination as international firms have access to international markets and invest in destinations where they feel they can get a return based on a throughput of tourists from their originating markets. Products on offer locally tend to develop when there is a critical mass of demand. This investment cycle is yet to take place in Albania.

<sup>20</sup> A Mini Hotel Survey of 32 country-wide hotels was carried out during the preparation of this case study. The hotels surveyed were all those advertised through the internet. Information was obtained locally concerning hotels that did not advertise. The average realized room revenue is calculated from a total sample of 50 hotels (from a total of 1000 registered hotels in Albania).

<sup>21</sup> This average is calculated by the International Hotels Association and based on 3 star standards.

### **Box 2.1. Data Sources**

There is a dearth of available data on the tourism sector in Albania. There are also inconsistencies in the data reported for Albania that arise from the collection methods from different institutions (Ministry of Interior, Institute of Statistics, Bank of Albania, Ministry of Tourism, Culture, Youth and Sports). None of these institutions follow standard international practices and consequently the number of tourists reported for 2006 varies from 60,000 (estimated from a sampling of hotel occupancy) to over 1 million which is estimated from all visitors crossing any and all borders in Albania, including those in transit. The findings in this chapter are constructed from the following sources:

- January 2008, interviews conducted by World Bank staff with tourism operators and government officials;
- April 2008, a mini hotel survey of 30 hotels in Tirana, Saranda and Durres, the main tourism destinations;
- April 2008, findings from the ICS data, specific to hotels and restaurants;
- UN World Tourism Organization consolidated tourism statistics for 2006;
- 2008, World Economic Forum Travel and Tourism Competitiveness Report.
- June 2007, IFC Office Memo, "IFC Tourism Strategy in Croatia, Montenegro and Albania"
- August 2007, Tourism Partnership "Tourism: Sector Status Report" for EU-funded project; Urban Planning for Tirana Durres;
- December 2007, Marco Bordini, UNDP, "Summary of Albanian Tourism Statistical Data";
- December 2007, UNDP, background documents for the preparation of tourism support through UNDP's Albania Country Program
- December 2007, Andrew Seidl, Consultant, Colorado State University, Mid-term Report of a tourist survey at Mother Teresa International Airport

In addition extensive internet research was carried out on the market presence and presentation of Albania in key source markets. Available tourism data for Croatia, Montenegro and Bulgaria was also consulted for comparison and benchmarking where possible.

#### Tour Operators

**2.45. Foreign tour operators, who control a large part of the flow of tourists are either unaware of Albania or have a poor opinion of the country.** Image problems and fears of political instability cut into Albania's competitiveness. Several international tour operators and travel agents were contacted (see earlier reference) in order to find out why they were not selling Albania more. The major constraint cited was that there were no effective local tour operators or "ground handlers" operating with consistent international service standards.<sup>22</sup> There are also very limited support services for tour operations – e.g. insurance cover for travelers / vehicles / operators and guides.

#### Urban Fabric and Townscapes

**2.46. Neglect of historical townscapes hampers development of a potential comparative advantage for Albanian tourism.** Albania has some remarkable townscapes including the medieval town of Kruja, several villages along the Ionian coast and the UNESCO World Heritage sites of Berat and Butrint. Collectively these add to the inherent competitive advantages, which fail to be realized due to weak service delivery and overall neglect of these landscapes. In

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<sup>22</sup> Some Greek agencies are organizing limited excursions, although excursions to Saranda (e.g. from Corfu) are not in the brochure and cannot be pre-purchased.

particular, several reports cite poor waste management services, inadequate road maintenance, lack of standards in building codes and lax environmental controls as major bottlenecks for the full exploitation of these sites.

#### 4. INSTITUTIONAL FRAMEWORK AND POLICY ENVIRONMENT

2.47. **Poor coordination among ministries and other government agencies is a major impediment to the development of the tourism sector.** The organization of tourism in Albania is under the control of the Ministry of Tourism, Culture, Youth and Sports. As is common in countries with emerging tourism industries, the Ministry is responsible for everything – destination marketing, policy formulation, development control, regulation and licensing. There are several other ministries which have an influence over the development of tourism. These include those responsible for development, planning, management, protection, and natural resources management. Effective tourism policy formulation and implementation suffers from poor coordination amongst these ministries (observations from various reports). Institutions are typically weak and operate with uncertain authority in local areas, where it is often difficult to determine who the principal decision makers are. In an attempt to ease coordination failures, the Minister of Tourism has appointed a Board of Advisors but without any private sector representation as is normal in most countries. Additionally, in March 2007 the government developed a new tourism policy and reorganized the Ministry into the following:

- General Directorate for Policies for Art, Culture & Youth;
- General Directorate for Tourism and National Cultural Heritage;
- General Directorate for Tourism Market & Statistics;
- General Directorate for Supporting Services; and
- General Directorate for Internal Audit.

2.48. **While there are signs of the private sector developing its own structure in support of tourism, current structures do not allow a mechanism for public-private dialogue.** A private national Association of Tourism Agencies based in Tirana has been established, while private regional associations are also forming across Albania. However, these private entities are poorly coordinated with existing Government structures, reflecting the fact that the Government seems inclined to maintain close control of the formulation and implementation of tourism policy, perhaps due to low acceptance of the tourism industry as a private sector responsibility.

2.49. **The policy environment is moving towards harmonization with the EU.** The Albanian Government is focused on European integration and is bringing all ministries in line with achieving standards required for the Stabilization and Association Agreement (SAA) signed with the EU in 2006, which has replaced the previous Trade and Cooperation Agreement of 14 May 1992 establishing institutional relations between Albania and European Union. The SAA is part of the Stabilization and Association Process (SAP) that the EU adopted for the Western Balkans countries in 1999. An Integrated Planning System (IPS) was instituted in 2005 to guarantee effective implementation processes for public policies. In 2006 efforts were made to integrate all the sectoral and intra-sectoral strategies of different ministries in the planning process. These strategies have to meet the EU financial framework 2007-2013 in order to facilitate the National Plan for the SAA.

2.50. **Within the framework of harmonization with EU rules, the Ministry of Tourism, Culture, Youth & Sports is involved in the design and drafting of a series of strategies which are related to its own policy areas** such as tourism, culture, youth and sport. Various policies have tried to address the need for foreign investors and there is an incentive program for

investment in the tourism sector. The investor can, pursuant to a law entitled, “For development of the areas with tourist priorities”, obtain the title of “stimulated person” and would be entitled to profit from a tax exemption for the first five years of activity and for the following five years would pay only 50 percent of the profit tax. Such persons would also be excluded from custom taxes on imported goods used for capital investment and be entitled to export foreign currency funds to pay interest on loans and dividends.

2.51. **While tourism specific policies appear to be generally sound, other areas of policy are lagging and may be the reason for the slow foreign investment uptake.** For instance a property registration process has been completed in approximately 85 percent of the total land area, almost entirely in the rural areas but very little in high value urban and coastal areas. Many of the unregistered properties are in the south coastal area, which is more valuable for its tourism potential, and where disputes appear to be frequent. This continues to be a major issue in the sector with many claims stuck in the courts. Additionally, as highlighted in the World Economic Forum’s 2007 *Travel and Tourism Competitiveness Report*, Albania ranks last of 124 countries in environmental regulation and almost as poorly in the prioritization of tourism development strategies.

## 5. ANALYSIS AND RECOMMENDATIONS: TOWARDS GROWTH AND COMPETITIVENESS

### The Current Situation

2.52. **All the Balkan countries have positioned tourism as a development priority and all face similar challenges involving overcoming the legacy of being closed to foreigners for extended periods in their history and having a weak or non-existent private sector.** Tourism growth and development are inevitable throughout the region as long as peace and security, as well as the perception thereof, in each country and the region as a whole prevail. As the 1990s demonstrated, the thriving tourism sectors of Montenegro, Bosnia-Herzegovina (BiH), and Macedonia quickly disappeared when war started in BiH and Kosovo.<sup>23</sup> In 1989, Yugoslavia received 8.6 million international visitors but by 1992, this had dropped to 700,000 for what was by then referred to as “Former Yugoslavia.” Tourism is however a resilient sector that attracts visitors back to destinations as peace and security are restored. In the Balkans, this was proven beginning with recovery in Croatia in the mid 1990s and then later spreading to Montenegro a few years later. Croatia and Bulgaria are the high performers in the region and are fast establishing themselves as tourism hotspots; each attracting well over 5 million international tourists in 2006, as well as a similar number of domestic and regional tourists. EU accession in 2007 reportedly increased Bulgaria’s tourism arrivals from EU countries by 30 percent.

2.53. **As a late entrant, Albania is being left behind by its competitors in the region whose governments have prioritized investments in supporting infrastructure and tourism planning and focused on attracting foreign operators into their domestic markets.** The long-term prospects of the tourism industry in Albania will depend on the ability to develop a modern hotel infrastructure with the help of foreign investors, but also on sustainable coastal zone management and the restoration of cultural heritage attractions. In particular, the development of a viable tourism sector in Albania faces the following key challenges:

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<sup>23</sup> Macedonia experienced conflict and violence in 2001, which affected its tourism sector.

- **Acquiring land for tourism investment is risky** as a result of unclear land claims due to a weak land registration cadastre and an uncertain legal restitution processes – the example of the continued failure of the proposed Club Med investment project deters additional FDI interest in hotels.
- **Weak environmental regulations and enforcement** that earned Albania low ratings on the WEF Tourism Competitiveness Index are indicative of a lack of effective action on environmental protection by both public and private sectors. This threatens to undermine tourism growth.
- **Insufficient hard infrastructure and weak supporting infrastructure services**– electricity, ICT services, transport, roads, waste management, tourist facilities, accommodation.
- **Poor government budgets for tourism development, planning and promotion** – budget allocations are much smaller than in comparator countries.
- **Insufficient policy focus** to implement national policies and strategies.

## Recommended Strategic Actions

### By Government

#### **Establish a high level *National Tourism Development Steering Committee***

2.54. This body should report to the Council of Ministers, should facilitate intergovernmental coordination, oversee the implementation of the newly written National Tourism Policy and Strategy and should be composed of high level (up to Deputy Ministers) government members supported by technocrats and key private sector members with tourism interests. This body should also link with foreign donors to help finance the specific programs outlined. This method of helping to build political capital and overseeing the implementation of policies and strategies has worked very well in other countries. Notable examples are Mexico, Costa Rica, UK, France, Germany, Rwanda, and South Africa.

2.55. The following membership should be considered at a minimum:

- i. **The Ministry of Tourism, Culture, Youth and Sports** should lead the overall process and be responsible for the set-up, implementation and monitoring of the National Tourism Strategy, the comprehensive legal framework for tourism development, related planning and development process, support for regional administration and tourism organization at the national, regional and local level.
- ii. **The Ministry of Public Works, Transport and Communication** is responsible for urban planning, road maintenance and investment for new tourism roads, development of the sea transport and civil aviation transport in priority tourism areas.
- iii. **The Ministry of Environment, Forests and Water Administration**, is responsible for environment policies and sustainable management of nature resources that will enable the development of tourism in protected areas, sustainable use of resources, access rules, payback schemes as well as tourism environment impact assessment.

- iv. **The Ministry of Agriculture and Consumers' Protection** is responsible for the development and implementation of strategies for rural development, including development of tourism in rural areas, as well as for issues related to quality and safety of food and beverages.
- v. **The Ministry of Education and Science** provides education and training for qualified tourism workers, guides and others and could develop specified curricula for local tourism guides and operators in the regions with high tourism potential.
- vi. **The Ministry of Interior** has a role in collecting immigration statistics as well as coordinating with local governments.
- vii. **The Ministry of Finance** is a key ministry for tourism development, particularly in the area of taxation policy and budget allocation.
- viii. **The Bank of Albania** has a key role in coordinating the collection of tourism statistics.
- ix. **The Archeology Institute and the Culture Monument Institute** (under the Ministry of Tourism, Culture, Youth and Sports) are critical for providing the information needed for the handouts, handbooks, websites for cultural tourism sites and materials for educational programs for tourism professionals.
- x. **Albanian Foreign Investment Promotion Agency**
- xi. **Private Sector Associations** concerned with tourism.

2.56. **Key long term tasks** – representative of systemic public sector issues with tourism development – should be assigned to concerned sub-committees with this structure:

- Develop and implement strategies to improve **data collection**;
- Develop and implement strategies to improve **coordination of key infrastructure investments** (in particular the development of an international airport in the south, and strategically placed cruise and yacht marinas along the coast);
- Develop and implement strategies to improve **training and capacity building** in the tourism sector;
- Develop and implement strategies to improve **waste management collection and environmental standards**;
- Develop and implement strategies to streamline **business operating environment** issues (e.g. licensing and regulation of tourism enterprises);
- Develop and implement strategies to improve **land registration** cadastres;
- Develop and implement strategies to improve **public information and communication** around tourism issues;
- Develop and implement strategies to improve the **quality of information** provision about tourism products (such as Tourist Information Centers in key tourism areas) including establishing tourism information signage in English in line with international standards.

#### **Establish sustainable financing mechanisms**

2.57. This should be aimed at augmenting government budgets to implement specific tourism development programs such as marketing and promotion, tourism training, signage, information collaterals etc. Albania could implement a mechanism used by a number of countries, such as a dedicated **tourism development fund**. Annual budgets and expenditures would be agreed by the Steering Committee. Albania will need to identify seed capital for this fund, but should conceive it as a revolving fund in a relatively short time.

**Target FDI investment and make 3-5 happen over the next 3-5 years**

2.58. Tourism related foreign investments should be targeted through the Albanian Foreign Investment Promotion Agency, following a previously agreed strategy for attracting FDI in tourism.

By the Private Sector

**Enhance the capabilities of the private sector tourism umbrella association with professional technical assistance**

2.59. This action should be aimed at providing a private sector platform and advocacy voice to dialogue with the Steering Committee. At least two members of this association (plus a technical advisor) should sit on the Steering Committee permanently. The private sector in tourism in Albania is very weak and lacks human resources and internationally competitive skills to improve and organize its stakeholders. Through a professionally strengthened umbrella association, the private sector needs to develop complimentary strategies to those outlined for public sector action.

**Organize and package the existing domestic product for an international independent traveler market target and focus on niche markets**

2.60. With external assistance through donor/IFI programs the Albanian private sector should take a lead in formulating strategies to diversify and define tourism product offers that are directly available to independent travelers. Albania has the potential to develop a range of niche products inter alia walking and trekking, sailing, boating and cruise tourism, lake tourism, bird watching, cultural tourism, agro or rural tourism, cycling, spa tourism and hunting and fishing. The current emphasis on mass beach tourism has obvious limitations and potential negative impacts.

### 3. MINING

*Given Albania's endowments of mineral resources, a balanced development of the mining sector, notably via attraction of foreign investors, can significantly contribute to the international integration of the Albanian economy. Provided that appropriate steps are taken, the mining sector can substantially increase the creation of jobs (both directly and indirectly), stimulate the transfer of technologies and knowledge, and generate valuable foreign exchange earnings. This Section intends to provide a concise overview of the current stance of the mining sector in Albania. It will evaluate the major events that took place in the last two decades (especially regarding the privatization process), and delineate its governance, overarching policy and legal frameworks. By clearly pointing out the weaknesses and difficulties that the sector faces, the report then suggests an outline for a comprehensive reform program. The overall conclusion of the section is that sector reform should emphasize new **greenfield resource potential** through generative exploration by competent **foreign investors**, the mainstay of sustained sector growth. New resource development would be undertaken within a strengthened governance framework reinforced by a competitive, transparent, stable, non-discretionary regulatory regime.*

*Policy actions necessary to fulfill the potential for mining sector development include:*

- *Establishing an efficient, non-discriminatory, transparent licensing regime, which would be reinforced through the preparation of the new Mining law in line with good practice and in consultation with all relevant stakeholders*
- *Strengthening of the main institutions which administer, regulate and monitor the Albanian mineral sector – this includes a review of the management functions of main institutions involved in the mining sector and capacity building*
- *Improved transparency and accountability of payments that are generated by mineral exploration and mining operations (especially exploration and rental fees, royalties, tax payments) through adoption of the Extractive Industries Transparency Initiative (EITI) – this involves initiation of the first step of the procedure for Albania becoming an EITI country*
- *Addressing existing environmental and social legacy issues – this includes preparation of a Sector Environmental and Social Assessment Study and a priority action plan for addressing legacy issues and a thorough assessment of the incidence of small-scale mining*
- *Improved sustainability on the community level, for instance through better and broader benefit sharing and stakeholder involvement – this includes preparation of procedures on how to engage communities to participate in the development of their respective areas and consultation frameworks*
- *The compilation of existing geo-data and collection of new geo-data for sector promotion*

## 1. INTRODUCTION

3.1. **After serving for more than fifty years as a foundation of industrial growth and economic linkages, the mineral industry of Albania has succumbed underinvestment, cannibalization and decay.** Building on an underlying resource endowment of chrome (until the 1980s one of the world's major producers), nickel, iron and copper mineralization, large industrial complexes operated across an integrated value-chain from mining through metallurgical processing to downstream metals fabrication. The history of the Albanian mining industry is one of systematic expansion followed by rapid decline to such a degree that remaining operations today realize only 10 percent of rated plant capacities (see Annex A for more information) with most having succumbed to a decade of underinvestment, cannibalization and decay. Given that a well-managed mining sector can substantially increase the creation of jobs (both directly and indirectly), stimulate the transfer of technologies and knowledge, and generate valuable foreign exchange earnings, measures for reform are urgently required, so that appropriate international investors can re-start the production and bring the sector back to its natural potential.

3.2. **The current situation results from a commercialization process having weak design, poor implementation and lax enforcement of contractual obligations.** It therefore seems antithetical to remark that despite the sector's poor performance, the underlying mineral endowment remains highly prospective and a potential source of growth. To determine the extent of that potential, some strategic assessments are needed:

- (i) ***Defining Resource Potential*** - by applying current market prices, production costs and available technology to known deposits to identify the subset of resources that might form the basis of potential investor interest.
- (ii) ***Improving the Investment Climate through Reforming the Policy, Legal and Regulatory Frameworks, including Enhanced Administrative Capacity and Sector Promotion*** – used to govern the sector, in that a well governed sector inherently outperforms regimes having superior mineral potential but poor governance; to determine Albania's ability to engage technically and financially qualified investors within a transparent, competitive, non-discretionary, and stable administrative system; lastly there is a need to assess the technical capacities of the government to sustain reforms, undertake sector promotion and ensure that investors benefit from an efficient administrative system and ongoing access to new investment opportunities.

3.3. **The assessment of the underlying resource potential is challenging, in that many of the operations are now highly fragmented.** From the outset there is need for a dual focus (a) to determine what actions might be taken to enable new investors to enter into existing operations, and (b) what actions are needed to attract quality investors to undertake generative exploration towards new discoveries under improved sector governance. In this regard, experience demonstrates the uplift of lesser performing mines by new mines established under improved operating conditions. To achieve this outcome, the assessment of overarching policies, laws and frameworks becomes paramount to an initial scoping analysis, in that these instruments form the structural framework within which investors might undertake new generative exploration and development.

3.4. This study summarizes a first-pass evaluation to inform an overall reform strategy and to identify commodities and/or resource areas of particular interest going forward – “low hanging

fruit" that might offer new growth opportunities. The first pass evaluation summarizes current investment climate, including reforms to date, the strengths and weaknesses of the fiscal, legal and regulatory framework in attracting investment; and the impact of foreign investment on existing mining operations.

3.5. The overall conclusion of the study is that sector reform should emphasize new Greenfield resource potential through generative exploration by internationally well acknowledged investors, the mainstay of sustained sector growth. New resource development would be undertaken within a strengthened governance framework reinforced by a competitive, transparent, stable, non-discretionary regulatory regime. Although now highly fragmented, existing operations would be uplifted with the introduction of superior performing new operations, subject to the private sector being enabled to consolidate license holdings under improved regulatory enforcement that removes inactive speculators.

Figure 3.1. Map of Albania with the Three Mineral Regions Highlighted



## 2. THE ALBANIAN MINING SECTOR: CURRENT STATUS AND PROSPECTS

3.6. **A detailed history of the Albanian mining sector serves to underscore the differences between the formerly integrated mine / metallurgical operations of the 1980's in contrast to the now highly fragmented nature of remaining assets** (see Annex A). The brief history presented here touches upon some of the more salient historical events to describe the rapid descent of the industry because of under-capitalization and, thereafter, an irrational fragmentation leading to eventual closure.

3.7. **For nearly fifty years the Albanian mining sector was an engine of growth feeding raw materials to downstream industrial activities that included steel, metals fabrication and value-added metallurgical products for export.** Mineral production and exports peaked in 1989 at US\$140 million<sup>2</sup> when chrome, copper and nickel accounted for 80 percent of total Albanian exports (by value). However, by 1992 mining exports had fallen significantly to \$20 million, a result of political instabilities, economic decline within the country and the onset of a commodity recession that would persist throughout the remainder of the decade. Under severe financial constraints, reinvestment in mines and plants all but ceased and was replaced by cannibalization that rendered essential processes non-operational.

3.8. **A program for restructuring, rationalization and/or consolidation of potentially viable mines and concentrators as well as closure of uneconomic operations was proposed by the World Bank (1993), based on a systematic approach to social, environmental and financial liabilities.** While some positive steps were taken with the 1994 Mining Law, the transfer of mineral operations to highly qualified investors did not take place. In 1998, the government embarked on a license transfer to reassign mineral exploration and exploitation rights to mitigate emerging discontent within rural areas. A majority of mineral rights were assigned to individuals having neither the technical capacity nor financial resources necessary to recover the sector. Moreover, as a part of this transfer, large integrated mining operations were unbundled into dissociated units lacking the economies-of-scale necessary for efficient metallurgical processing. An ensuing decade of lax contractual enforcement enabled these license holders to passively hold resources, and thus effectively sterilizing key assets and restricting access to qualified investors.

3.9. **The ensuing decade after 1998 would show incoming investors to be largely under-capitalized speculators, having neither the technical wherewithal nor financial strength to manage underlying mineral assets.** Within two years, nearly all remaining productive capacity of the large, diversified, integrated mining sector had been stripped away. The decay of the major mining operations is well exemplified by the history of the Elbasan Steel Works: Darfo S.p.A., an Italian investor, assumed control of the ferrochromium plant at Burrel and the steel mill at Elbasan<sup>24</sup>. The capacity of the latter was designed for a steel production capacity of 750,000 tonnes and a production value of \$ 140 million (in 1989). Under Darfo the plant was significantly downgraded and was eventually taken over by Kurum of Turkey whose production was a mere 100,000 tonnes (\$20 million). The plant was eventually closed, with Kurum citing high electricity costs,<sup>25</sup> as well as imports that would be too competitive for Albanian production to meet. Today, other remaining operations are a mere 10% of their rated capacities and most have been

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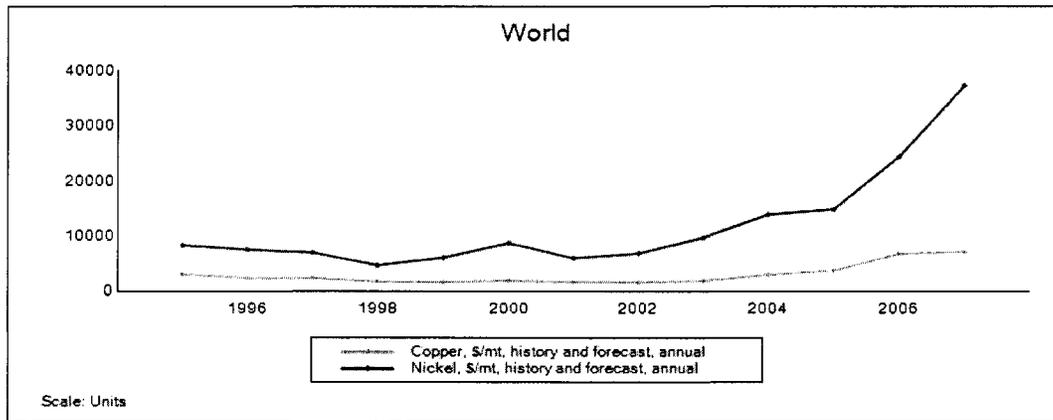
<sup>24</sup> This is a good example of an integrated production process, as it has existed in Albania until the 1990s. Ferrochromium is used for the production of stainless steel.

<sup>25</sup> These comments from Kurum stem from their own view on the Albanian Investment Promotion Act. While Kurum gives no numerical value with regard to electricity costs and exact cost disadvantages relative to neighboring countries are difficult to obtain, it can at least be confirmed that electricity supply is unreliable, especially for energy-intensive production.

cannibalized to a state of disrepair<sup>26</sup>. Whereas the objective of privatization was to coincide with the macro-economic shift towards market-based economic growth, the outcome was markedly different. The sector is a mere shell of its former self. The fragmentation of both large and small mines has rendered many investment opportunities “uninteresting” to the international investment community. Large-scale investors face considerable challenges<sup>27</sup> to consolidate former operations into viable assets.

3.10. **Few of Albania’s operations have undertaken new investment to take advantage from rising commodity prices in recent years.** Beginning 2001 commodity prices have strengthened to record highs (see Figure 3.2) and, despite recent declines, continue at levels well above the long-run cost of many metallic and industrial mineral mining operations. Despite this recovery, few of Albania’s operations have realized significant new investment. Additionally, environmental and social legacy issues associated with former state-owned mining enterprises abound and inadequate mine closure has further added to a wide swath of negative impacts across much of north and central Albania.

**Figure 3.2. Price of Nickel and Copper, 1995 – 2007, in Dollars per Metric Ton**



### Current Production

3.11. **The Albanian mining sector has traditionally been based around three main metals (chrome, copper and nickel).** However, in line with what was said above, USGS statistics from 2005 reveal that production in 2005 is lower for most metallic or industrial minerals than in 1995. It can be seen that production re-gained momentum in most cases from 2001 / 2002 onwards (for chromite, crude steel, dolomite and salt; ferrochromium production followed a similar pattern after 2003). Below is a more complete overview about past and current production patterns of the most important metals (Table 3.1), industrial minerals (Table 3.2) and mineral fuels (Table 3.3). Especially for the production of the former two (metals and industrial minerals), it becomes evident that the years 2000 – 2001 marked something of a watershed regarding to production.

<sup>26</sup> Annex C contains an accounting of rated output capacities of major Albanian mining operations.

<sup>27</sup> These challenges have to do with a lack of coordination between relevant public institutions, lax enforcement of regulations, legacy problems and often inadequate infrastructure.

**Table 3.1. Production of Metals (in metric tns)**

Commodity	1995	1997	1999	2001	2002	2003	2004	2005
<i>Bauxite</i>		4,454	4,624	5,000	5,000	5,000	n.a.	n.a.
<i>Chromite*</i>	242,998	157,203	79,445	200,000	215,000	220,000	160,300	170,000
<i>Ferrocromium</i>	42,986	31,144	28,120	11,900	22,800	37,800	47,700	35,780
<i>Copper</i>	257,709	24,895	33,945	n.a.	n.a.	n.a.	29,030	73,000
<i>Crude Steel</i>	5,000	5,000	5,000	94,100	96,600	86,117	98,026	140,000

\* Chromite production was around 1 mil. tns in 1980

**Table 3.2. Production of Industrial Minerals and Salt (in metric tns)**

Commodity	1995	1997	1999	2001	2002	2003	2004	2005
<i>Clay, kaolin</i>	500	500	500	385	350	n.a.	300	310
<i>Dolomite</i>	50,000	50,000	50,000	500,000	1,000,000	1,500,000	1,613,000	1,000,000
<i>Salt</i>	10,000	10,000	10,000	25,783	22,746	21,448	24,783	25,000

**Table 3.3. Production of Mineral Fuels (in metric tons)**

Commodity	1995	1997	1999	2001	2002	2003	2004	2005
<i>Asphalt and bitumen</i>	32,850	16,900	16,625	n.a.	4,200	42,076	61,035	60,000
<i>Coal, lignite (in thousand metric tns)</i>	80,906	38,900	30,000	16,400	20,300	18,000	12,600	12,000

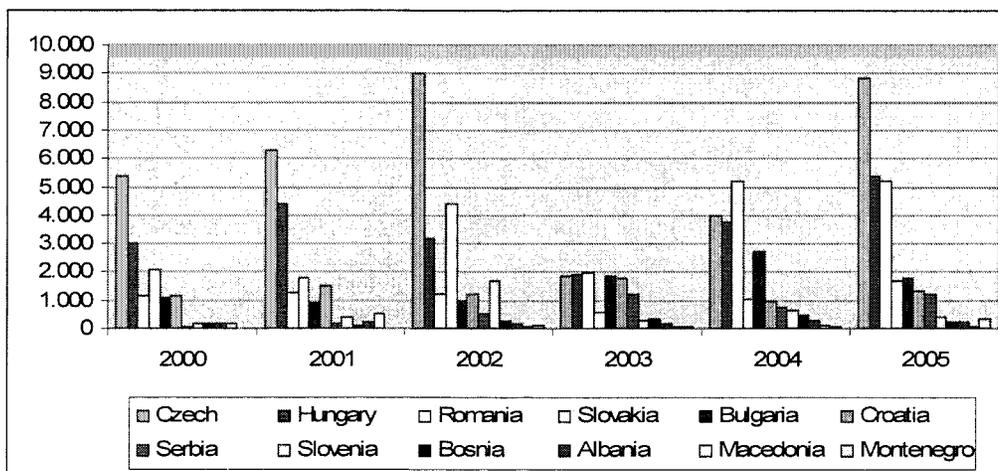
3.12. **The fact that the mining sector is still plagued by a variety of difficulties becomes even more evident when examining disaggregated, mine-level data.** Production data of seven mining entities across different locations are given below. The considerable changes and disequilibrium of production figures suggest one or more of the following issues as root causes: (i) inadequate mine development planning, (ii) insufficient funds for mine development investments, (iii) mine problems including depletion of ore reserves, or use of obsolete equipment; and/or (iv) changes across specific commodity prices leading to unsustainable production.

**Table 3.4. Production of Individual Mining Entities**

Name of company	Location	Mineral type	Surface Area km <sup>2</sup>	Production
Volalba	Virova	Clay	0.11	In m <sup>3</sup> 2000: 109,424 2001: 116,002 2002: 131,444 2003: 117,937 2004: 123,457 2005: 138,715 2006: 155,000
M.I.D. - AL	Priske	Limestone	0.022	In m <sup>3</sup> 2001: 500 2002: 10,178 2003: 9,700 2004: 11,000 2005: 9,847 2006: 8,450
Heronjte Bater	Bater	Chromium	0.17	In tons 2004: 5,339 2005: 4,656
Darfo Albania	Bulqize	Chromium	0.92	In tons 1995: 112,225 1996: 110,000 1997: 90,236 1998: 74,068 1999: 63,406 2000: 53,054 2001: 41,130 2002: 43,910 2003: 70,962 2004: 76,539 2005: 73,995
Beralba	Munelle	Copper	0.68	In tons 2003: 2,000 2004: 27,523 2005: 68,312
Kruja Cement Factory	Kruje	Lime Stone	1.195	In m <sup>3</sup> 2005: 380,000 2006: 49,295
Kruja Cement Factory	Kruje	Clay	0.216	In m <sup>3</sup> 2005: 26,500

3.13. **Cement production is an exception** (see separate case study in Box 3.1). In any case, it is obvious that following the opening of the domestic minerals sector to foreign direct investment, Albania's mines have failed to maximize their potential, and the sector is not yet proactively high-profile in attracting foreign investors of the most desirable type. Indeed, when compared to its neighboring countries, Albania is currently seen as being a minor location for foreign investors.

**Figure 3.3. Foreign Direct Investment into the Balkans (Million Euros), 2000 – 2005**

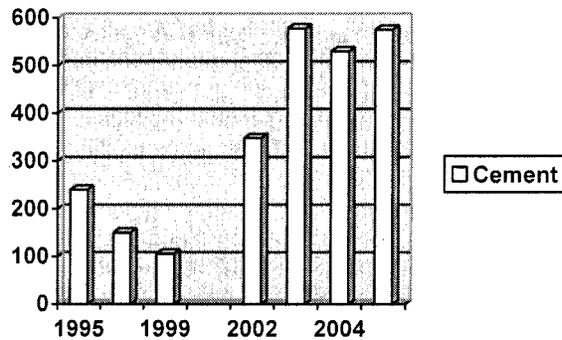


Data: Vienna Institute for International Economic Studies ([www.wiiv.ac.at](http://www.wiiv.ac.at)).

**Box 3.1. Case Study – Albanian Cement**

The Albanian cement sector presents an interesting contrast to the experience of the upstream mining sector. This is because the cement appears to have overcome institutional and administrative barriers to realize some very large new investments. Due to the persistent construction and infrastructure boom, production has risen more or less continuously since 2000, making cement one of the fewer success stories of the Albanian mineral industry, and 2005 production amounts to 575,000 tonnes as opposed to 106,000 tonnes in 1999. The planned rehabilitation and expansion of the Fushe Kruje Cement Factory would increase domestic production significantly, as the factory is designed for a capacity of 1,33 million t.p.a. This increase in supply would meet growing demand (annual growth of the Albanian cement market since 1996 is 10 percent), which in turn is fuelled mainly by the growth of the housing market. The Fushe Kruje plant would also curb imports, as the current consumption is way beyond production capacities (1,525 million tonnes of annual consumption, vs. roughly 0,6 mil. tonnes of production). In addition, nearby supplies of necessary limestone ensure production in Fushe Kruje for up to 83 years. A problem that needs yet to be addressed however is clearly, as in many other cases of the mineral industry, the insufficient and unreliable supply with energy.

**Figure A Graphic Illustration of Cement Production, 1995-2005**

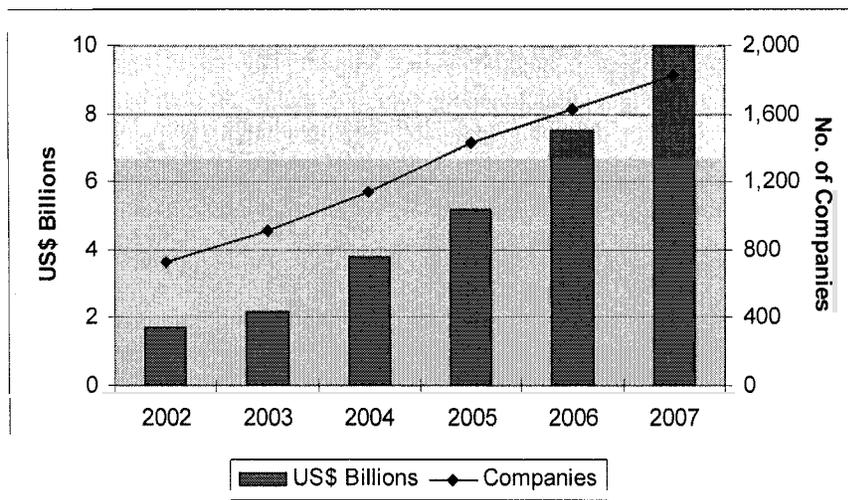


**Table A. Cement Production 1005-2005**

	1995	1997	1999	2001	2002	2003	2004	2005
<i>Cement (in 1000 metric tons)</i>	240	150	106	n.a.	348	578	530	575

3.14. However, this is an issue that should be addressed rather sooner than later, in order to reap the benefits of the current rise of activities within the sector. Exploration activities, investments and the number of world-standard juniors are all on the rise (Figure 4)

**Figure 3.4. Global Non-Ferrous Metal Exploration Budgets 2002-2007**



Data: Metals Economics Group ([www.metalseconomics.com](http://www.metalseconomics.com))

3.15. Today, there is agreement among the stakeholders concerned on the key issues in order to ensure revival of the vital sector through increased Foreign Direct Investment:

- improvement of the overarching policies, laws and regulatory frameworks in order to improve *sector governance* with particular attention to create a transparent investment climate, backed by strong policies on revenue management and benefit sharing
- improvement of the *regulatory effectiveness*, including contract enforcement on existing operations
- strengthening the *technical capacities* of the relevant organizational institutions (e.g. METE and supporting agencies)
- implementation of a transparent, competitive and non-discriminatory *mineral licensing regime*, and
- solution of *environmental issues and legacies* (tailing dam designs and spills, soil contamination, dust collection and precipitation systems, emission controls and adverse working conditions) as well as repair/mitigation of past mining damages at mines that have been closed/abandoned, including removal of decaying ruins)

3.16. All of the above with the aim to, under an overall strategic road map for future sector development, promote the sector to attract international competitive investors, with the adequate technical and financial potential to transform the sector once again into a dynamic source of economic growth.

3.17. The resource potential for select metallic deposit types is high and offers growth potential, favoring modern exploration for new discoveries by good practice investors. Sustained mining sector growth will result from a diverse portfolio of investors across:

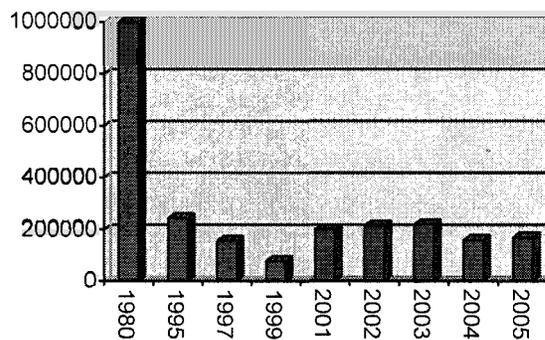
- (a) smaller *chromite* mines run by domestic investors having reached an output equilibrium lower than historical (1990) levels but generating employment, export earnings and revenues to government;
- (b) the potential for larger *nickel and copper* mining operations in which international investors undertake the requisite exploration towards establishment of new mining operations employing international good practices that will have

a positive catalytic effect across the sector.

### *Chromite Production*

3.18. **The Exploration Potential for chromite is high for small-to-medium size deposits, using modern exploration technologies searching for deeper deposits in prospective areas.** It is necessary that new discoveries be added to the portfolio of operating mines in order to replenish ore reserves that sustain sector growth. The Albanian Geological Survey (AGS) has previously identified the opportunity for extensions to known larger ore bodies and some government technical assistance may be needed to guide enterprises who lack the in-house capacity for systematic prospecting / exploration.

**Figure 3.5. Graphic Illustration of Chromite Production, 1995-2005**



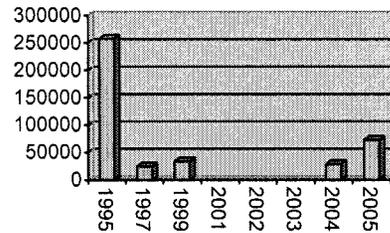
3.19. **Regarding its Future Potential, Albanian's chromite sector has reached a natural state of equilibrium in its production levels, with most operations being small-scale small enterprise or family-run operations** that do not lend themselves to either consolidation or expansion of individual outputs. The requirement to undertake further State-run exploration is minimal, except with regard to ancillary PGM potential associated with the chromite ores.

3.20. **Regarding current and potential investors,** the only investment of known significant size is the DCM - Terwingo Austro-Russian JV that has been involved at Bulqiza since February 2007. The potential target investors into Albania's chromite sector should include Turkish companies. These have a proven record of significant production levels on Alpine-type Podiform chromite deposits.

### *Copper Production*

3.21. **The Exploration Potential for copper is very high for smaller deposits occurring in clusters, with incoming investments by international explorers introducing modern exploration techniques.** Because of the type of deposit model present in Albania, the country is less likely to be a world-class producer of copper but several countries within the region enjoy a robust copper sector built on this type of copper deposit (Cyprus and Turkey). The ultimate reserve potential is unknown, and will be informed by ongoing exploration programs that began 2007. Metallurgical processing in-country remains an issue for further investigation (at least one flotation plant is currently re-vitalized). The copper sub-sector remains under-developed and represents a source of investment opportunity.

**Figure 3.6. Graphic Illustration of Copper Production, 1995-2005**



3.22. **Regarding its Future Potential, Albania's copper sector is the smallest of those currently active in the Balkans.** It will be important to attract international mining companies that adhere to "good practice" in their exploration and mining activities to search for and exploit Albania's deposits. These companies tend to be listed on the major stock exchanges and are regulated by stock exchange rules and standards. Thus, they uniformly adhere to systems such as Canada's NI 43-101 rules for handling their Resources and Reserves calculations and use recognized reporting codes, e.g. CIM or JORC, with their results being compliant with those codes.

3.23. **Current and target investors** include the traditional junior exploration sector (UK, Canada and Australia) that represent a viable source of competent and capable investors. The main investors throughout the Balkans base and precious metals exploration activities are drawn from this source. Exploration investors in Albania include Canadian junior explorer Tirez Resources that has introduced industrial "good practice" in its exploration activities and undertaken a major airborne geophysical survey. The company is actively rejuvenating exploration interest in the Mirdita zone by the introduction of modern ore genesis models that are being tested by modern technology.

### *Nickel Production*

3.24. **The Exploration Potential is high for medium-sized deposits that can be economically significant and represent viable targets for international companies.** Deposits are thought to be comparable to Greece, with tonnages similar to neighboring Kosovo (10,000 tpa). The ultimate reserve potential is unknown, but could be comparable to Turkey (e.g. Çaldağ). Metallurgical processing in-country remains an issue for further investigation. Overall, the nickel sector remains under-developed and a source of investment opportunity.

3.25. Regarding its **Future Potential**, Albania's nickel sector is currently benefiting from the arrival of European Nickel, an exploration UK-based junior company that has introduced international approaches to exploration and professional development.

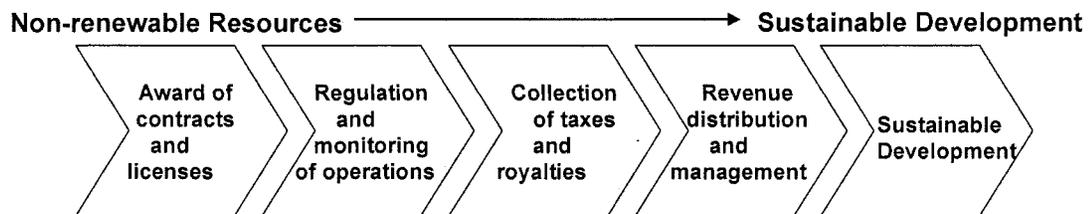
3.26. **Current and target investors.** The current investors in Albania's nickel exploration sector include Adriatic Nickel, which is a wholly owned subsidiary of European Nickel ([www.enickel.co.uk](http://www.enickel.co.uk)) that is currently commissioning the Çaldağ Ni-Co Mine in western Turkey. It is noteworthy that European Nickel has trained its domestic Albanian technical staff to the point that they are now fully adhering to "good practice" without any international supervision, apart from occasional managerial progress monitoring visits. The company is planning to establish an acid leach plant similar to that being commissioned at Çaldağ and sell the 30% Ni concentrate product to nickel smelters in Europe. Overall, the Albanian nickel sector has substantial Indicated Reserves and should aim at attracting more junior companies, similar to

European Nickel. The senior nickel companies are already engaged on major expansions at their nickel sulphide operations in Canada, South Africa and Australia.

### 3. INSTITUTIONAL AND LEGAL FRAMEWORK

3.27. **When well managed, extractive industries create jobs, stimulate the transfer of technologies and knowledge, and generate valuable foreign exchange earnings, thus providing governments a financial base for the development of infrastructure and the provision of social services.** Unfortunately, many governments have mismanaged their mining revenues and have suffered to varying degree “the resource curse,” whereby poor policy choices coupled with corruption have exacerbated the cycles of poverty and conflict. Good sector governance begins with sound management and transparency along the full spectrum of the mineral governance chain, from the awarding of contracts, to the monitoring of operations, to the collection of taxes, to the sound distribution of revenues, and, finally, to the implementation of sustainable development projects.

**Figure 3.7. Increasing the Value from Mineral Resources for the Economy: From Non-Renewable Resources to Sustainable Development**



3.28. **Sector reform uses instruments to provide an integrated holistic approach encompassing good governance and transparency along the entire chain** (Figure 3.7). A dual-track approach of reform is often used:

- *broader initiatives to stimulate sector dynamics*, mostly through one or two reform-minded operations dominant within the peer group. Such operations can incubate skilled labor, enhance government revenues, and attract foreign direct investment towards improved operational efficiencies.
- *slow reform of rent-distorted operations to limit pushback* from those who have prospered under existing conditions while broader initiatives build a pro-reform political constituency<sup>28</sup>

3.29. **A reform strategy may even encourage ‘enclave’ operations (those under the reformed fiscal and regulatory framework), bolstered by a tight legal contract and public-private partnerships for ancillary social/physical infrastructure.** Since the Albanian mining sector has undergone a structural dislocation through an imperfectly regulated “privatization” process, it is unclear what candidate operations might be suitable for early broader initiatives. Instead, the reform strategy might seek to foster one or more new Greenfield operations with the intention to have a positive knock-on effect on existing under-performing assets. In this regard,

<sup>28</sup> Benefiting from Mineral Enclaves, Richard Auty (Lancaster University)

lessons learned in the Albanian cement are especially relevant for reform of metallic and other industrial mineral operations.

## **Governance – The Situation at Present**

3.30. **A 2003 Mining Sector Strategy was prepared, but has not been fully implemented and needs updating.** Albania's 1994 Mining Law provides for private sector led investment, has early environmental and licensing good practices, and strengthening of enforcement is needed, together with additions in managing social risks. The sector will benefit overall from an improved enforcement of the terms and conditions to which license holders are obligated.

3.31. **Despite some early reforms and privatization of the mining sector, Albania has attracted a small number of global good practice investors.** By comparison, the resource potential for select deposit types is high and offers growth potential, favoring modern exploration for new discoveries by good practice investors. In this regard, the Government of Albania has received some encouragement from international investors to undertake serious reforms to recover the sector. Required strategic actions are likely to include:

- developing a *strategic road map* for future sector development
- strengthening the *overarching policies, laws and regulations* that govern the sector; with particular attention towards creating a transparent investment climate backed by strong policies on revenues management and benefits sharing
- strengthening *institutions for better enforcement* of the policies, laws and regulations, including contract enforcement on existing operations
- implementing a transparent, competitive, non-discretionary *mineral licensing regime*
- undertake *sector promotion* to attract and retain technically / financially qualified investors

## **The Albanian Mining Law**

3.32. **The Ministry of Economy, Trade and Energy has begun to address overarching institutional and legislative frameworks by drafting a new mining law, currently under internal review.** However, mining law reform would logically follow adoption of a national mineral policy – the detailed roadmap whereby the government, industry and civil society have come to a common agreement after broad consultation.<sup>29</sup> Below is a graphical illustration of the responsiveness of the draft new mining law with regard to economic, social, environmental and community issue prerogatives, which was prepared considering the following categories/elements:

- *Economic:* Tenure, transparency, flexibility, types of rights, obligations, incentives, violations, dispute resolution
- *Environment:* Assessment, management, health & safety, reclamation
- *Social:* Consultative processes, frameworks, mitigation, compensation, and gender issues
- *Community Development:* Economic, environmental, and social development; and artisan

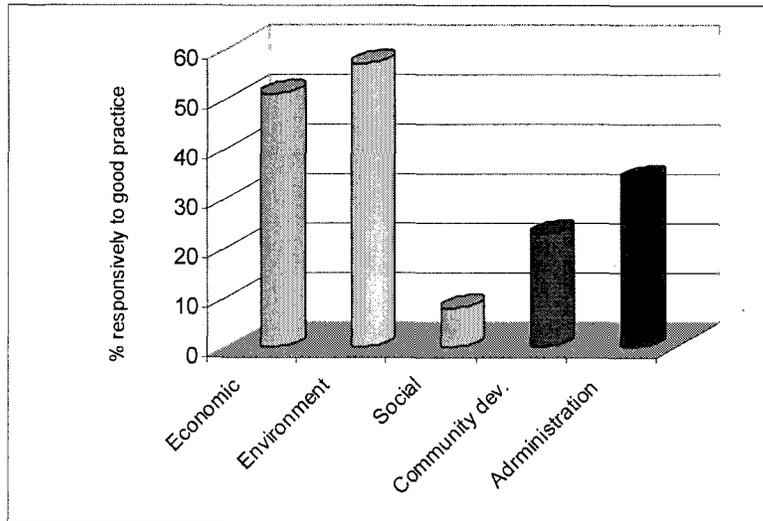
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<sup>29</sup> The full slate of issues that Albania will want to consider in sector policy and law is included in Annex B.

mining issues

- *Administration*: Competent authorities; responsibilities, inspection, violations and penalties, resolution and appeals

**Figure 3.8. Mining Law/Regulations Assessment against Good Practice**



**Average score against the good practice template – 35 percent**

3.33. From the **economic** point of view the draft law provides for a clear and transparent licensing system, ensuring the secure of tenure, clearly stating the relations with the surface land owners and flexibility in timing for exploration and exploitation. Some of the provisions related to the type of rights and eligibility of cancellation, obligations for taxes, duties and royalties and renewal, transfer, termination of the licensing should be strengthened to include clear indication of what it is required from a titleholder in order to benefit of such rights. The draft law does not address the reliance on private sector to provide investment, with expectation for economic multipliers in the economy and job creation. Also, there is no provision for binding tax stability or related to the authorization of the appropriate government agency to provide financial tax provisions or amortization, depreciation and loss-carried forward.

3.34. **Attracting qualified investors through an appropriate licensing methodology.** Mineral resource development relies upon comprehensive regulations in order to provide a maximum gain out of such operations, whereby the interest of the state needs to be balanced against the interests of the investor / resource developer. The benefits of a dual methodology for the assignment of mineral exploration / exploitation rights – depending on the level of information available for the underlying resource should be considered. Of the utmost importance is that the government will ensure that qualified investors (in the sense of technical and financial capability and also of Corporate Social Responsibility) will become the developers of a resource. The currently employed “first come / first served” approach is appropriate for exploration licensing when little is known of the underlying resource potential. When past discoveries or production increases the likelihood of future production, then a competitively based selection (for exploration or small deposits) or a full scale auction respectively (for the exploitation of larger deposits) may be more appropriate. The utility of a competitively based selection is due to the fact that the licensing agency can select the best candidate based on a technical evaluation of the information about the financial and technical capabilities of that

particular candidate, investment and work plans of the candidates, and can also exert more influence with regard to payments of royalties and surplus rents (mineral rents). The main steps of the process should be clearly specified by the Mining Law, while the details regarding the procedures and criteria for selection should be part of the sub sequential regulations.

3.35. The **environmental** aspects are well covered from health and safety and emergency response as well as mine reclamation. However, the draft law does not specify what are the environmental safeguards that the title holder needs to observe (such as the requirement of preparing an Environmental Impact Assessment (EIA) before any mining activity, Environmental Management Plans (EMP), etc).

3.36. With regard to **social** aspects, namely pre-development social planning (requirement of a SIA and mitigation plans), resettlement and compensation as well as community well being, the draft law is very silent and does not have any provision that would look at these aspects.

3.37. With regard to **consultation** processes, the draft law provides for consultation with local authorities, in case it is considered that granting the mining rights may seriously impact on and lead to contradictions with the inhabitants in the relevant area (Art. 13). This article has two main shortcomings (decision on the impact on the communities is discretionary and consultation is required only with local authorities) and it is not in accordance with Good Practice related to consultations processes.

3.38. **Community development** aspects needs also to be strengthened, especially in clarifying the provisions for preparation of an initial mine closure plan as part of the licensing process. Additionally, there is no requirement on progressive closure (“close as you mine” where and when possible) and no specifications on what type of social mitigation measures need to be taken in order to ensure that communities from the affected areas would be sustainable after the closure. The provisions related to the mining legacy issues and how government is going to deal with them need to also be strengthen to clarify when closure falls under the responsibility of the license holder and when under government’s one.

3.39. **In terms of administration of the law, the draft law has clearly defined violations and penalties, but needs to be strengthened with regard to the responsibilities of the competent authorities and transparency of their activity and public disclosure.** Also the draft law should be clearer on the access to information, the functions of the mining cadastre, and documents/reports required to be prepared by the titleholder during the mining activity.

#### 4. AN AGENDA FOR SECTOR REFORM

3.40. **The Albanian mining sector reform agenda should be supported by clearly defined roles and responsibilities for government agencies** (Annex B), in order to ensure sustainable development of extractive industries through strengthening of the policy, fiscal and regulatory framework, through institutional strengthening & capacity building, and finally through promotion to attract investments for continued sector growth.

3.41. **Best practice would require that institutional arrangements and roles of each institution involved be clearly defined in the law** and this would include (i) the relevant *Mining Ministry* - responsible for preparing and managing the mining strategy/policy through a prioritized action plan; including mining related laws; (ii) the *Geological Survey* - responsible for the collection and dissemination of geoscientific data to government and industry, as an independent public research entity on a partial fee-service basis; and (iii) a *Competent Authority* – as an independent entity that implement the mining strategy/policy, monitors and controls the sector activities, including licensing process (mining cadastre), management of industry

assessment reports, assessment of royalties, environmental and social compliance, health and safety, closure / post-closure monitoring, and control of mining activities. In this way the responsibilities of setting up the regulatory/legal framework are separated from the implementation of such framework, eliminating the conflict of interest that may arise if the same institution prepares/adjusts legislation and implements it. The licensing authority should definitely have a certain level of independence from other relevant ministries (mining, environment, etc.) and ideally should be functioning under the coordination of the prime minister.

**3.42. Despite current conditions Albania continues to enjoy competitive advantages.**

Albania has a rich mining tradition recognized for its strong engineering expertise, deployment of advanced technologies (up to the early 1990's), and former place among global commodity markets.<sup>30</sup> Additionally, Albania retains an extensive geological archive of maps and reports within the Albania Geological Survey (AGS). Through attrition that agency has streamlined itself from more than 8,000 employees (pre-1990) to 200 employees today. It is the World Bank's experience that the most effective tool for sector growth is a strong geological survey providing geological data to investors in electronic formats at relatively low cost.

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<sup>30</sup> In 1990, Albania remained third in the world for the production and export of chromite.

**Table 3.5. A Matrix of Thorough Mining Sector Reform in Albania**

<i>Reform</i>	<i>Principal Objective of Reform</i>	<i>Target Group</i>	<i>Area of Focus</i>
Preparation of a road map/strategy for sustainable development of the mining sector	Develop strategic actions for future development of the mining sector, including addressing mining legacy issues	Ministry of Ministry of Economy, Trade and Energy, Ministry of Environment	Nationwide
Strengthened institutions	Improved sector administration of exploration and development; Clear-cut Terms of Reference to avoid both institutional overlap and gaps appearing in the minerals administration	Ministry of Ministry of Economy, Trade and Energy	Nationwide
Efficient, non-discriminatory, transparent licensing, enforced properly	Strong adherence to laws to mitigate against non-transparent / discretionary authority; Facilitate access for investors in Albanian Mining sector through “one stop shop”; Strengthening enforcement of mining policies, laws and regulations.	Independent Mining Licensing (Cadastral) Authority working in conjunction with Ministry of Economy, Trade and Energy; and Ministry of Environment  Revocation of licenses that do not perform according to contract agreements and/or regulations	Mineral license areas  Non-performing license holders
Strong mineral policies based on global good practices	Sustainable long-range sector development in which a broad stakeholder group participates in resource development planning and sharing of benefits; this also requires transparency with regard to payments between the companies and the government	Stakeholders and vulnerable groups	Affected communities around resource development
Compilation of existing geodata and collection of new geodata for sector promotion	Increased investment in exploration and development National geological database into an electronic format and made publicly accessible on an integrated basis via a dedicated website	Mineral industry, Geological Survey, oversight by the Independent Mining Licensing Authority	Prospective mineral areas for metals, cement and industrial minerals
Environmental / Social Legacy Issues	Prioritize unaddressed environmental / social legacy issues to define a strategic long-range program through the preparation and implementation of a SSA recommendations	Former metallic mining operations, small-to-medium construction material operations, pensioned miners	Nationwide

3.43. **An overall reform agenda would be based on strengthening sector governance using five key actions:**

#### **I. Strengthening the Fiscal and Regulatory Regime**

3.44. Good sector governance is defined by a stable, transparent and efficient regulatory environment that enables private-sector led investments, facilitates sustained economic growth, and increases revenues to the Albanian government. Through commercialization and/or privatization of state-owned enterprises, the Ministry focuses on policy making and regulatory functions across five main areas:

- **Setting Sector Policy** by creating and implementing policies for solid and energy minerals, and take the lead in formulating policies and drafting laws, regulations, standards, and model contracts.
- **Strengthening laws** by defining transparent, non-discretionary laws, regulations, licenses, contracts, and standards. The Regulation requires that Ministry of Economy,

Trade and Energy be able to measure or verify production; calculate royalties, fees; and inspect and make the necessary measurements to check compliance with health, safety, and environmental standards.

- **Improving Sector Revenue Management** through (a) improved regulatory enforcement on surface fees and royalties for small and large-scale mining, and (b) strengthening assessment and collection of royalty payments. Transparency and accountability of the sector revenues will benefit from the country adopting the Extractive Industries Transparency Initiative (EITI), a generic, proven program that could bring beneficial results in a comparatively brief time. EITI is currently implemented in around 30 countries worldwide. Through regular reporting of all payments to the government that spring off the mineral sector, and the parallel reporting of government receipts, transparency is credibly increased and shows the country's commitment to accountability. In addition, EITI can involve a full audit process, which enables civil society and the government to assess whether the levels of payments received are equal to what the companies are supposed to pay according to the prevailing contracts. Due to the fact that these revenues will be scrutinized by an independent auditor on a regular basis, and thanks to the active involvement of civil society stakeholders, EITI has shown to create widely accepted accountability of the mineral sector, and is often an incentive for the administration to save or spend revenues more appropriately.
- **Building Strategic Planning and Technical Capacity.** Formulating strategies for sector growth will challenge METE to develop a better understanding of factors that make sectors economic and efficient, and to adjust institutional, legal and contractual frameworks based on learning.

## **II. Institutional Strengthening and Capacity Building**

3.45. Capacity building and institutional strengthening comes via exposure of personnel to best international practices in the mineral industries. Key tasks include:

- **Functional Management Review** to assess necessary capacities for administration, regulatory functions, and collection of geoscience for sector promotion.
- **Institutional Reform** to look at the demands placed on the METE, the type of agencies needed to respond, the long-range policy and legal planning capacity, the need for strong regulatory institutions, and the need to collect geoscience and produce ongoing production statistics in support of sector promotion. Attention is given to the specific needs of ministerial departments for sector policy, cadastre services, mines inspection, health and safety issues, environmental matters, commodity certification and quality control, and geological survey and laboratory services.
- **Sustaining Sector Growth** The Mining Licensing Authority will need to maintain an up-to-date database on natural resources and production, provide vital data and information (such as production, sale, exports, imports, prices paid) to private sector participants and promote the sector to potential investors.
- **Strengthening of Mineral Rights Regime** Establishing an independent cadastre office for administration of all existing and future mineral licenses and improving monitoring and enforcement of health and safety, and environmental and social compliance.

## **III. Addressing Environmental and Social Legacy Issues**

3.46. Another important factor to make the Albanian mineral sector more attractive to new good practice investors, as well as to improve its developmental outcome will be to address the environmental / social legacy issues. A strategic long-range program should be defined through the preparation and implementation of a Sector Environmental and Social Assessment Study, which will also include a priority action plan. The following are priority actions:

- Completion of an environmental baseline study outlining the status of existing and former mining operations, resulting in a detailed action plan.
- Improvement of reporting and information sharing between the Ministry of Environment and the Regional Environmental Agencies. The aim is to provide all environmental agencies with better information on who is doing what, and on what scale.
- Establishment on an up-to-date database program (with the relevant IT equipment), in order to monitor more effectively the environmental impacts of mineral operations.

#### **IV. Improving Sustainability at the Community Level and Benefit Sharing**

3.47. Sustainable long-range sector development, in which a broad stakeholder group participates in resource development planning and sharing of benefits, will greatly enhance the developmental impact of Albanian mineral operations. In line with the Government's own assessment in its Mining Sector Strategy, mineral operations have to fulfill critical benefits in the country's rural regions, which often lack alternative productive activities. It is therefore necessary for all future operations to link up with the communities at an early stage, and involve the stakeholders into the process. Procedures on how to engage communities to participate in the development of respective areas and consultation frameworks should be developed.

#### **V. Sustaining Sector Growth**

3.48. In order to encourage private-led investments, the Mining Licensing Authority will need to (i) maintain an up-to-date database on natural resources and production, (ii) provide vital data and information (such as production, sale, exports, imports, prices paid) to private sector participants and (iii) promote the sector to potential investors.

3.49. **Short Term Actions** by the government should consider the following as the start of a wider sector reform process:

- **Review of the Mining law** in line with good practice for the development of an efficient, non-discriminatory, transparent licensing regime, and in consultation with all relevant stakeholders.
- **Review of the management functions of the main institutions** involved in the mining sector and capacity building.
- Initiation of the first step of the procedure for *Albania becoming an EITI* country.
- **Preparation of a Sector Environmental and Social Assessment Study and a priority action plan** for addressing legacy issues and a thorough assessment of the incidence of small-scale mining.
- Preparation of **procedures on how to engage communities** to participate in the development of their respective areas and consultation frameworks.
- Compilation of existing **geo-data** and collection of new geo-data for sector promotion.

## ANNEX

### A. A Brief History of the Albanian Mining Sector

3.50. From its 1990 peak when the Albanian mining sector ranked third in the world in chrome production, the Albanian mining sector has succumbed to chronic under-investment, cannibalization and decay. The history leading to this collapse is summarized below.

#### *Pre-1990 centrally planned command and control development*

3.51. For nearly fifty years the mining sector was an engine of growth feeding raw materials to downstream industrial activities that included steel, metals fabrication and value-added metallurgical products for export. Despite this role, mining occupied a relatively small (<2%) share of Net Material Product through the early 1980s. It had a modest three percent of total employment as it relied on early deployment of new technologies. During the 1980s its share of total NMP doubled, through the exports of primary or semi-finished products. The value of external sales rose from \$50 million in 1980 to some \$140 million in 1989. Given broader economic stagnation, mining rose within industry's share of total exports to over 37 percent in the peak years 1988 and 1989, and represented virtually all of the country's increase in export values over that decade.

3.52. Following the break with China in 1978, coinciding with a significant strengthening of commodity markets, mining became an instrument of national economic stabilization. New fixed investments and supplementary resources were allocated to mining, and up to 25-35 percent of total investments for industry and energy came into the sector; largely as capital investment in processing facilities for downstream value-added processing plants (i.e. steel). Any one metallurgical processing plant was fed by a diverse source of upstream mines; but overall the high degree of vertical integration was across the sector. Albania was using minerals as the basis of its long-term growth strategy.

#### *1990 - 2000 Transition*

3.53. Mineral production and exports peaked in 1989 at US\$140 million when chrome, copper and nickel accounted for 80 percent of total Albanian exports (by value). Chromium products were the main export product with an estimated value of about US\$89 million, copper products ranked second with nearly US\$26 million, while exports of nickel amounted to less than US\$6 million in 1989 nominal USD.

3.54. By 1992, mining exports had fallen significantly to \$20 million, a result of economic decline within the country and the onset of a commodity recession that would persist throughout the remainder of the decade. Under severe financial constraints, reinvestment in plant and equipment all but ceased and was replaced by cannibalization of key assets to sustain production. The physical facilities of mines and metallurgical operations deteriorated with many essential processes rendered non-operational. Operating deficits of state-owned mines and metallurgical plants were covered by transfers from the Government's budget and an opaque system of inter-company debt throughout the economy.

3.55. By early 1993, the mining sector had been crippled by government restrictions on funding ongoing operating deficits of state-owned enterprises and further accumulation of inter-company debt. The ensuing credit contraction forced suppliers to demand cash-on-delivery payments during a time in which falling export demand limited hard currency

injections. As the situation worsened, the World Bank responded (1993) with a series of recommended structural reforms.<sup>31</sup>

*“... A considerable part of the Mining sector's activities appear to be uneconomic, or at best marginal. Consequently, in the context of a market economy they require substantial restructuring which should comprise the closure of uneconomic operations and substantial rationalization, consolidation and divestiture of remaining activities. There is a need to reevaluate all mineral resources on sound economic criteria and to formulate a detailed medium term restructuring program embracing overall mineral activity. ... The study should (i) assess the viability of each deposit, mine and metallurgical unit; (ii) formulate a strategy designed to cease uneconomic activities; (iii) support and improve those with recovery potential; and (iv) identify new economically viable mining and metallurgical operations. A program designed to alleviate the social impact of a contraction in employment opportunities should also be formulated.*

*Restructuring should be carried out under a joint venture approach with the private sector. ... The promotion of these objectives will require the creation of a mineral and investment framework designed to (i) attract private investors in a free market economy on the basis of clear and transparent rules-of-the-game; and (ii) address the whole process of exploration, development, production, marketing, fiscal and environment. Corrective measures (privatization, modernization, rehabilitation) even if undertaken promptly will involve significant time intervals until production and investment performance can be increased substantially.”<sup>32</sup>*

3.56. The outcome was a program for restructuring rationalization and/or consolidation of potentially viable mines and concentrators, as well as closure of uneconomic operations. The program included undertaking a comprehensive technical and economic audit of ore reserves in order to consolidate small operations (to the extent possible) and eliminate duplication of facilities and overheads. Mine closure was to be systematic with adequate attention to social, environmental and financial liabilities. Additionally, a social safety net for retraining and relocation of displaced workers was to be undertaken with additional incentives to induce voluntary retirement.

3.57. A program of capacity building and restructuring of governmental agencies, such that they might attract and retain new qualified investors, was also undertaken. It called for the:

- completion of legal and regulatory framework to attract private investors, with emphasis on completion of mining code and regulations, fiscal regime and environmental legislation, guidelines and norms.
- Compiling, interpreting and prioritizing target areas on the basis of available data to outline priority prospects of interest to mining investors; and dissemination of geological information reinforced by capacity building of geologists.
- Preparation of environmental regulations under the proposed mining legislation, to clarify investors' roles and responsibilities within a clear and transparent regulatory framework.
- Extensive restructuring of government agencies.

3.58. The notable response by the government was the 1994 Mining Law, a balanced and modern piece of legislation to begin the process of attracting qualified investors. However, the transfer of mineral operations to such investors did not take place. In 1998, the government

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<sup>31</sup> Albania: Mining Sector Strategy Paper, The World Bank, Country Operations Division (1993)

<sup>32</sup> Albania: Mining Sector Strategy Paper, The World Bank, Country Operations Division (1993), page 27

embarked on a license transfer to reassign mineral exploration and exploitation rights to mitigate emerging discontent within rural areas. A majority of mineral rights were assigned to individuals having neither the technical capacity nor financial resources necessary to recover the sector.

3.59. The former mining operations endured continued cannibalization of assets such that the Albason steel works was reduced to processing scrap steel. A majority of firms suffered from thin capitalization and limited operational expertise.

## **B. Sector Governance, Overarching Regulatory Frameworks and Institutional Objectives**

### **Sector Governance**

3.60. Mining sector governance is described according to three elements:

- **Technical Capacity** - a government's capacity to effectively manage its resources and implement sound policies by reducing the regulatory burden and increasing administrative effectiveness;
- **Sound Institutions** - creating sound institutions that respect the rule of mining law and reduce corruption; and
- **Transparent / Participatory Processes** - competent authorities ensuring stable, transparent processes in which local affected communities participate in planning and execution of resource development.

3.61. Additionally, the performance of the sector is evaluated according to *World Bank guiding principles* for sector sustainability:

- Strengthen governance and transparency
- Ensure that extractive industry benefits reach poor people
- Mitigate environmental and social risks
- Protect the rights of people affected by extractive industry investments
- Strengthen Revenues Management and Benefits Sharing
- Public-private partnerships are needed to ensure mining is a driver of regional infrastructure development

3.62. Good governance is essential to avoid misallocation of national resources that could lead to increased poverty, corruption, and local opposition. As a starting point, the government of Albania needs to ensure competition, transparency, and adherence to international best practices in respect of licensing. It is important to recognize the need for transparent procedures at each key decision point in terms of (a) upstream issuance of mine title and/or authorization of investment agreements; and (b) downstream management of benefit streams through sound sector policy.

3.63. **Mineral Policy** - Good sector policy is guided by the principles of sustainable development – the economic, environmental, and social impacts by which performance of the sector in Albania will be monitored, measured, and reported. Mineral policy is a detailed roadmap for sector development and based upon the equitable principle of sharing of resource rent among all levels of government, companies, and communities. Sound sector policies define mechanisms to create a competitive business environment, establish competitive provisions to attract

investors, and strike a balance between direct mineral taxation (royalties and fees), and indirect taxation of industries along the value chain. Revenue transparency is essential.

3.64. ***Mining Law*** - Albania retains ownership of solid minerals and assigns revocable rights to third-parties to develop these resources. With these rights, investors are obligated to invest in the mineral property, comply with all articles of the law, and file periodic assessment reports verifying continued exploration or development such that the mineral asset is being improved. Payment to the state for the privilege to develop mineral resources includes mineral royalties – a unique payment from the developer to the government based on unit of production, unit of output, gross revenues, or value of processed mineral products.

3.65. Good mining law includes clear definition of the rights, privileges, and obligations of holders of mineral rights towards social and environmental management plans, fiscal and regulatory obligations including equitable distribution of resource rents, and provisions for mine permitting and mine closure. Cross- references are included for essential obligations and provisions under other laws (principally taxation, foreign investment, and treatment of labor).

3.66. The granting of mineral rights in Albania should be transparent, efficient, and non-discretionary, and therefore a mining cadastre and title registry system is paramount in attracting investments. Key elements considered by investors when evaluating the competitiveness of the granting of mineral rights across the country will include the process by which exploration areas are granted and relinquished, rights and obligations to surface owners on the same or adjoining parcel, term and renewability of rights, rules and procedures for maintenance and cancellation of mineral rights, compensation in the case of expropriation, transferability or reassignment of rights, and security of tenure in transferring exploration rights to mining rights upon discovery.

3.67. ***Mining Regulations*** - Mining regulations define specific procedures by which mineral rights are acquired, transferred, expanded, rescinded, or otherwise modified. Central to defining clear regulations for Albania will be the calculation, procedure, and administrative processes for payment of royalties and surface fees. Albania's revised regulations should also define the organizational structure of the ministry (and its regulatory departments), as well as the National Agency for Natural Resources and Albania Geological Survey. Regulations should also be expanded to define the terms and conditions for the assessment and management of social and economic impacts, and ongoing monitoring of key sustainability indicators. To this end, Albania's mining regulations will form the basis through which the government will define mine closure and the transfer and sustaining of key economic, social, and environmental programs when major mines close.

3.68. ***Mining Contract / License*** - Major projects often require a mining contract (mineral development agreement) to clarify terms and conditions of the legal, fiscal, and regulatory environment. A mining contract for Albania forms the basis for monitoring of contractual obligations and is likely to include project-specific provisions regarding schedules of investment, financial commitments and surety of closure through performance bonds, and general understanding regarding the economic, environmental, and social contributions of the mine.

### **3.69. Government Objectives**

- attract high risk private sector exploration and development capital expenditures from international and domestic investors;
- improve the benefits to the nation especially through increased employment and skills transfers especially to rural areas;
- improve environmental and social performance of mining, hydrocarbons and industrial operations;

- achieve safer natural resource exploration and development operations; and
- increase tax and royalty collections at a time when revenue collection is a critical country priority.

### **3.70. Ministry Objectives**

The ministry should achieve:

- separation of regulatory and commercial operational functions (including addressing state-owned enterprises);
- capacity to provide strategic planning advice to the Minister on the direction of programs and the requirements for donor interventions.
- establish an ongoing development and support function for the coordination of donor activities in the ministry through the creation of a donor coordination function within a program management unit;
- provide continuous improvement of regulatory processes by establishing a mining and hydrocarbon sector regulation department;
- policies and regulations to support the implementation of the mining and hydrocarbons laws through a legal and policy branch;
- new private sector mining and hydrocarbon investment to the country by strengthening the geological survey;
- an industrial development and regulation function for the regulation and promotion of light industries and downstream processing of natural resources;
- the management capacity to develop and manage industrial parks to promote new industrial development;
- ongoing human resource, financial, and information technology services and support to the ministry.

### **3.71. Independent Mining Licensing Authority**

It should achieve:

- an efficient, transparent and effective mining cadastre office to issue licenses to operate to existing mining and hydrocarbons operations as well as process new applications for mining and hydrocarbons exploration and development licenses and sufficient capacity to efficiently implement and enforce mining and hydrocarbons legislation;
- an efficient, transparent and effective office of inspection and engineering to carry out mining and hydrocarbons inspection and technical audit functions, as well as develop skills in occupational health and safety audits to ensure adequate standards are followed;
- an environmental and social protection office to ensure that the mining, hydrocarbons and other industries follow appropriate and acceptable environmental and social management practices;
- improved stakeholder consultation processes, project facilitation, and management of mining benefit streams by establishing a mining and hydrocarbon coordination and liaison function;
- improved performance of the small scale mining sector by establishment of a small scale

mining regulation and extension service;

### 3.72. Geological Survey

It should achieve:

- be an independent public research entity on a partial fee-service basis;
- collection and dissemination of geoscientific data to government and industry;
- by upgrading the capacity of the geological survey, regional geological, geophysical and mineral resource maps be prepared;

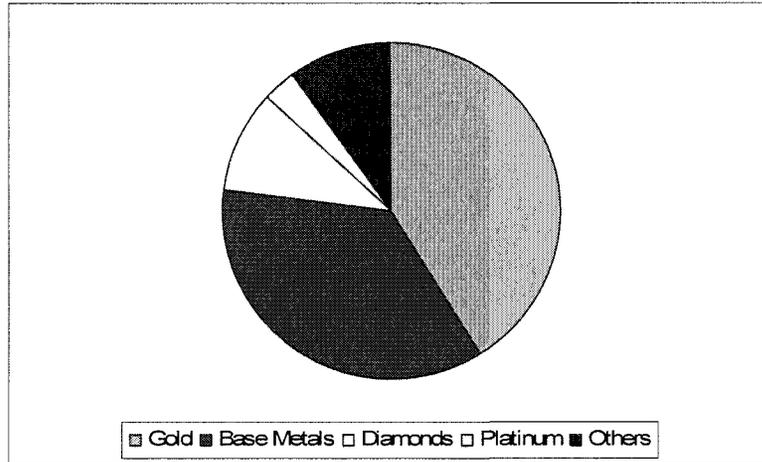
## C. Mineral Resources and Exploration Prospects

3.73. The World Bank (1993) undertook an extensive compilation of mineral resources in Albania. The summary that follows is of select districts and deposits to demonstrate the diversity and richness of the suite of mineral commodities of interest.

Chromites	32,8 million tons from which 12.8 mill. 30-42% Cr <sub>2</sub> O <sub>3</sub> 20 mill. 18-30% Cr <sub>2</sub> O <sub>3</sub>
Iron – Nickel	220 million tons
Nickel – Silicate	102 million tons
Copper	53 million tons
Basaltic rocks	Unlimited – SiO <sub>2</sub> 47-50%;
Limestones	500 million tons and over
Dolomites	160 million tons
Marlstones	2.5 mill. m <sup>3</sup>
Gypsum	85 million m <sup>3</sup>
Silica sands, sandstones, quartzites	200 mill. m <sup>3</sup>
Rock salt	70 billion tons
Decorative Stones etc	300 mill.m <sup>3</sup>
Clays	262
Magnesite	1.1
Titano-Magnetite	137
Bauxites	12
Coal	712 (3200 kcal/kg)

3.74. It is evident that base metals, such as those that have historically formed the core of the Albanian mining sector, are highly competitive with precious metals as far as global mineral exploration companies are concerned.

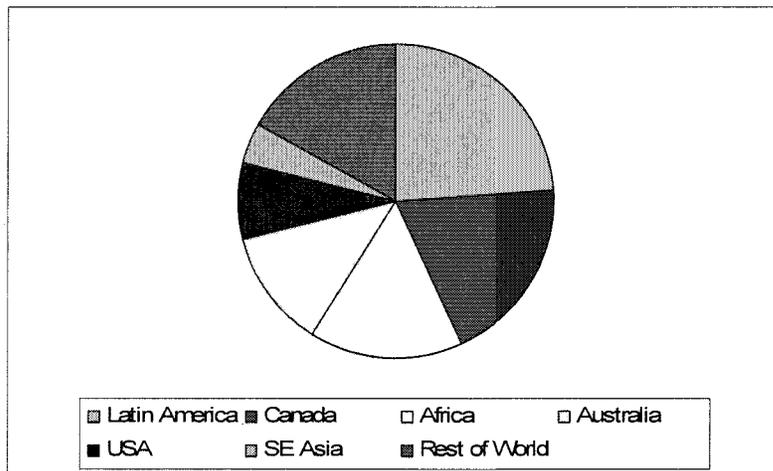
**Graph 1. Global non-ferrous exploration budget allocation by commodity, 2007.**



Data: Metals Economics Group.

3.75. The current geographical focus of exploration expenditure is in the traditional mining centers of Latin America, North America, Africa and Australia. Europe in general and the Balkans in particular have failed to register in a major way in the global search for non-ferrous metals.

**Graph 2. Global non-ferrous exploration budget allocation by location, 2007.**



Data: Metals Economics Group.

3.76. It is noteworthy that Greece appears as the only representative of the Balkans of the 25 countries assessed in the 2007 edition of the annual Behre Dolbear ([www.dolbear.com](http://www.dolbear.com)) mining country ranking survey. As such, the Balkans would appear to represent a minor segment in the global mining consciousness.

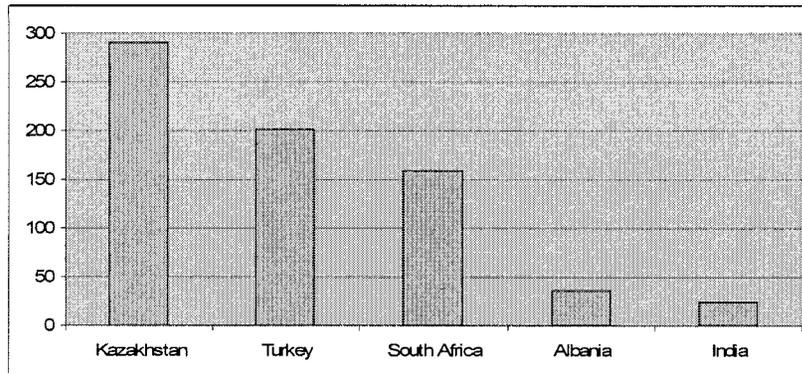
## **CHROMITE**

### **A) Global Perspective.**

3.77. *Overview:* Chromium is a hard metallic element that is an essential component of stainless steel and other alloy steels, where it is used in the form of the alloy ferro-chromium. Its compounds are important pigments and the natural mineral chromite is used in refractories.

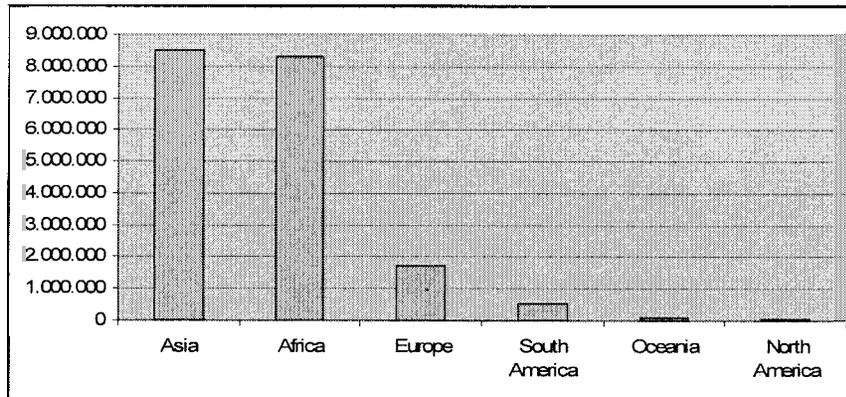
3.78. *Sources:* Chromite ore is restricted to two main geological sources, as an early stage magmatic differentiate in a layered ultramafic intrusive complex (e.g. Voshkod, Kazakhstan and the Bushveld, South Africa) or in ophiolitic layers (e.g. Balkans). The former dominate the latter in both tonnages of individual deposits and on a cumulative basis, with ophiolitic ores being restricted to a maximum size of  $\pm 5$  million tonnes.

**Graph 3. Chromite ore reserves (Million Tonnes), 2008.**



Data: US Geological Survey ([www.usgs.gov](http://www.usgs.gov)), Geological Survey of Albania ([www.gsa.gov.al](http://www.gsa.gov.al)) and Mining Journal ([www.mining-journal.com](http://www.mining-journal.com)).

**Graph 4. Chromite ore and concentrate production by continent (Tonnes), 2006.**

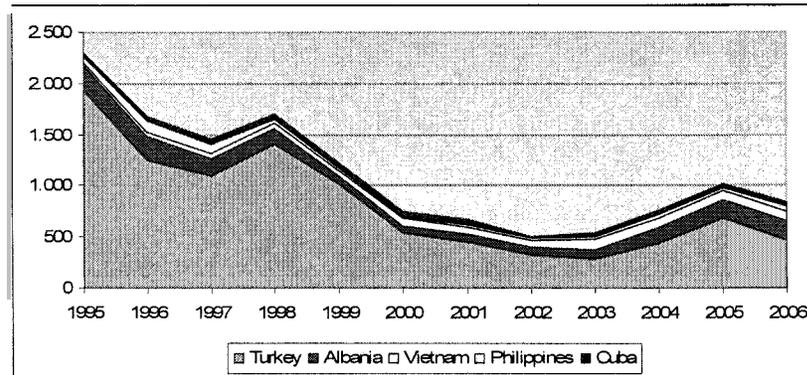


Data: British Geological Survey – [www.bgs.ac.uk](http://www.bgs.ac.uk) (Russia included under Europe).

### **B) Albania Perspective.**

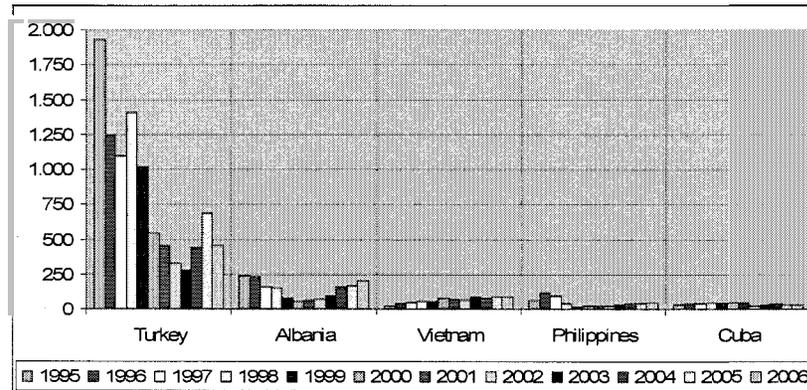
3.79. *Albania's Market Competitors:* After removing the dominance of the layered ultramafic intrusive hosted ore sources from the global supply of chromite, it is evident that Albania must compete with other sources of ophiolite-hosted ore. These sources are globally distributed and the rising cost of sea freight allows Albania to compete for the European market, although Turkey provides substantial, if dwindling, competition. Turkey retains large reserves but production is highly dependent upon the prevailing price of chromite.

**Graph 5. Cumulative ophiolitic Cr ore production (Thousand Tonnes), 1995-2006.**



Data: World Bureau of Metal Statistics – [www.world-bureau.com](http://www.world-bureau.com) (1995-2001) and British Geological Survey (2002-2006).

**Graph 6. Individual ophiolitic Cr ore production (Thousand Tonnes), 1995–2006.**



Data: World Bureau of Metal Statistics (1995-2001) and British Geological Survey (2002-2006).

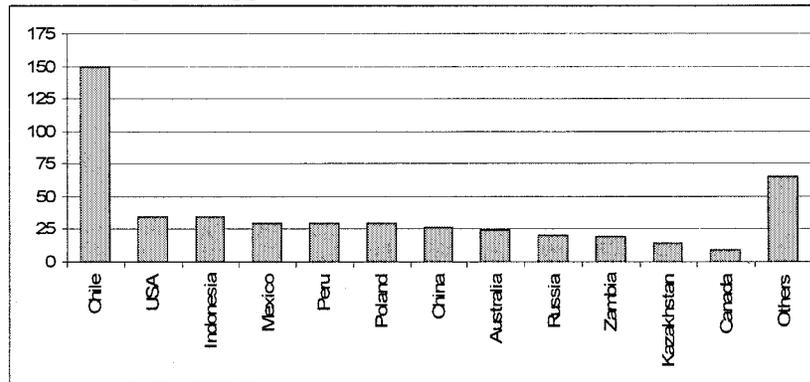
## **COPPER**

### **A) Global Perspective.**

3.80. *Overview:* Copper is a reddish, malleable and ductile element with excellent thermal and electrical conductive qualities. It is a very important industrial material and is used in the electrical, electronics, transportation and construction industries.

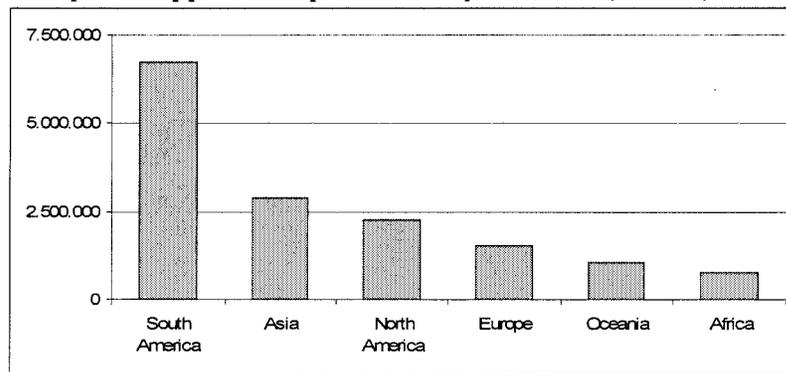
3.81. *Sources:* Copper is found in a variety of geological systems, but is dominated by the porphyries of the Pacific Rim. Sedimentary copper deposits, particularly in the Central African Copperbelt and Poland, form the second major source. Volcanogenic massive sulphides, such as in Albania, are much smaller but often of higher grade than the porphyries.

**Graph 7. Copper metal reserves (Million Tonnes), 2008.**



Data: United States Geological Survey.

**Graph 8. Copper metal production by continent (Tonnes), 2006.**

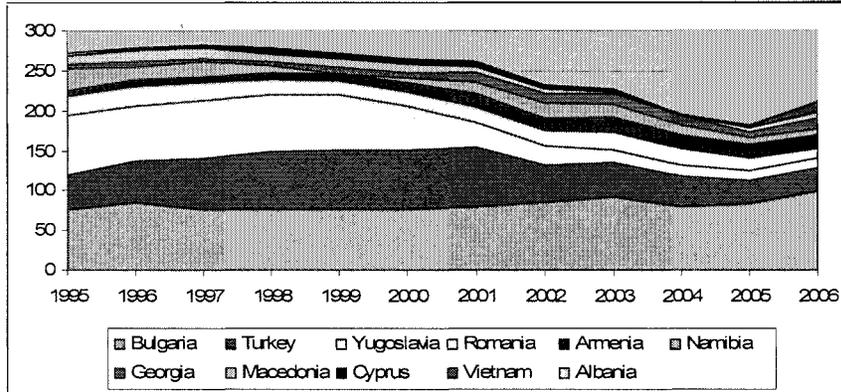


Data: British Geological Survey (Russia included under Europe).

**B) Albanian Perspective.**

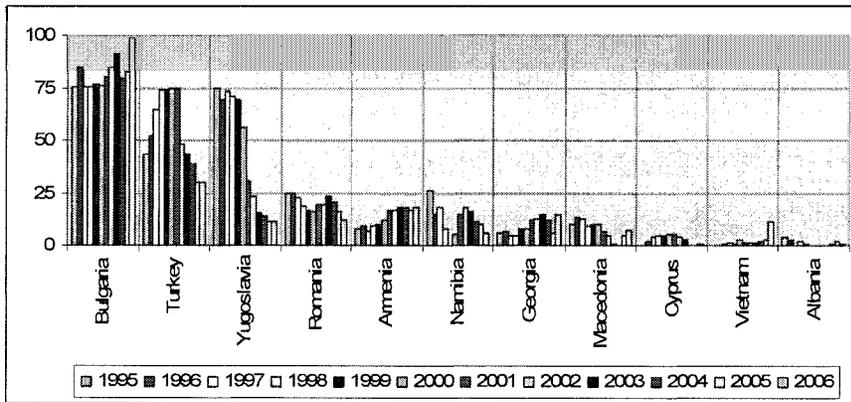
3.82. *Albania's Market Competitors:* The dominance of VMS (Volcanogenic Massive Sulphide) polymetallic deposits in the Balkans places Albania in direct competition for the European market with many of its neighboring countries. The largest individual deposit tonnages present in the Balkans are also porphyry-hosted (Serbia, Macedonia, Bulgaria and Greece). Paramount amongst these are Bor in Serbia and Chelopech in Bulgaria, although Bor is currently on a "care and maintenance" regime whilst awaiting another privatization tender. The production from Chelopech has skewed the Balkan copper production away from VMS deposits.

**Graph 9. Cumulative VMS/Balkan mined metal Cu (Thousand Tonnes), 1995–2006.**



Data: World Bureau of Metal Statistics (1995-2001) and British Geological Survey (2002-2006).

**Graph 10. Individual VMS/Balkan mined Cu metal (Thousand Tonnes), 1995–2006.**



Data: World Bureau of Metal Statistics (1995-2001) and British Geological Survey (2002-2006).

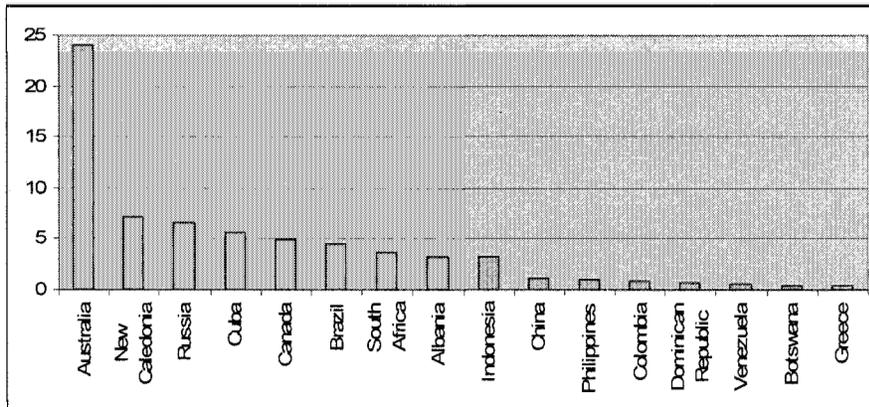
## NICKEL

### A) Global Perspective.

3.83. *Overview:* Nickel is a hard, strong, corrosion-resistant malleable and ductile metal that is a good conductor of heat and electricity. Its most important use is in steel alloys where it imparts strength and toughness. It is also widely used in plating, both metals and plastics, and combined with copper in cupro-nickel alloys.

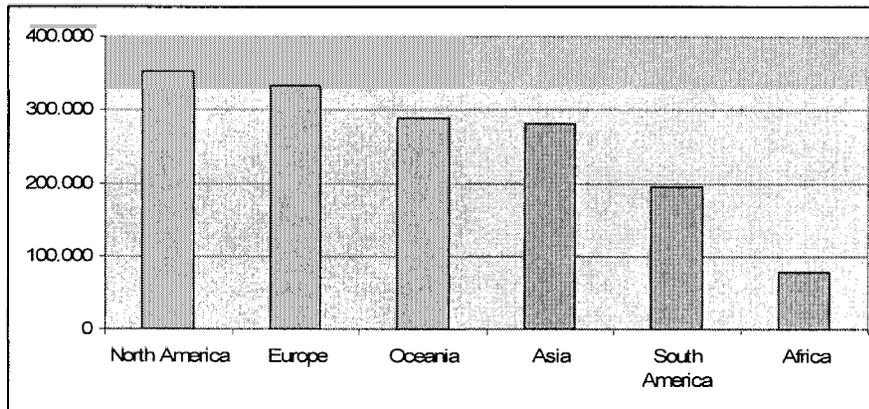
3.84. *Sources:* Nickel ores are divided into two main types; magmatic sulphides (e.g. Norilsk, Russia, and including the astrobleme-hosted deposits of Sudbury, Canada), which accounts for 60% of all known reserves and lateritic (e.g. the Balkans), which accounts for the remaining 40%.

**Graph 11. Nickel metal reserves (Million Tonnes), 2008.**



Data: United States Geological Survey and Geological Survey of Albania.

**Graph 12. Nickel metal production by continent (Tonnes), 2006.**

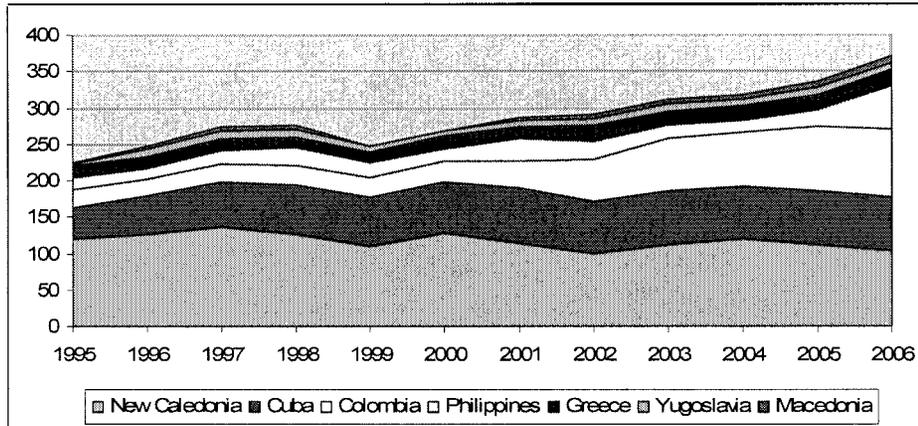


Data: British Geological Survey (Russia included under Europe).

**B) Albanian Perspective.**

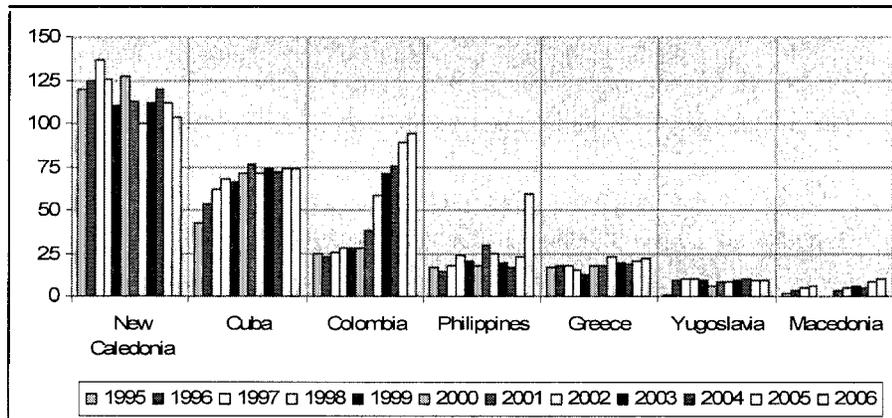
3.85. *Albania's Market Competitors:* The Balkans reserves of nickel are dominated by lateritic ores, including the fossilized laterites present in Albania as nickel silicates and iron-nickel ores now preserved beneath overlying Cretaceous – Eocene limestones and conglomerates. Thus, Greece, the former Yugoslavia and Macedonia are viewed as the main competitors, Resurgence of the nickel sector in neighboring Kosovo and the emergence of a domestic lateritic nickel mining sector in Turkey are prime competitors. Both of these competitors are being governed by foreign companies that are producing NI 43-101 compliant reserves and resources estimates.

**Graph 13. Cumulative ophiolitic mined Ni metal (Thousand Tonnes), 1995–2006.**



Data: World Bureau of Metal Statistics (1995-2001) and British Geological Survey (2002-2006).

**Graph 14. Individual ophiolitic mined Ni metal (Thousand Tonnes), 1995–2006.**



Data: World Bureau of Metal Statistics (1995-2001) and British Geological Survey (2002-2006).

## D. Former Production Capacities of Major Mining Operations

3.86. *Annual Capacity of Major Facilities (n.b.: many enterprises operate significantly below their rated capacities)*

<b>Commodity</b>	<b>Location of main facilities</b>	<b>Annual capacity (thousand metric tns)</b>
<i>Cement</i>	Elbasan, Kruje, Shkoder, Vlore	1,200
<i>Chromite</i>	Bater	450
-“-	Bulquize	450
-“-	Kalimash	250
-“-	Kam	100
-“-	Klos	50
-“-	Pogradec	100
<i>Coal, lignite</i>	Maneze, Mezes and Valias mines near Tirana; Krabe, Alarup and Cervnake near Pogradec; Mborje-Drenove and Memaliaj	2,500
<i>Copper</i>	Fushe-Arrez	350
-“-	Gjejan	150
-“-	Golaj	150
-“-	Kurbnesh-Perlat	100
-“-	Rehove	100
-“-	Reps	350
-“-	Rreshen	50
-“-	Shkoder	100
<i>Ferrochromium</i>	Burrel	40
-“-	Elbasan	36
<i>Iron Ore</i>	Prenjas	650
-“-	Guri I Kug	500
<b>Commodity</b>	<b>Location of main facilities</b>	<b>Annual capacity (thousand metric tns)</b>
<i>Natural gas (million cu feet)</i>	SW Albania	35,000
<i>Petroleum, crude (bpd)</i>	Marineze, Ballsh, Shqisht, patos, Kucova, Gorrisht	35,000
<i>Petroleum refineries</i>	Ballsh, Cerrik, Fier, Stalin	33,000
<i>Steel</i>	Party Metallurgical Combine at Elbasan	150





