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STAFF APPRAISAL REPORT

ALBANIA

RURAL POVERTY ALLEVIATION PILOT PROJECT

FEBRUARY 2, 1993

**Agriculture and Water Supply Operations Division
Central Europe Department
Europe and Central Asia Region**

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CURRENCY EQUIVALENTS

Currency Unit = Lek

AVERAGE EXCHANGE RATES

(Lek per US\$)

	<u>Jan-Aug</u>	<u>Sept-Dec</u>	<u>Jan-June</u>	<u>Nov</u>
<u>1987-90</u>	<u>1991</u>	<u>1991</u>	<u>1992</u>	<u>1992</u>
US\$1.00 = lek	8.00	10.00	25.00	50.00
				90-100

WEIGHTS AND MEASURES

Metric System

ALBANIA - FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

ASAC	Agricultural Sector Adjustment Credit
ABAD	Albanian Bank for Agricultural Development
EC	European Community
Ha	Hectares
IFDC	International Fertilizer Development Center
MTS	Machine Tractor Station
NGO	Non-Governmental Organization
RDF	Rural Development Fund

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RURAL POVERTY ALLEVIATION PILOT PROJECT
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ALBANIA

RURAL POVERTY ALLEVIATION PILOT PROJECT

Credit and Project Summary

Borrower:

Government of Albania

Credit Amount:

SDR 1.80 million (US\$2.4 million equivalent)

Terms:

Standard, with 40 years maturity

Project Objectives:

The proposed pilot project's objective is to help the Government begin implementing its Rural Poverty Alleviation Program by establishing and making operational an autonomous Rural Development Fund and testing approaches in rural public works and small-scale credit. The Program has three main objectives: (a) to create employment for the rural population and inject cash resources into rural households, (b) to repair basic rural infrastructure, and (c) to use small-scale credit to promote private sector activities and help create a rural market economy. It would also provide feedback for developing a rural policy and the on-going local government and finance reform, and implement a new economic and financial approach at the local level.

Project Description:

Within the general objectives of Albania's Rural Poverty Alleviation Program, the proposed pilot project would test approaches to the implementation of the Program during its first year of operations. It would:

(a) Create the institutional capacity needed for program implementation by establishing the Rural Development Fund (RDF) and training a first group of local staff.

(b) Develop RDF's operational procedures and mechanisms of technical and financial control.

(c) Evaluate, design, finance, and implement approximately 142 rural infrastructure projects, and establish and fund some 50 village credit funds.

(d) Establish and implement, using technical assistance as necessary, training programs to improve local capacity to identify, appraise, and implement small public works projects; the ability of village credit funds to evaluate and administer small loans, and programs to transfer appropriate technology to farmers and small rural entrepreneurs.

Benefits:

The project's direct and immediate benefits would come from the rural works projects it would finance and the 5,000 small loans expected to be disbursed from the village

funds. Wages paid workers on infrastructure subprojects would also inject much-needed cash into Albania's rural economy.

The project's monitoring and evaluation components would result in further benefits by providing feedback to adjust and shape the countrywide Rural Poverty Alleviation Program.

Risks:

The main risks are common to social or rural development funds, and include start-up problems, weak local institutional capacity, and political interference. Test and pre-pilot phases that included significant input from the commune and village levels should greatly reduce project start-up problems. While local, particularly commune, organizations are weak, the experience of the pre-pilot phase shows that good professional staff are available and training and technical assistance should provide them adequate support as institutional strength is built up. RDF's autonomous status will help prevent political interference. The other major risk is inherent to the learning by doing aspect of the pilot project; this would be minimized by strong supervision and technical assistance supported by built-in monitoring and feedback components.

Estimated Project Costs:

	Local	Foreign	Total
	-----US\$'000-----		
Rural Works	1,510.5	79.5	1,590.0
Small-Scale Credit	675.0	75.0	750.0
Studies, Technology and Training	153.7	212.3	366.0
Equipment for RDF	18.4	350.6	369.0
RDF Recurrent Costs	478.5	195.5	674.0
Technical Assistance	<u>355.6</u>	<u>660.4</u>	<u>1,016.0</u>
TOTAL	3,191.7	1,573.3	4,765.0

Financing Plan:

(US\$ million)

IDA (SDR 1.80 million)	2.4
EC	2.0
UNDP	<u>0.4</u>
TOTAL	4.8

Estimated IDA Disbursements:

	FY93	FY94	FY95
	-----US\$ million-----		
Annual	0.2	1.0	1.2
Cumulative	0.2	1.2	2.4

Economic Rate of Return: Not applicable.

ALBANIA

RURAL POVERTY ALLEVIATION PILOT PROJECT

STAFF APPRAISAL REPORT

I. INTRODUCTION

1.1 Albania is the poorest country in Europe - 1992 GDP per capita is likely to be below US\$400. The 45 years of highly autocratic central planning that ended in 1990 have left its 3.3 million people with a stagnant economy caught in a low level productivity trap. Economic and political turmoil at the beginning of the decade led to the breakdown of the centrally planned economy and the election in March 1992 of a fully democratic government dedicated to continuing and expanding the economic and social reforms begun in 1991. A macroeconomic framework for those reforms was established in August 1992 when the Government embarked on a stabilization and restructuring program under an IMF Standby Arrangement. While the reform program can, if successful, lay the foundation for significant medium-term growth, its initial phases will cause considerable hardship a large segment of Albania's people, 65% of whom live in the rural areas.

1.2 Revolution and reform have transformed Albania's rural population, changing some 380,000 collectivized agricultural worker families into a new class of private land owners whose average holding is a very small 1.4 ha per family. While these new farmers have great potential for productivity and income growth, they face a daunting set of obstacles. Many of their tiny new holdings - often scattered among two or three plots - are too small to provide the food needed to feed a family unless credit is available to buy inputs and other supplies. Roads, electric lines, water supply and irrigation systems, and other rural infrastructure, already in poor shape under the old government, were devastated during the revolution - which also destroyed the rural organizations in charge of infrastructure development and maintenance. The network of economic infrastructure - input suppliers, and transport, market, and credit mechanisms - that was dominated by state-owned enterprises is in disarray, or has disappeared.

1.3 The Government's immediate objective in agriculture is restoring production to assure food security while providing the rural employment and incomes that will be the key to economic recovery in the sector. It has already taken significant steps on the macroeconomic side - culminating in the August 1992 Standby Arrangement with the IMF - and has removed price controls from all but four items: wheat and flour, sugar, rice, and vegetable oil, freed almost all agricultural prices and removed import and export restrictions. Because of the critical food supply situation and market imperfections, price and trade liberalization for these key foodbasket items - now largely provided through donor aid - will need to be phased in. In July 1992 the government substantially raised prices for these commodities, though the new prices were held below world market levels to mitigate their effects on consumers; it recognizes the need to liberalize them completely in the medium term to induce a supply response.

1.4 However time will be needed for the Government's reform program to bear fruit. The proposed Rural Poverty Alleviation Pilot Project would address the immediate emergency of lack of income in the rural areas through a rural public works program that will provide a source of desperately needed income to farm families while rebuilding basic infrastructure. It would also provide village-based credit for small-scale economic activities, studies that will help the

Government develop rural development policies, appropriate technology development, and training.

II. ALBANIA'S RURAL SECTOR

A. Main Features of the Rural Sector

2.1 Albania is predominantly an agricultural country; 65% of its population lives in rural areas. The agricultural sector, which generated close to 35% of GDP during the 1980s, and 40% in 1991, accounts for more than 50% of employment. About 705,000 people were employed in agriculture and forestry in 1990, and an additional 100,000 in related sectors.

2.2 Food and industrial crops lead agricultural production with 38% of output; the other major subsectors are livestock (27%), and fruits and olives (5%). Forage and forestry products account for the remainder. The main food crops are wheat and maize; industrial crops are led by tobacco, sunflower seeds, cotton and sugar beets.

2.3 The principal feature of the rural sector is the scarcity of land in relation to the rural population. The area of agricultural land per family varies from 0.6 ha in the Puke District to 2.8 ha in Kolonje; the nationwide average is 1.4 ha per family (Annex 4, Table 1). Almost 900,000 ha of natural and improved pasturage are, however, available for livestock production to supplement agricultural incomes. Although a significant reclamation program has increased arable land from 400,000 ha in 1950 to 702,000 ha, and irrigation development has been extensive, population growth - encouraged by government policy - has been even more dramatic, and the number of Albanians rose from 1.2 million in 1950, to 3.3 million in 1990.

Table 1: RURAL HOLDINGS AND INCOMES IN ALBANIA

	<u>Avg Holding Per Family</u> (ha) ^{1/}	<u>Per Capita Agricultural</u> <u>Income (1986 lek)</u>
Nationwide	1.4	3,933
Coastal Districts	1.44	4,624
Mountain Districts	1.22	2,623
(of which, 10 poorest)	1.10	2,326

Source: 1991 Statistical Yearbook of Albania, Ministry of Finance and Economy, Statistics Department

^{1/}Projected holding per family after June/July 1992 land distribution.

2.4 The second major feature of the rural sector stems from Albania's geography. Most of the country beyond the coastal plain (57% of arable land) is hilly or mountainous (43%); in these regions only valleys are available for the development of agriculture, when they are not occupied by mines or heavy industry. The old central planning system stressed income equalization, using price subsidies to raise incomes in disadvantaged agricultural regions. According to their location in plains, hilly or mountain area, agricultural cooperatives and state farms were charged a decreasing price for inputs and

received an increasing price for production.¹ Thus, agriculture in the hilly and mountain areas was heavily subsidized.

B. The Impact of Land Reform: Return to Subsistence Farming

2.5 Until 1991 agricultural production was dominated by the cooperatives - which held 76% of arable land - and state farms, with 24%. The cooperatives, using funds allocated by the central government, had an important role in rural infrastructure investment, accounting for a third of national investment in rural construction (irrigation, farm buildings, feeder roads, etc.) and half of national investment in land improvement (land reclamation, water and soil conservation, permanent drainage, etc.). The cooperatives also undertook almost all maintenance of rural infrastructure. Their dissolution in 1991 has left a vacuum in infrastructure development and maintenance that the Government is moving to fill by developing local organizations.

2.6 Agricultural inputs were distributed by state enterprises (Agro-Tregtare). Mechanization services were provided to the cooperatives by the state-owned Machine Tractor Stations (MTS). The state ensured agricultural marketing and processing. Government privatized the cooperatives and distributed their lands to cooperative workers in 1991; it is still drawing up a privatization program for the state farms and agricultural state enterprises.

2.7 The 1991 land reform led to the creation of 380,000 small farms: the average allocation was 1.4 ha per family (Annex 4, Table 1), but in four of the 13 mountain districts it falls below 1.0 ha, far below subsistence level². While the land reform has been carried out rapidly and efficiently - only 10% of the ex-cooperative land remains to be distributed - nothing has been done to provide the new private farmers with working capital, except to distribute, in a very uneven way, the assets of the cooperatives. Thus, the farms lack basic inputs, and it has been reported that 90% of farmers did not use fertilizer in 1991/92³. They have little equipment, and most of those who use mechanical cultivation hire MTS services to disc and plow their fields. While the Government intends to privatize the tractor stations, the small size of the new private holdings will also require significant changes in mechanization approaches. The same kind of structural change is needed to adapt irrigation systems to the new land-ownership structure.

2.8 On the market side, the situation is not much better. Although the state collection centers (*Grumbullimi*) still exist, only 5% of private wheat production was delivered to them in 1992. Because of the small size of plots and the uncertain economic and institutional environment, most farmers are subsistence-oriented and prefer to keep their wheat and make their own bread. They are also unwilling to specialize according to their comparative advantage, or to grow agroindustrial crops that require off-farm processing.

1/In June 1991, the prices were paid under the following conditions :

	coefficient for inputs	price for cereals(leks/quintal)
low areas	100	210
hilly areas	91	270
mountain areas	85	320

2/ The planned dissolution of the state farms will not make more land available for former cooperative workers as they are mostly in different areas and their land resources are likely to be distributed to state farm workers.

3/IFDC, "Fertilizer in Albania: Situation, Analysis, and Recommendations," February 1992.

2.9 The first impact of the land reform has been, therefore, a regression toward subsistence farming. Three steps must be taken to reverse this trend and begin the transition to a market economy:

- (i) Employment outside agriculture must be created to provide income to rural families and reduce their dependency on their farm plots so that a process of consolidation into more economic units can begin⁴;
- (ii) Credit must be made available to give rural households access to the capital they need to develop both on- and off-farm enterprises; and
- (iii) Rural infrastructure must be re-established; this must include the development of a new rural market structure.

C. The Safety Net in Rural Areas

2.10 The new private agricultural sector's regression toward subsistence farming has left most farming families, with the exception of some in the more productive plains, unable to build sufficient stocks to survive through the 1992/93 winter until the next harvest, mainly because of lack of access to inputs and credit; many farms in hilly and mountain areas cannot meet their food needs for more than three to five months. The Government is fully aware of this problem and has set up a rural safety net based on two programs:

- A land-based compensation program included in the Land Reform Act. The amount of benefit depends on the per capita land allocation and the fertility of the land. The program reaches less than 9% of Albania's rural population and is limited to hilly and mountain areas. The amount paid monthly varies from lek 60 to lek 120 per person, but many eligible beneficiaries are not yet getting these stipends because of unclear land titles or because funds have not arrived in their districts;
- A wheat subsidy that was initially intended for the whole country, with the level of subsidy depending on location. This program has been put into effect only in mountain and hilly areas, and wheat is being dispensed without regard to income levels or holding sizes. In some districts part of the subsidized wheat has vanished in transport.

2.11 The safety net program was revised in October 1992 to target it toward landless families and farms with less than 2,000m² per capita. The new program excludes families that have members with full or part-time employment outside agriculture. While the number of beneficiaries is about the same as the 185,000 covered by the earlier land-based program, the budgetary impact of the combined program is considerably less than the lek 100 million a month spent on its predecessors.

2.12 Although similar income support programs have been used in other countries (e.g., in Ireland during the 1930s), it is clear that Albania's budget resources are too meager to provide this support through subsidies for an extended period. A significant change in the socioeconomic situation of the people living in the

⁴/this restructuring is not likely to take place before 3 to 5 years as the Land Reform Act does not allow farmers to sell their land, precluding voluntary consolidation through private transactions. Before introducing a land market, the government intends to complete the registry and compensate former land owners.

mountain area is necessary. Programs need to be introduced that combine poverty alleviation with economic development while moving away from pure subsidy programs. The Program described in Chapter 3 would achieve this. It is likely that in the medium term, the only solution for some of the more poorly endowed mountain areas is migration of a part of the population and specialization of those remaining in livestock, especially sheep and goat breeding that takes advantage of extensive community grazing areas.

D. Local Government in Transition

2.13 In addition to its direct effect on land distribution, dismantling the cooperatives had a secondary effect on the management of local resources and the organization of rural life. The cooperatives had been established in 1946 as a voluntary program and expanded - and quickly made mandatory - to cover the whole country by the late 1960s. The cooperative policy's main objectives were to organize a collective system of production and replace the traditional local government system - which had successfully withstood four centuries of Ottoman rule - with centralized authority. The process had a positive side in that the new system took charge of developing and maintaining rural infrastructure. The share of the cooperatives in rural infrastructure investment was very important. Over 1985-90 roughly 1/3 of national investment related to rural construction (irrigation, farm buildings feeder roads) and half of national investment related to land (land reclamation water and soil conservation, permanent drainage) was undertaken by the cooperatives. This shows the vacuum left by the dismantling of the cooperatives and the urgent necessity to build new institutional and financial solutions for rural infrastructure maintenance and development.

2.14 The June 1992 local government reform abolished the old centrally oriented organization. The number of districts was increased from 27 to 36 to diffuse the regional distribution of power. The 530 "joined villages" created under the old regime have been replaced by 314 slightly larger "communes." The 2,700 village councils have been abolished, but Parliament enacted in September 1992 a complimentary bill providing for the election of village chairmen, who would not be members of commune councils, but would be responsible for articulating village needs to those councils. The institutional gap created by dismantling the cooperatives has not yet been filled, and the organization of commune services is still underway. Although the legal situation is not yet clear, management of local resources (irrigation, pasture, forests) and maintenance of local infrastructure is expected to become the responsibility of the communes and their constituent villages.

E. Deterioration of Rural Infrastructure and Natural Resources

2.15 Albania's rural areas face particularly acute problems as regards rural infrastructure and natural resource degradation. The cost/efficiency ratio of public investment under the previous system was low for several reasons. A lack of financial evaluation and cost-plus reimbursement for projects led to expensive and capital-intensive technical designs. Compulsory labor led to low execution standards, while the state enterprises carrying out the projects had high administrative costs and margins. A scarcity of budget resources stretched the entire investment process, and led to poor maintenance that was exacerbated by a lack of user interest in preserving what was seen as state property and a minimal investment in the protection of natural resources.

2.16 Albania's already poor rural infrastructure was severely damaged during the unrest in 1990, and there was considerable scavenging of materials for private use. The present situation can be summarized as follows:

Roads: Around 10,000 km of rural roads need to be rehabilitated. They are mainly dirt roads connecting villages and communes, and many are seasonal roads that cannot now be used in winter. They are, however, essential to the village inhabitants and for the development of effective rural markets. These roads were a village responsibility and were maintained with bulldozers from the now defunct cooperatives. Setting up a new structure to rehabilitate them and keep them maintained is an urgent necessity.

Water Supply: A national village water supply scheme was begun in the 1980s with the goal of supplying all villages one tap per 60 people by 1992. All but 400 of some 2,700 villages now have systems, but a third of these systems need rehabilitation or extension.

Energy: While rural areas were electrified 20 years ago, power per household is limited to 200 watts, which is only enough to provide light. About 25% of Albania's 30,000 km electricity network has been destroyed. Besides immediate repair of the electrical network, the system's capacity needs expansion.

Irrigation: The irrigation infrastructure, which includes 313,000 ha that have been distributed to private farmers, is one of the agricultural sector's major capital assets. Here also, the dissolution of the cooperatives created a organizational vacuum. The subsector needs to be rehabilitated, adapted to the new land structure and reorganized on the basis of water user associations.

Telecommunications: Albania has 1.4 telephones per 100 inhabitants compared with 10 per 100 in Hungary and 38 in Greece. While each village had at least one telephone, a large part of the network was destroyed during the land reform, as farmers used telephone wires to fence the new property boundaries. At least 1,000 villages no longer have telephone access.

Schools: Most of the schools in the rural areas are in poor physical condition. Moreover, during the unrest in 1990 around 875 village schools were damaged, and about 50 burned, while in urban areas the destruction was limited.

Market Infrastructure: Most cooperative buildings have been destroyed and there is a great need for small marketplaces with adequate facilities for live animals and perishables, such as stalls, weighing stations, and cleaning equipment.

Afforestation: Forests cover 1 million ha, 48% of Albania's land area. Forests close to villages provided fuelwood and timber for the villages under the supervision of the cooperatives, which controlled some 60% of the forests. Since the dissolution of the cooperatives there has been no control over farmer wood cutting.

Water and Soil Conservation: Works have been carried out over the last 40 years over an estimated 400,000 ha. These works were mainly to put new land under cultivation, and little, if any, attention was paid to environmental concerns. In areas of high slope some of these works increased erosion problems when fragile soils were put under cultivation.

2.17 Repairing and rehabilitating rural infrastructure is both, thus, an urgent necessity and an employment opportunity for the rural population.

III. THE GOVERNMENT'S RURAL POVERTY ALLEVIATION PROGRAM

A. Overall Strategy

3.1 The October 1992 World Bank-EC report "An Agricultural Strategy for Albania" identifies the main short- and medium-term measures required in price and trade policy, land market, privatization of the state farms and state enterprises, and rural finance.⁵ The Government has endorsed the report's analysis, and to complement the policy changes called for in the strategy, is formulating a comprehensive rural development approach aimed at rebuilding the rural economy - on a free-market basis - from the bottom up. The program has emphasized poverty alleviation. This rural development approach seeks to integrate and improve the programs already in place and develop and implement new programs to fill in the gaps while assisting farm families through a difficult transition process. The strategy focuses on:

- *Actively alleviating rural poverty:* The first challenge for the Government in the rural sector is to develop employment and food production. Even if emigration prospects improve and the services sector expands, the rural sector will have to absorb a large part of the Albanian labor force for at least the next few years. Given the very high land/labor ratio, this means the development of off-farm full- and part-time activities.
- *Restoring food security:* While Albania is giving no consideration to returning to its old policy of food self-sufficiency, it recognizes that incentive mechanisms, adequate physical infrastructure, and working food processing and transport systems must be established to restart the food production and marketing chain. Price and tariff policies that will address the problem at a macroeconomic level must be supplemented with programs that help small farmers intensify production of cereals and other basic foods to cover their own needs and produce surpluses to feed the cities. A significant factor in this process will be the injection of cash resources into the rural economy.
- *Promoting the small private sector:* Privatizing state enterprises will require time, capital, and management capabilities. Privatization must be complemented by a self-employment policy that helps people not to fall out of the employment market so that they have to be supported by the safety net. This policy would help prepare for the coming market economy in which most of the services up- and downstream of agriculture will be private.
- *Repairing basic rural infrastructure:* Adequate rural infrastructure is a precondition for economic and social development. A large part of this rehabilitation work can be done under the aegis of the communes using local labor and generating local incomes.

^{5/} An Agricultural Sector Structural Adjustment Credit, which is being prepared, will focus on implementing the corresponding sectoral policies supported by a hybrid loan that will include a quick disbursing component and a component allocated to agricultural credit.

- **Strengthening local governments:** The main weakness of the newly created communes is their lack of financial resources and experience in financial and economic management. Making financial resources available for infrastructure investment responds to their immediate needs; technical assistance and training will introduce improved approaches to project evaluation, investment financing, and implementation and maintenance.
- **Rooting rural development policies in local tradition and culture:** For 45 years local governance traditions were purposely pushed toward oblivion in favor of collectivist dogma that have now been discredited. The credibility of the rural development policy depends on its capacity to merge local culture and new orientations coming from the West.

3.2 This rural development strategy calls for creating a transition institution that would establish and direct labor-intensive rural works, and provide small loans that meet the needs of the poorest part of the population, while the Bank for Agricultural Development expands its activities for larger loans. This proposed institution is the Rural Development Fund (RDF) described in paras. 3.21-3.24.

B. The Program

3.3 The Government's Rural Poverty Alleviation Program responds to the deep concern of President Berisha, expressed during his July 1992 visit to Washington, and to the Government's two stated priorities: employment and food security. The idea of the program arose from the agricultural strategy sector study that identified the main issues facing Albanian agriculture. The interest expressed by several international and bilateral donors including a French NGO, which provided the first seed money for a rapid action initiative against poverty, helped to formulate and initiate it.

Program Objectives

3.4 Albania's Rural Poverty Alleviation Program has three main objectives: (a) creating employment for the rural population and inject cash resources into rural households, (b) repairing basic rural infrastructure to facilitate economic growth, and, (c) promoting small private sector activities to help create a rural market economy. Careful monitoring of progress toward these objectives will provide feedback to the Government for developing rural policy, including improving on-going local government and local financing reforms. The program avoids the multi-sectoral integrated rural development approach, which gave mixed results in many countries in the 1960s, and focuses instead on bringing capital and training resources to the bottom level of rural society, leaving full initiative to villages, communes, and farmers themselves.

Program Description and Components

3.5 The Government's Rural Poverty Alleviation Program has three components: (a) a rural works program, (b) promotion of small economic activities through a credit program focusing on very small loans, and (c) studies, technology and training.

The Rural Works Program

3.6 The rural works program focuses on financing basic local infrastructure rehabilitation. The rehabilitation projects will be initiated by the villages and executed under the control of the communes. The types of infrastructure to be financed will be chosen under priorities defined by the communes within a framework of the availability of materials and equipment. Three main criteria will be used to select subprojects: economic and social impact; the labor intensity of works, and their potential contribution to local institution building. Selection criteria are described in detail in Annex 3.

3.7 The types of projects that meet these criteria are, in the first stage: (a) rehabilitating ex-cooperative dirt roads, (b) repairing or extending water supply systems, (c) rehabilitating small village irrigation schemes and adjusting them to the new land-ownership structure, (d) repairing and rebuilding schools and possibly health centers, and (e) establishing new market facilities. Examples of project requests already submitted by rural communities are presented in Annex 3.

3.8 Electricity and telephone rehabilitation and extension have not been included in the first stage (except in special cases such as repairing the electrical network needed for the functioning of a pumping station) for two main reasons: (a) the dimension of works and the change of technical norms require a country-wide approach, and (b) these two types of infrastructure are not regarded by the villagers themselves as having priority. Reforestation, and water and soil conservation have high labor content and positive environmental effects but relatively low economic and social impact in the short term. Above all, the legal aspects of forest ownership must be clarified before the communes or villages accept any responsibility in this sector.

3.9 In all cases, local subprojects will be limited to a size and number compatible with the capacities of the communes in terms of execution, maintenance and recurrent cost coverage. The 142 subprojects anticipated under the pilot phase reflect a cautious appraisal of the capacity of RDF and local organizations to implement infrastructure projects. Contracts will be signed with the communes defining work programs, timing, cost estimates, and future maintenance (for details of the proposed "project cycle" see Annex 3). The communes will then hire technical and supervisory personnel - drawing on the pool of technicians from the former cooperative farms - and village labor to carry out the works. Basing financing decisions on simple technical and economic criteria is expected to introduce a new approach in public investment and give more responsibility to local government.

3.10 Rehabilitating rural infrastructure will create employment opportunities and generate cash income desperately needed not only to buy basic farm inputs but also, in many cases, to ensure family survival.

Promoting Economic Activity Through Small-Scale Credit

3.11 Albania's rural environment is in a state of great uncertainty as regards prices, input supply, access to markets, privatization of irrigation, mechanization, etc. The rural credit system is still rudimentary, and few farmers have

access to either seasonal credit for inputs⁶ or longer-term loans. Farmers have reacted by adopting a subsistence risk-avoiding strategy that concentrates on the food security of their own families rather than producing marketable surpluses.

3.12 The main institution for formal credit to agriculture is the Albanian Bank for Agricultural Development (ABAD) which was spun off from the State Bank of Albania in 1991. It remains far from fully operational. ABAD has a portfolio of some lek 4 billion in loans to state farms and state-owned enterprises. With total private sector loans of only lek 320 million, ABAD is still at a very elementary stage of lending to farmers and rural entrepreneurs. It lacks the institutional capacity to develop small credit, or to cover the high transaction costs of small-scale rural lending. The Parliament is still debating whether to place ABAD under the general banking law approved in 1992. This places ABAD in a difficult position as regards mobilizing Central Bank resources, while pressure on it to lend to state farms is crowding out private sector credit.

3.13 While ABAD is expected to be capable of providing credit to commercial farming operations once its legal status under the banking law has been clarified, it lacks the mechanisms to service the credit needs of small farmers. ABAD procedures are roughly the same for small and large credits, which raises the transaction costs of smaller loans and discourages small farmers from asking for loans: loan requests must be accompanied by an imposing number of documents and certificates and take at least three months to process. In this context, it is necessary to design and test a system of rural credit that can address this group's needs while ABAD concentrates on larger loans and develops the expertise to process small ones. Such a system has been worked out with farmers themselves and ABAD local staff; it is based on the creation of village credit funds that will enable financial intermediation to take place at the local level.

3.14 The Village Credit Fund component of the Government's Rural Poverty Alleviation Program is designed to fill the gap left by ABAD's present inability to meet the seasonal and investment credit needs of farmers. As the average number of households per village varies between 100 and 200, and the average size of loan would be approximately \$150⁷, the amount of a village fund should be approximately \$15,000, normally starting with a first tranche of \$5,000. Short-term loans would be used for inputs, while medium-term lending would be used for livestock or equipment purchases by farmers and micro-entrepreneurs.

3.15 The Village Credit Funds will be supervised by Village Credit Committees made up of the village head and at least two other villagers, elected by the villagers, and representatives of ABAD and the Rural Development Fund. RDF will deposit funds in an interest-bearing account earmarked for the village in the local ABAD branch, and sign standard contracts with ABAD and the Village Credit Committee to manage and supervise the funds.

3.16 While RDF will retain ownership of these accounts, the committees will act as its agents in deciding on credit allocations and controlling the repayment of loans; ABAD will keep accounts and handle the money. RDF and ABAD will be remunerated for their services, while the village committees will operate on a non-remunerated basis. Security pledges will be defined by village committees,

⁶/ An IFDC survey during the 1991/92 season showed that 25% of farmers borrowed money. However, only 1% borrowed from ABAD, with the rest borrowing from family or friends without interest. Average loan size was \$50, and the main uses of credit were to pay for tractor services, or buy seeds, fertilizers, manure and pesticides. The credit was repaid after the harvest.

⁷/The maximum loan amount would be US\$300 equivalent per family during the Pilot Phase.

and can be based on crops, equipment, or personal or group guarantees. Assurance of repayment should be maximized by bringing loan decisions to the village level, where they will be made by neighbors who both know potential creditors and are in a position to exert social pressure for timely repayment. A second level of security would be added by having RDF stop all new commitments from a village fund if there are defaults. An Emergency Fund financed from a 0.5% fee added to loan repayments would be built into the system to help borrowers who face exceptional repayment difficulties. Detailed arrangements for the operation of the Emergency Fund, and mechanisms for mobilizing rural savings to make village funds self-sustaining, including mandatory savings account deposits tied to loan repayments, will be tested during the Program's pilot phase.

3.17 As in all credit schemes, the main problem is to ensure the sustainability of the system by covering the cost of capital - including inflation - and transaction costs. The villagers themselves suggested creating an inflation index based on the price of crops or animals, but this would be difficult to apply. The seven ongoing Phase Two credit schemes (para. 3.19 and Annex 5) use an alternative approach to ensuring that interest rates are positive in real terms: loans have been expressed in lek, but repayments fixed in constant-dollar equivalent terms, thus approximately capturing the effects of inflation.⁸ This has been accepted by the villagers, and it is proposed to apply the same system to the pilot project. Initial fees to cover transactions costs, which will be reassessed as the credit program progresses, have been set at:

Village Committee	0.0%
ABAD	2.0%
RDF	2.5%
Total	4.5%

Rural Studies, Technology and Training

3.18 One of the challenges faced by the Government is to define rural development policies rooted in local culture and, at the same time, open to new technologies and market mechanisms. This will not be easy in a country where local traditions and historical community organization have been deliberately destroyed for 45 years and where all relations with the outside world were cut. This program component will begin with studies to understand better the basic structure of rural Albanian society and the contributions it can make to rural development. It will have three subcomponents:

(a) A rural studies subcomponent will collect information on local traditions and farmer attitudes on such issues as land ownership, labor organization, off-farm activities, village organization, and informal credit before collectivization. The survey will also inventory village problems, such as access to markets, water and energy supply, land use, management of local resources such as irrigation, pastures, and forests which, for the moment, still belong to the state, and farming methods and conditions, including cropping choices, input use, and household budgets. The purpose of these studies will be to establish profiles of farms and villages where village credit funds can be established. The surveys will be complementary to existing IFDC surveys. They will also help monitor

^{8/} Lek repayments will be calculated according to the current dollar exchange rate to capture the dollar equivalent of the original loan.

the credit program and provide valuable information for rural development policy.

(b) A technology subcomponent will seek small-scale technologies appropriate to local resources and markets, test them, and facilitate the procurement of small equipment for private entrepreneurs. This could be organized in collaboration with the EC funded Small and Medium Enterprise Support Unit, which is expected, in the near future, to have seven regional agencies.⁹

(c) The training component will consist of training courses for local government technical staff in project evaluation, financial management and market economics, courses in business planning and management for farmers and rural entrepreneurs, and professional exchanges with local governments or enterprises in other countries.

C. Methodology: A Participative Process Approach

3.19 The Government program is being implemented in four phases:

Phase 1: Early test actions, already underway, comprise the execution of two small rural works projects, and the first village and farm surveys. They are being financed by Frères d'Espérance, a French NGO, for a total amount of US\$20,000.

Phase 2: Pre-pilot phase which started in November 1992, is testing the organizational and technical approaches possible for eight more rural works projects and seven Village Credit Funds. This phase (US\$100,000) is being financed by UNDP.

Phase 3: Pilot phase, involving an IDA-financed project. This is the project described in Chapter 4. It is scheduled to start in early Spring 1993. The year-long pilot project financed by IDA and other donors will cost approximately US\$4.8 million.

Phase 4: Full-scale project, amounting to approximately US\$32 million over three years could be co-financed by IDA and other donors if the pilot phase is successful. It was agreed at negotiations that RDF would undertake evaluation of the Pilot Project eight months after effectiveness of the Credit for the Pilot Project for the purpose of designing the Full-Scale Project, which would extend the project to the whole country.

3.20 This process approach allows the program to be adjusted to local needs and constraints as lessons drawn from each phase are used to prepare the next one. It will also allow for - in fact, encourage - participation by local people and institutions. During the pre-pilot phase, the organization of the rural works and the village credit fund concept were worked out in continuous dialogue with commune and the village representatives to maximize their chances of success. This included contractual arrangements between communes, village councils, and the Bank for Agricultural Development that define their responsibilities and the relationship between them and the pre-pilot project. This participative approach

⁹The Support Unit organizes business training programs, finances investment credit and insures procurement of equipment for small- and medium-scale enterprises. The average loan amounts to \$6,000, far above the average size of the intended village fund loans (\$20 to \$300). Although their target populations are not the same, the programs will run in parallel, and coordination should not be difficult.

is an application of modern management methods (e.g., quality circles) to the rural sector.

D. Implementation: Creating A Rural Development Fund

3.21 The Rural Poverty Alleviation Program outlined above cannot be carried out efficiently and rapidly by Albania's administrative services - which are themselves in a period of adjustment and reform - or by ABAD, which is not yet able to carry out a full-fledged rural credit program. Following the experience of other countries, the Government has established a small independent agency outside the normal government structure - the Rural Development Fund (RDF) - to implement the program. RDF was established by the Council of Ministers in January 1993 (Annex 1); its major features are summarized below:

RDF Organization

3.22 The RDF is an agency under the oversight of the Council of Ministers, established as a juridical person with the authority to enter into contracts, and with administrative, technical and financial autonomy. Local institutions (e.g., village credit committees or water user associations) will contract with RDF to carry out the credit and public works components of the program, and standard contracts with these local institutions will be included in RDF's Operational Guidelines.

3.23 The Fund's orientation, during the pilot phase, will be poverty alleviation in rural areas through the program described above. During this phase the target population of the Fund's rural works component will be the poorest part of the rural population; those with limited, if any, cash income and whose farming is by necessity now oriented toward self-sufficiency. The rural credit component will be broader, addressing farmers and rural micro-entrepreneurs who do not have access to banks. RDF resources will mainly be those assigned it by multilateral or bilateral aid agencies. RDF's governing bodies are:

(a) A Board of Trustees, chaired by the Deputy Prime Minister, and comprising the deputy ministers of Agriculture and Food, Economy and Finance, Labor, and a representative of the Office for Local Governments.

(b) An Executive Committee formed by the Executive Director, the two Deputy Directors and the financial director of RDF. The Executive Director will be named by the RDF Board Chairman, in consultation with, and with the approval of, IDA. Any successors to that post during the project period will also require IDA approval. The appointment of an RDF Executive Director will be a condition of project effectiveness.

3.24 The Board defines and oversees RDF's main policy and program objectives, while the Executive Committee is responsible for its management. The proposed organization of the RDF is set out in Annex 1. It consists of an administrative and financial department, and operational departments for infrastructure projects, rural credit, and studies, training, and technology. An internal audit unit will report directly to the Chairman of the Board. Technical assistance will be provided for an initial period of two years by two full-time advisors, one for the rural works component and one for the credit component. These field specialists will be supported by short-term missions by other specialists as required. RDF staff requirements have been estimated at 35 persons in the first year, rising to 79 in the fourth year as the number of subprojects financed increases (Table 2).

Table 2: RDF STAFF PROJECTIONS

<u>Years:</u>	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
Director	1	1	1	1
Senior management staff	4	6	8	9
Engineers/credit officers	18	28	37	45
Accountants	1	2	2	2
Secretaries	2	3	4	4
Driver/mechanics	9	13	16	18
TOTAL	35	53	68	79

3.25 Within the framework of the decree establishing RDF (Annex 1), the agency's operations will be governed by its Regulations (Annex 2) and comprehensive Operational Guidelines covering procurement and implementation of the rural works and credit components, and the criteria under which districts and communes would be selected for eligibility. These Regulations and Guidelines will support the approaches to each component set out in paras. 3.6-3.18 above, detailing, inter alia:

For the Rural Credit Component: The relationship between RDF, village credit committees, and beneficiaries, including eligibility criteria for villages and beneficiaries and model agreements for the contractual relationships between RDF, ABAD, village committees, and beneficiaries. The Guidelines will also cover village credit committee membership and credit procedures, including lending and collateral criteria and the indexing methodologies used for loan repayments, ABAD supervision of loan accounts and default procedures.

For the Rural Works Component: The regional and sector distribution of public works subprojects. The project cycle, including subproject identification, selection, appraisal, approval and implementation. This would include technical criteria and specifications for the works to be carried out and evaluating their economic impact. The Guidelines would also cover procedures and model contracts for contracting with subproject implementing agencies - usually the communes - including their counterpart contributions, maintenance, and user-fees, where applicable.

The establishment of an information system/database to provide subproject implementing agencies with nationwide price information that will allow effective purchasing of the goods and services needed to carry out subprojects. Payment, accounting, and auditing procedures.

3.26 A working group to implement the Test and Pre-Pilot phases was established in September 1992 under the sponsorship of the Minister of Agriculture. UNDP and the Frères D'Espérance provided funding to hire local professionals, who have worked with expatriate consultants to set up village credit committees - seven of which are already operational (Annex 5) - and train commune leadership in developing the mechanisms to define and select local public works subprojects. Local support for, and participation in, this process has been strong, and very encouraging. The working group's training and experience in implementing these early phases has created a potential nucleus for the Rural Development Fund's staff.

3.27 Implementation of the major project components would build on the experience of the first two phases, which are described in Annexes 3 (rural public works) and 5 (small-scale credit). RDF's Infrastructure Operations Department will evaluate rural works subprojects proposed by the communes to

ensure that they are in line with Project priorities and local needs as expressed by the villages. The experience of Phases 1 and 2 has shown that technical staff are available at the local level and capable of preparing cost estimates and work programs. RDF staff will work with local staff to ensure satisfactory subproject design and supervise implementation, which will remain a commune responsibility. For the credit component, RDF's Credit Operations Department will work with village credit committees and ABAD staff, as described in paras. 3.11-3.17. These arrangements appear to have worked well in the early test phases of the Program.

Geographical Area of Intervention

3.28 The Fund will ultimately (under Phase 4) finance subprojects in the 313 rural communes, including 24 small rural towns, although priority will be given to the poorest areas for labor-intensive rural works. Given the importance of urban unemployment - which rose to 50% during early 1992 - and the political concern of the Government, the Fund may try to organize the participation of town inhabitants in rural works around the cities and experiment with a credit approach for urban self-employment in parallel with the village funds.

Sustainability

3.29 The Rural Development Fund is not intended to be a permanent institution. Its program will be adjusted as it evolves from a rural poverty alleviation focus to become a rural development program. It is hoped that the village credit fund system, after being tested and shown to work on a broad scale, can ultimately be handled directly by a strengthened Bank for Agricultural Development, or become the nucleus of a rural cooperative banking system. The rural works component is designed to strengthen local government capacity to select, design, organize, and implement infrastructure projects, and it is anticipated that responsibility will progressively be transferred from RDF to the communes.

Expected Program Achievements and Costs

3.30 The proposed Rural Poverty Alleviation Program would take four years. During this period, the total investment of the Rural Development Fund (i.e., separate from administrative costs and studies), estimated at \$31,800,000, would be divided approximately between the rural works program (70%), small scale credit (25%), and rural studies, technology, and training (5%). This would allow for the realization of more than 800 infrastructure projects, the average cost of which has been estimated at \$11,000, rising to \$32,000 in the fourth year on the assumption that small rehabilitation projects will progressively be replaced by new projects and that exceedingly low labor and local supplies costs (monthly wages amount to \$12) will tend to rise toward international market levels. On the average, the program would finance 2.6 projects per commune, enough to have a significant impact, but still far below the real needs.

3.31 During the four-year program period RDF is expected to finance 500 village credit funds, estimated at an average size of \$15,000 the first year and reaching \$24,000 in the fourth year. The village funds are expected to cover less than 20% of Albanian villages. This represents a very prudent approach that takes into account the considerable time and effort needed to set up each village fund and ensure its proper supervision. If the system works well, which also requires a well-functioning banking sector, this component could expand more rapidly.

3.32 The rural studies and technology component has been designed on the assumption that it will include 500 village profiles and 70 pilot operations introducing and testing small-scale production equipment in rural areas.

Technical assistance missions in Albania and technical support abroad are included in this component.

3.33 The training component includes six-week preliminary courses for RDF staff, who will also receive on-the-job training, 140 study trips abroad, and training for 870 commune staff and 420 rural micro-entrepreneurs. This component includes technical assistance.

3.34 Program design has been carefully based on the implementation capacity of the RDF and other executing agencies - communes, villages, the Albanian banking sector, and local contractors - rather than on the potential demand.

3.35 The four-year program would cost about \$36.0 million; a cost summary is shown in Table 3. Except for the increase in dollar prices of local labor and supplies, which has been estimated at 30% for the first year and at a decreasing rate thereafter, no other contingencies have been provided. Any further increase in average subproject costs would result in a reduction in the number of subprojects.

**Table 3: ALBANIA RURAL POVERTY ALLEVIATION PROGRAM,
ESTIMATED FOUR-YEAR COST¹
(US\$ million)**

	<u>Local</u>	<u>Foreign</u>	<u>Total</u>	<u>% FE</u>	<u>%Base Cost</u>
Rural Works	18.1	1.0	19.1	5	53.1
Small-Scale Credit	9.5	1.1	10.5	10	29.2
Studies, Technology, and Training	0.9	1.3	2.2	58	6.1
RDF Equipment	0.0	0.6	0.6	95	1.7
RDF Recurrent Costs	1.6	0.6	2.2	29	6.1
Technical Assistance, Monitoring & Evaluation	0.5	0.9	1.4	65	3.9
Total	30.6	5.5	36.0	15.3	100.0

¹ Estimates are not given in lek because of uncertainty about inflation

3.36 Recurrent costs have been kept to a minimum. Recurrent costs represent about 6.1% of total cost, and equipment costs 1.7%. A significant part of expenditures (1.2%) would be used to cover transport and travel expenses, as RDF staff will have to make frequent field trips. The rural works officers, located in Tirana will share cars, while the credit officers, located in district towns, will use motorcycles. Information and promotion expenses (0.7%) have been included in operating costs.

3.37 Technical assistance will be important during the Program's first and second years. It includes two full time expatriates for two years (terms of reference in Annex 8), and regular follow-up and support missions by a rural works engineer and a credit specialist. Monitoring and evaluation missions and international auditing once a year are also included in this category, which amounts to 3.9% of the program's four-year cost. Except for training- and technology-related costs, which have been included in the corresponding programs, technical assistance has been listed separately to avoid distorting recurrent costs.

E. Rationale for IDA Involvement

3.38 It is proposed that IDA support Albania's Rural Poverty Alleviation Program, starting with the Pilot Project described in Chapter 4 below. IDA involvement is justified because the proposed project is fully in line with the Bank Group's overarching objective of addressing poverty in economically efficient ways. It is now urgent for the Government to start directing resources toward activities that foster economic development while alleviating poverty. Albania's Rural Poverty Alleviation Program would achieve these goals by providing incomes in very poor rural areas while improving infrastructure and providing small-scale credit to allow increased economic activity. The Program will also begin the critical task of creating new locally based institutions to take over the infrastructure development and maintenance functions of the dissolved cooperatives.

3.39 IDA involvement in the program would provide for urgent measures to be taken while mainline IDA interventions are being designed to help bring about structural change, such as the proposed FY93 ASAC and the FY95 Rural Roads Project. The program would also be linked with the proposed Education Project, which could use the Rural Development Fund as an executing agency for repairing and rebuilding schools.

F. Applicable Lessons from Bank/IDA Experience

3.40 The design of the proposed Rural Poverty Alleviation Project builds on past experience with public rural works and credit projects by the Bank Group and its antecedents stretch even further back in time. Rural development and regional investment funds exist in many countries with the basic objective of decentralizing public investment decisions and giving more initiative to those who know best about their needs: local government or the beneficiaries themselves. Since the mid-1980s the need to counterbalance the negative social impact of structural adjustment programs has led many countries to create social funds dealing with this specific problem. The lessons the Bank/IDA and its borrowing member countries have learned from their experience with social funds are described in Annex 9. These lessons offer important guidance for Albania's Rural Poverty Alleviation Program:

- the program's target population should be well defined, and it should focus on assisting small private farmers and the rural unemployed.
- to ensure its transparency, effectiveness, and ability to disburse funds rapidly, the RDF should be autonomous, authorized to adopt flexible procurement practices and offer private sector salaries to its staff.
- to ensure RDF accountability, it should report regularly on its activities to the Government, Parliament and the press, carry out regular audits of its financial statements and physical investments, and have a management information system that tracks the implementation of each subproject.
- the selection of subprojects proposed by the local level for support from RDF should be made after full consultation within the concerned communities

3.41 However, the main recommendation that can be drawn from the Bank/IDA experience is that no program can be replicated from one country to another. One of Albania's hallmarks is that it is a small country in which subprojects can be at once decentralized and controlled from the center. Although local government has just been reformed, the communes have inherited the administrative experience accumulated by the former joined villages. The financial and economic approach has to be adapted to market principles, but the educational level of the population and the technical capacities of local staff are good. Even though the communist regime attempted to bury local traditions, there are vivid memories of the village organization, and the will to become once again self-governed and self-sufficient. Finally because of the recent land reform, which distributed land equally between the former cooperative workers, rural wealth in each village is relatively level - although that level is quite low - with the differences between villages arising according to their access to land and irrigation.

IV. THE PROJECT: THE RURAL POVERTY ALLEVIATION PROGRAM'S PILOT PHASE

4.1 The proposed project would provide financing for the Rural Poverty Alleviation Program's Pilot Phase, which would establish and staff the Rural Development Fund and begin implementing rural credit and public works programs. This pilot approach is seen as a means to combine quick action to meet urgent problems in rural Albania with a flexible incremental approach that will allow testing of each component as it is put into place and implementation begins. The project, thus, includes a strong monitoring and evaluation component that will be used to provide feedback that will allow continual adjustment as the program develops.

4.2 Phases 1 and 2 of the Program (para. 3.19) have provided implementation experience that has been used to design the more ambitious Pilot Phase described in this chapter. Two rural works schemes were executed in Phase 1, and five more in Phase 2; they have demonstrated a high level of interest among villagers and local government officials in participating in the works program, and confirmed the capacity of local technical staff to design and organize construction work using labor-intensive techniques. They have also served as a training ground for local staff in subproject design and evaluation. The seven village credit funds established under Phase 2 (para. 3.26 and Annex 5) have provided valuable feedback; contractual arrangements have been worked out with village credit committees and the logistics of credit distribution tested on some 120 separate loan packages. Results have been highly favorable, giving considerable confidence that the Pilot Project can be launched successfully.

A. Project Objectives

4.3 The proposed project's objective is to establish Albania's Rural Development Fund and provide financing for its first, pilot, year of operations. Test and pre-pilot phases of the program have already been carried out with funding from a French NGO and UNDP. As a pilot project it would have a strong monitoring and evaluation component, so that immediate experience in both institution-building, and subproject financing and implementation, would provide feedback to fine-tune and improve program effectiveness. This oversight would include a mid-term review (para. 3.19) eight months after Project start-up that would evaluate whether progress was sufficient to warrant moving ahead to IDA support of the Government's proposed full scale Phase 4 Rural Poverty Alleviation Program. The review criteria would include evaluating the performance and institutional capacity of RDF, the communes (for public works subproject

selection, design, and implementation), and the village credit funds (including their repayment performance). While eight months may seem a relatively short time to begin this review, the village credit funds, commune public works programs, and a precursor RDF organization are already operating under the test and pre-pilot phases, and project start-up should be quite rapid.

B. Project Description and Components

4.4 Within the general objectives of Albania's Rural Poverty Alleviation Program, the proposed project would:

(a) Create the institutional capacity needed for program implementation by establishing the Rural Development Fund and training a first group of local staff. The project would provide equipment for the establishment of the RDF, 56 man-months of technical assistance, including full-time expatriate advisors for two years for the rural works and credit components, and recurrent costs including transport costs.

(b) Develop RDF's operational procedures and mechanisms of technical and financial control.

(c) Evaluate, design, finance, and implement approximately 142 rural infrastructure projects, and establish and fund some 50 village credit funds.

(d) Establish and implement, using technical assistance as necessary (about 4 man-months) training programs for commune staff, farmers, and local technicians and entrepreneurs to improve the capacity of village credit funds to evaluate and administer small loans, and programs to transfer appropriate technology to farmers and small rural entrepreneurs.

Pilot Project Implementation

4.5 As the pilot project corresponds to the first year of the planned four-year Rural Poverty Alleviation Program, its description and components are basically the same as those described in Chapter 3. The Government has agreed to conclude, prior to effectiveness, an agreement acceptable to IDA under which it would pass the proceeds of the Credit to the project implementing agency, RDF, as a grant. RDF, with the assistance of consultants, will carry out the Project through its infrastructure, rural credit, and studies/technology departments.

4.6 RDF's will implement the Project under its Regulations and Operational Guidelines. It was agreed at negotiations that the Regulations and Guidelines, and any subsequent changes to them, will be subject to Association approval; production of the Regulations and Guidelines acceptable to IDA are a condition of Project effectiveness.

Monitoring

4.7 The project's pilot nature provides the opportunity for its approaches to be continually tested so that they can be adapted to increase their effectiveness. For that purpose, close monitoring of the following elements will be carried out:

For rural works components:

- Types of works, their technical design, unit prices and cost estimates and methods and organization of construction; this should allow RDF to build a database and establish a standard list of projects and costs.
- Project beneficiaries at commune, village and farm level. This will enable better targeting of the program toward the poorest part of the population.
- Local partners, including supervision engineers and technicians, public and private subcontractors, enterprises supplying materials and services including the banking sector. Including this information in the RDF database will help organize the local market and facilitate the selection of subcontractors.
- Financial organization and control, which has to be organized and tested.

For the rural credit component:

- The organization and functioning of village funds and their cooperation with ABAD.
- Loan amounts, and economic activities financed.
- Repayment rates and reasons for defaults.
- Loan beneficiaries, by age, sex, and education and income levels.

4.8 Data from the monitoring program will be used to revise and adjust the village credit fund component before extending it to a larger scale.

Studies

4.9 Rural studies will improve understanding of village and farm problems, monitor the overall program, and evaluate its impact. Technology transfer will be tested with a limited number of equipment types corresponding to the main needs of the rural population. Training, in the first stage for the RDF staff, will expand progressively toward commune staff and rural micro-entrepreneurs. It will be progressively adjusted to integrating a better knowledge of the RDF needs and the profiles of trainees.

C. Programming and Distribution of Resources

Regional Distribution

4.10 The RDF would program its financing separately for the rural works and rural credit components. The rural works, which are to be a grant program, would focus mainly on poor areas, seeking to generate income rapidly, but avoiding uneconomic investments that would essentially serve as subsidies to support people who might otherwise migrate from the rural areas. The rural credit component, whose loans would bear real positive interest rates, would start in areas representing all types of development situations.

4.11 The rural works program will be limited during the pilot phase to Albania's 10 poorest districts¹⁰. The funds would be allocated to the districts based on a formula (for details see Annex 4) taking into account district population and three poverty indicators: arable land per capita, percentage of hilly and mountain land, and the rate of unemployment. Within the district, the funds will be allocated to the communes under the same criteria. This distribution formula will be re-examined after nine months and allocations can then be changed, not exceeding 10% of the total budget.

4.12 The rural credit component would begin in five districts in the plains, hilly, and mountain areas representing Albania's different regions. These are likely to be Mirdite in the north, Elbasan, Librazhd, and Gramsh in the center, and Kolonje in the south.

Focusing on the Rural Poor

4.13 The proposed project would target the poor in two specific ways in addition to its allocation of funds for rural infrastructure works to poorer areas. Workers on rural infrastructure projects will be selected according to poverty criteria, and only one member of each family will be accepted. The credit component will include a \$300 per family loan ceiling during the first year. Farmers or rural entrepreneurs who need larger loans will submit their requests directly to ABAD.

Women in Development

4.14 Albania's rural women are now entirely absorbed by farm tasks, as their overriding concern is to ensure family food security until next harvest. They do most of the manual work, which has increased because of the mechanization crisis brought on by a lack of operating tractors, the inadequacy of tractors for preparing small plots size, and the cost of tractor services. They often work 15-hour days, and have few opportunities to develop other activities.

4.15 The project's pilot phase would address this issue in a number of ways. Increasing rural incomes and providing credit would allow an increasing amount of cultivation to be carried out with mechanical or animal power because farmers would have cash to hire rented services. Water supply subprojects carried out under the project would reduce the very heavy and time-consuming task of carrying water, which is mainly carried out by women. The project could also finance hand tillers, which could be used by groups of farmers to reduce cultivation time and effort. Project preparation also included discussions with village women's associations, which are preparing specific credit programs for women that could be financed by the RDF. These programs could be organized on the basis of the solidarity group approach inspired by the experience of the Grameen Bank in Bangladesh.

Environmental Effects

4.16 The project has been assigned an environmental category 'B' rating, and does not require an environmental assessment. Given the types of subprojects to be financed under the project, no significant environmental impact is expected, and in some cases these subprojects would promote improved natural resource management. For example, it may be possible to include environmentally positive

^{10/} The 10 poorest districts are Puke, Mirdite, Tropoje, Mat, Kukes/Was, Librazhd, Gramsh, Skrapar, Diber/Bulkiye, and Pogradec.

reforestation works in the list of projects to be contracted with the communes, and village credit funds could be used to finance seedlings or nurseries to plant fruit trees along the boundaries of farm plots. A set of environmental criteria would be developed and applied to each subproject through a standard subproject checklist. These criteria would be drafted by a consultant specializing in natural resource management and included in the RDF Operational Guidelines. Public facilities to be built or repaired would include proper waste disposal facilities, and rural roads and irrigation systems would be designed to mitigate erosion potential. With regard to the rural credit component, IDA is providing support to the Government of Albania under the June 1992 Critical Imports Project in the selection of appropriate fertilizers, pesticides and related safety equipment.

D. Pilot Project Costs

4.17 Within the total cost of the program, presented in Chapter 3 and amounting to \$36 million, the pilot phase represents \$4.8 million - first-year costs of \$3.9 million, plus recurrent costs, technical assistance, and monitoring for 12 additional months (\$0.87 million). This additional funding will allow for the continuity of the program during the appraisal of a possible next phase.

4.18 The pilot phase will cover the financing of 142 rural infrastructure projects for a total cost of \$1.6 million, the creation of 50 village credit funds for a total amount of \$0.75 million, and studies, technology and training for an amount of \$0.4 million. The breakdown of the pilot project's costs is shown in Table 4:

Table 4: COST ESTIMATES^{1/}

	<u>Local</u>	<u>Foreign</u>	<u>Total</u>	<u>Local</u>	<u>Foreign</u>	<u>Total</u>	<u>Percentage</u>	
	----- (tek million) -----			----- (\$ 000) -----			FE	Base Cost
Rural Works	151.05	7.95	159.00	1,510.5	79.5	1,590	5	33.4
Small-Scale Credit	67.50	7.50	75.00	675.0	75.0	750	10	15.7
Studies, Technology, and Training	15.37	21.23	36.60	153.7	212.3	366	58	7.7
Equipment for RDF	1.84	35.06	36.90	18.4	350.6	369	95	7.7
RDF Recurrent Costs	47.85	19.55	67.40	478.5	195.5	674	29	14.1
Technical Assistance	35.56	66.04	101.60	355.6	660.4	1,016	65	21.3
Total	319.17	157.33	476.50	3,191.7	1,573.3	4,765	33	100.0

^{1/} More detailed cost tables will be found in Annexes 3, 6, and 8

E. Financing Plan for The Pilot Phase

4.19 Given Albania's very serious budgetary situation at present it is proposed that, at least for this pilot phase, the Government's contribution be mainly in kind - office space, participation of administrative services, etc. Subsequently, for the main project, counterpart financing of at least 5% of the investment cost should be required from the communes for the rural works financing. Given the lack of local investment budgets and the decapitalization of the rural population, this rule cannot be applied in the pilot stage. Thus, during the pilot phase, communes will be only requested to take charge of recurrent costs, which will be covered mainly by taxation in labor of the village inhabitants.

In the case of projects for which operating expenses are normally covered by line ministries or specialized agencies (e.g. schools or water supply), a formal agency commitment would be required before RDF signs a contract with a commune.

4.20 The wages paid on RDF financed rural works subprojects will be defined according to unskilled sectoral market rates. For some types of projects where the social impact is more important than labor intensity, salaries will be below market rates to allow for a village contribution to subproject financing. This may be the case for water supply projects, especially in the plains, where additional cash income is less an absolute necessity. The contribution of the villages to the credit fund component will consist of the voluntary work of the village committees.

4.21 Several donors have indicated their readiness to cofinance the pilot phase and expressed intentions to contribute to the full-scale project. The EC has financed consultants for project preparation, and UNDP financed the pre-pilot phase. Both have indicated their intention to continue their support to the RDF. The financing plan is summarized in Table 5.

Table 5: FINANCING PLAN
(US\$ million)

IDA (SDR 1.80 million)	2.4
EC	2.0
UNDP	0.4
TOTAL	4.8

F. Procurement

4.22 Procurement arrangements are summarized in Table 6.

Table 6: PROCUREMENT ARRANGEMENTS^{1/2}
(US\$000)

<u>Category of Expenditure</u>	<u>ICB</u>	<u>LCB</u>	<u>Other</u>	<u>TOTAL</u>	<u>% Share of IDA</u>
Civil Works	—	—	1,590 (1,130)	1,590 (1,130)	69
Equipment & Materials	—	—	369 (369)	369 (369)	100
Technical Assistance, Studies, Technology and Training	—	—	1,342 (400)	1,342 (400)	39
Credit Funds	—	—	750 (300)	750 (300)	33
Recurrent Costs	—	—	674 (201)	674 (201)	34
Total Financing Requirements			4,765 (2,400)	4,765 (2,400)	50

^{1/2}Figures in parentheses are the amounts to be financed by IDA. Civil works would be procured by hiring local technicians and workers; equipment and materials through local and international shopping procedures; international consultants would be selected in accordance with IDA guidelines on consultant selection.

4.23 The Rural Works Program would finance about 142 infrastructure subprojects at a total estimated cost of about US\$1.6 million, with an expected average cost per subproject of about US\$11,000 and a maximum cost per subproject of \$25,000. These subprojects would finance small civil works needed for rehabilitating dirt roads, repairing water supply systems, rehabilitating small village irrigation schemes, repairing and rebuilding schools and health centers and establishing market facilities. Given the small value and dispersed locations of the contracts, international competitive bidding or limited international competitive bidding are not considered suitable. The potential cofinanciers have agreed that procurement procedures should be as simple as possible, and that the procurement of civil works, equipment and materials would be carried out in the following manner:

- Rural Works: RDF, the project implementing agency, will sign contracts with communes and other local institutions (e.g., water user associations) for the execution of subprojects. In most cases, these works will be organized and carried out directly by the communes, which will hire local technicians to supervise the works. As small-scale contractors do not yet exist in rural Albania, the communes will also hire local workers to construct the works under regulations and wage rates spelled out in their contracts with RDF and the RDF Operational Guidelines. RDF bookkeeping and oversight procedures will also be set out in its Operational Guidelines. It is anticipated that by the time the pilot project is completed local contracting capability will be more developed and some communes will be able to use local shopping procedures based on inviting and comparing bids from several contractors. This situation will be carefully monitored during the pilot project, and every effort made to introduce local shopping procedures as this option becomes available. The aggregate amount to be procured under direct hiring is not expected to exceed US\$1.13 million, with a limit of US\$25,000 on any individual subproject.

- RDF Equipment and Materials: Contracts for equipment and materials not available in Albania (e.g., office equipment, vehicles), for an aggregate amount estimated at US\$350,000 will be awarded through international shopping procedures based on comparing quotes from at least three suppliers from three eligible countries. All contracts above \$40,000 will be reviewed by IDA. It is expected that individual contracts for the purchase of equipment will not exceed \$50,000. Local shopping procedures would be utilized for minor equipment and supplies to be procured locally for an aggregate amount estimated at US\$20,000.

- Technical Assistance, Studies, Training, and Technology: Local consultants will be hired for rural studies at an aggregate cost not expected to exceed US\$100,000; many qualified former cooperative personnel are available. International consultants will be hired in accordance with IDA guidelines on consultant selection. This is expected to comprise 48 person-months for two two-year consultancies to assist the rural public works and small-scale credit project components, and an additional six months of short-term consultancies, for an aggregate amount estimated at US\$300,000.

- Credit Funds: Procurement under village credit funds, which would involve very small amounts (US\$20-300), typically for purchase of minor farm inputs and supplies, would be organized by the farmers concerned in accordance with their traditional purchasing practices for an aggregate amount of \$300,000.

• **Recurrent Costs:** The Credit would finance recurrent costs of US\$201,000 consisting of the salaries and operating costs of RDF. The RDF staff would be recruited on the basis of minimum education standards, satisfactory to IDA. The RDF staff would be recruited initially for a probationary period of six months and would be confirmed after the successful completion of this period.

4.24 **Procurement Supervision and Review Process.** To safeguard propriety in procurement, the details of the above procurement practices would be included in RDF Operational Guidelines; as indicated earlier (para. 3.25), it was agreed at negotiations that these Guidelines, and any subsequent changes in them will be subject to approval by IDA; production of the Guidelines will be a condition of effectiveness. In addition, training would be provided to RDF and commune staff in procurement and disbursement. In particular, the RDF staff would be trained in project management and supervision. IDA staff, during supervision missions, would review procurement actions to ensure that they are carried out in accordance with the agreed procedures.

G. **Disbursements**

4.25 The proposed IDA credit is expected to be disbursed over a period of 30 months. The closing date would be June 1995. The disbursement schedule would be as follows:

<u>Period</u>	<u>Cumulative Amount</u> US\$ million
June 1993	0.20
December 1993	0.70
June 1994	1.20
December 1994	2.00
June 1995	2.40

Disbursements would be made as follows:

- (i) 100% of foreign and local expenditures for civil works;
- (ii) 100% of foreign expenditures, 100% of local expenditures (ex-factory cost), and 85% of local expenditures for other items procured locally, for equipment and materials.
- (iii) 100% of credits extended to village credit committees, and,
- (iv) 100% of local and foreign technical assistance and training.

4.26 All disbursements would be made on the basis of statements of expenditures certified by the RDF Executive Director. The required supporting documents would be retained by the RDF for at least one year after receipt by the Bank of the audit report for the year in which the last disbursement was made. This documentation would be made available for review by the auditors and by visiting IDA staff upon request.

4.27 **Special Account.** To facilitate timely project implementation, it was agreed at negotiations that the RDF would establish, maintain and operate, under terms and conditions acceptable to the IDA, a Special Account denominated in US dollars in a local or foreign bank acceptable to IDA, to which IDA would deposit

an initial amount of up to US\$300,000 which is judged adequate to cover about four months of expenditures under the pilot project. The Special Account would be replenished as appropriate when the undisbursed balance of the account falls below an amount equal to 50% or less of the amount of the Special Account. Documentation requirements for replenishment applications would follow the same procedure as described in preceding paragraphs. In addition, monthly bank statements of the Special Account, reconciled by the borrower, would accompany all replenishment requests.

H. Supervision and Reporting

4.28 The project would require intense follow up and supervision from the Association, given its pilot nature. The Association would undertake regular supervision missions including field visits and spot checks of a sample of projects.

4.29 It was agreed at negotiations that RDF would submit to the Association quarterly reports including the following information by district and sector: (a) rural works projects presented by the communes, appraised, in execution, completed and evaluated ex-post, including number of projects and beneficiaries, amounts committed and executed, average cost per beneficiary and the percentage of labor in the investment cost; (b) village credit funds created, number and total amount of loans distributed, activities financed, outstanding, repayment rate; (c) rural studies carried out, pilot project in new technology implemented, training courses performed; (d) RDF's key personnel and consultants indicating the changes that have taken place during the reporting period; and (e) operating costs of the RDF.

I. Accounts and Audits

4.30 The Internal Audit Unit, which reports directly to the RDF Chairman, will undertake quarterly audits of RDF operations combining financial assessment with physical inspection of works in the field done on a sample of subprojects. The auditors will prepare quarterly reports for the RDF Board and for the Association and other donors, as well as an annual summary of audits.

4.31 Private international independent auditors, acceptable to the Association, will also undertake annual audits of the RDF. Not later than six months after the end of fiscal year, RDF will submit to the Association certified copies of audit reports containing balance sheets, income statements and the auditor's opinion on whether the RDF is achieving its objectives in a cost-effective way and whether internal controls are adequate to minimize the possibility of misuse of funds.

J. Benefits and Risks

Benefits

4.32 The proposed project's direct and immediate benefits would come from the approximately 142 rural works projects it would finance, and the 5,000 small loans expected to be disbursed from the 50 Village Funds that would be created. Payment of some 542,000 person-days of wages to workers on public works subprojects would also inject much-needed cash into Albania's rural economy.

4.33 The proposed project's monitoring and evaluation components would result in further benefits by providing feedback to adjust and shape the countrywide Rural Poverty Alleviation Program of which this pilot is only the first phase.

These lessons will include information on communes and individual farmers needs, institutional and practical constraints, priority types of projects, prices and costs, and methods of work.

4.34 The proposed project is expected to have another set of benefits, which are important, but difficult to evaluate: At the center, commune, and village levels it would provide hands-on practice in evaluating projects and credit proposals, managing investment resources, and planning and overseeing project implementation and maintenance. The rules and practices of a market economy will, thus, be introduced at a local as well as a macroeconomic level, strengthening new government institutions and preparing them for a continuing role in rural Albania's development.

Risks

4.35 Test and pre-pilot phases that included significant input from the commune and village levels should greatly reduce project start-up problems. While local, particularly commune, organizations are weak, the experience of the pre-pilot phase shows that good professional staff are available and training and technical assistance should provide them adequate support as institutional strength is built up. Moreover, the process approach allows for continuous adjustment of the program. The pilot phase to be supported by the proposed project would build on the experience of the test and pre-pilot phases and would be evaluated after one year to appraise the feasibility of a successor full-scale project. The main risks are common to all social or rural development funds, and include political interference, which would be minimized by RDF's autonomous status. The other major risk is inherent to the learning by doing aspect of the proposed pilot project; this would be minimized by strong supervision and technical assistance supported by the project's built-in monitoring and feedback components.

4.36 While the risk of not obtaining cofinancing is relatively small, as the cofinancers have all expressed their intentions to fund the project, aligning its timing with the effectiveness of the proposed IDA project may be difficult. As this cofinancing, while important, is not critical to the Project's success - the IDA-funded portion alone would make a significant contribution to poverty alleviation and institution-building in Albania - securing it has not been made a condition of Board presentation or effectiveness.

V. AGREEMENTS REACHED AND RECOMMENDATION

5.1 It was agreed during negotiations that:

- (a) Appointment of an RDF Executive Director and any subsequent successors during the project period will be subject to consultation with, and approval by, IDA (para. 3.23)
- (b) RDF will draw up Regulations and Operational Guidelines acceptable to IDA, and any changes in these manuals will only be made in consultation with, and with the approval of, the Association. (para. 4.6)
- (c) The RDF will establish a Special Project Account denominated in US dollars in a local or foreign bank acceptable to IDA. (para. 4.27).

- (d) RDF will establish accounting procedures acceptable to IDA, have its accounts audited internally every quarter, and submit reports of these audits to the Association. A full audit of project accounts, by private inter-national independent auditors acceptable to IDA will be submitted within six months of the end of the fiscal year. (paras. 4.30-4.31).
- (e) RDF will submit to the Association quarterly progress reports on subprojects approved for financing, the progress of village credit funds, and monitoring and supervision results (para. 4.29).
- (f) RDF will undertake evaluation of the Pilot Project for the purpose of designing the Phase 4 Full-Scale Project eight months after effectiveness of the proposed Credit (para. 3.19).

5.2 Conditions of effectiveness include:

- (a) Execution of an agreement under which the Government would make the Credit proceeds available to RDF on a grant basis (para. 4.5).
- (b) Compilation of RDF Regulations and Operational Guidelines acceptable to the Association (para. 4.6).
- (c) Appointment of an RDF Executive Director acceptable to the Association (para. 3.23)

5.3 On the basis of the above-mentioned agreements and the staff appraisal, the proposed project is considered suitable for an IDA credit of US\$2.4 million, on standard IDA terms with a 40-year maturity.

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

**GOVERNMENT DECISION ESTABLISHING
THE ALBANIAN RURAL DEVELOPMENT FUND**

CHAPTER 1 -- General

Article 1. The Rural Development Fund, hereinafter referred to as the Fund, is hereby established as a juridicial person for a period of four (4) years with administrative, technical and financial autonomy. The Fund will be under the supervision of the Council of Ministers.

The Fund shall perform its activities pursuant to this Decree, implementing Regulations and its Operational Guidelines.

The headquarters of the Fund will be the city of Tirana and it may open offices in other jurisdictions within Albania.

Article 2. The Fund's objective shall be poverty alleviation in rural areas through the financing of rural works and the promotion of economic activities through credit, studies, technology transfer and training. The initial target population of the Fund for rural works will be the poorest part of the rural population, having limited, if any, cash income and oriented mainly towards self sufficiency. Its rural credit initiatives will address more widely farmers and rural micro-entrepreneurs who do not have access to banks.

CHAPTER 2 -- Guiding Principles of Fund Activities

Article 3. The Fund's objectives shall be accomplished as follows:

As regards rural works:

The Fund will promote and finance, through grants, labor intensive rural infrastructure construction and rehabilitation projects. Projects will be initiated by the villages and submitted to the Fund by the communes. They will be selected and financed by the Fund according to its Regulations and Operational Guidelines.

As regards promoting economic activities through small-scale credit:

The Fund will, in accordance with its Regulations and Operational Guidelines, establish loan accounts in the Bank for Agricultural Development in favor of Village Credit Funds to finance small loans to farmers and other rural residents favoring the productivity of agriculture, development of off-

farm activities, self-employment, rural micro-enterprises, and other productive activities undertaken by the target population.

As regards studies, technology transfer and training:

The Fund will carry out studies on Albania's rural economy, sociology and history to assess the new situation of the rural areas, orient the activities of the Fund, and provide basic information for development policies. It will carry out training, technology transfer, and advisory work activities needed to further the main activities of the Fund.

The Fund will carry out its rural public works and credit activities by forming contractual partnerships with local institutions. In the case of public works activities, the Fund's partners would be elected commune councils, elected village credit committees, and other bodies. In each case, these contracts would make provision for the operation and maintenance of subproject public works. In the case of rural credit initiatives, the Fund's partners would be elected village credit committees. Regulations governing the establishment of these institutions, unless otherwise covered by Albanian law, will be promulgated separately.

CHAPTER 3 -- Revenues and Resources of the Fund

Article 4. The Fund's revenues comprise:

- resources assigned by multilateral or bilateral aid programs,
- grants provided by the Government of Albania,
- domestic and foreign donations and legacies,
- resources derived from contracted soft loans,
- capital recovery from the loans granted and the interest earned,
- other revenues and income that may arise.

Article 5. The resources of the Fund are deposited in independent bank accounts in Albanian and foreign currency.

CHAPTER 4 -- Fund's Organizational Structure

Article 6. The governing bodies of the Fund are:

- the Board of Trustees,
- the Executive Committee

Article 7. The Board of Trustees, hereinafter referred as "the Board" shall be composed as follows :

- The Deputy Prime Minister;
- The Deputy Minister of Agriculture and Food;
- The Deputy Minister of Economy and Finance;
- The Deputy Minister of Labor, and,

- A Representative of the Office for Local Governments

Board members shall receive no remuneration for their service.

Article 8. The Board shall be chaired by the Deputy Prime Minister and during his absence by ministers in the order indicated in the preceding article.

Article 9. The Board shall have the following duties:

- Approve the policies and general guidelines regulating the Fund's activities;
- approve the Fund's annual budget;
- approve the Annual Financial Report;
- authorize negotiations and enter into agreements with the Government of Albania and international financial institutions necessary to achieve its purposes;
- authorize negotiations to contract the loans required by the Fund for its operations;
- approve the necessary Regulations for the implementation of this Decree;
- hold ordinary meetings every three months and extraordinary meetings as often as necessary on the initiative of the Chairman;
- all other duties assigned under the corresponding regulations.

Article 10. Meetings will be held with the attendance of at least four (4) board members and the decisions will be taken by the majority of the votes. The Board may invite the representatives of other public and private agencies to its meetings, who should have voice but no vote.

Article 11. The Executive Committee shall be formed by:

- the Executive Director
- two Deputy Directors and one Financial Director

Article 12. The Executive Director shall be named and removed by the Deputy Prime Minister and shall meet the professional requirements related to his function. The other members of the Executive Committee are appointed by the Executive Director subject to the approval of the Board.

Article 13. The Executive Director shall be the highest executive authority of the Fund and shall have the following duties:

- hold the Fund's legal representation;
- direct the operations of the Fund and implement Board decisions;
- manage the resources of the Fund;
- select and appoint the staff;
- sign the pertinent contracts for professional and technical services;
- prepare and propose to the Board the Regulations governing the Fund's activities;

- request the Board's authorization to contract external auditors;
- all other duties assigned by this Decree, its Regulations and Operational Guidelines.

Article 14. The Executive Committee shall have among its duties the approval or disapproval of all requests for financing submitted to the Fund. For this purpose only, the decisions of the Executive Committee shall be taken by the majority of votes. If the votes are equal, the vote of the Executive Director will prevail.

Article 15. The work relations of the staff shall be regulated by the clauses of the signed professional or technical contracts, which shall be subject to Albanian law.

Article 16. Staff expenses shall be financed with the Fund's resources. The salaries of the Executive Committee and professional staff members will be fixed by the Board of Trustees.

CHAPTER 5 -- Auditing

Article 17. Internal Auditors shall be responsible for monitoring the Fund's budgetary implementation and financial operations.

The Internal Auditors shall be headed by an Auditor designated by the Prime Minister and will report directly to the Board in accordance with the Fund's Regulations and Operational Guidelines.

Article 18. The Fund shall be subject to external auditing by independent international auditors acceptable to the World Bank. Reports from the External Auditors shall be reviewed by the Board for the corresponding legal actions.

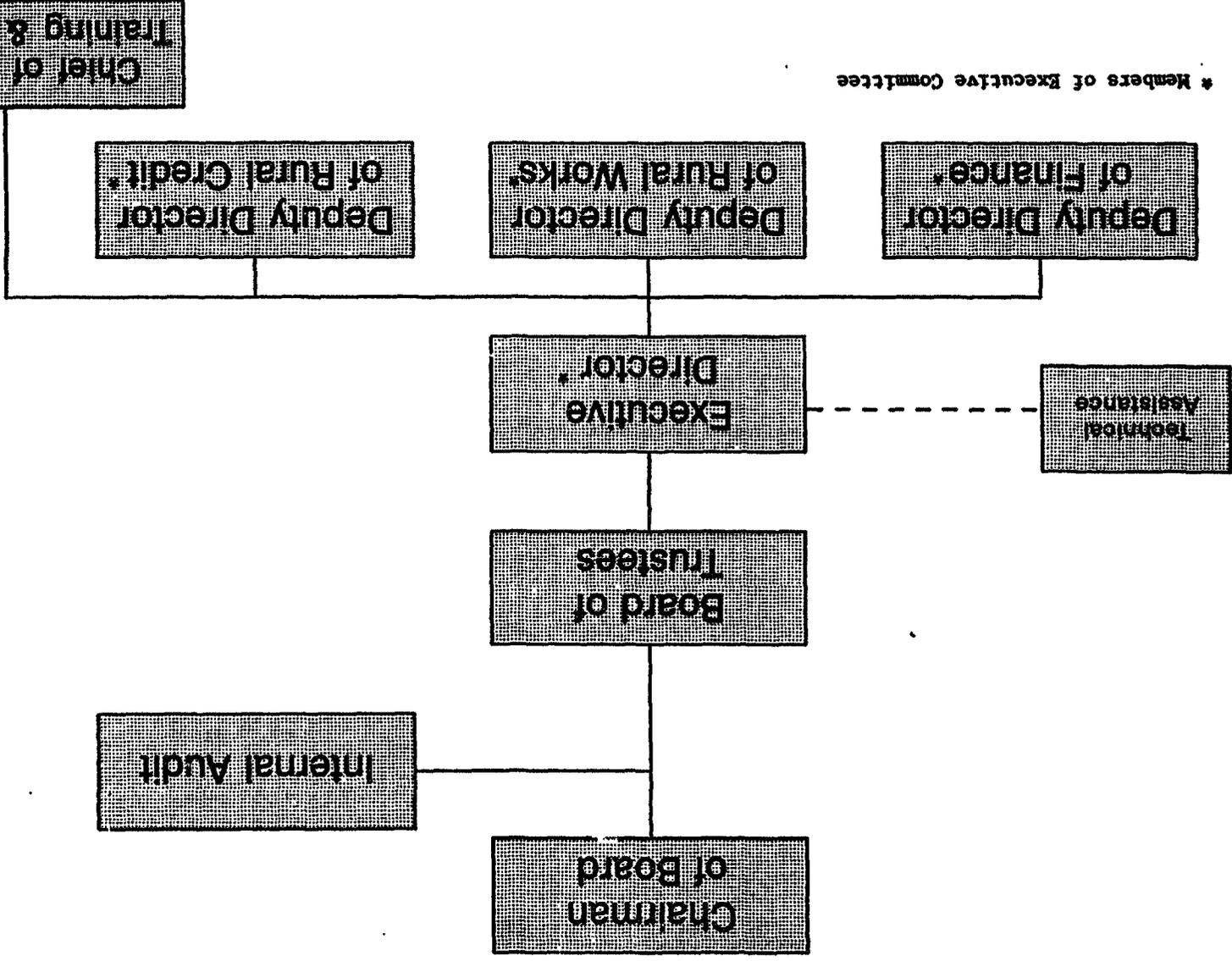
CHAPTER 6 -- Final and Temporary Provisions

Article 19. The Fund should be exempt from any taxes, fees and charges, or from any other national or local revenue contributions, present or to be established in the future.

Article 20. The four-year lifespan of the Fund may be extended by decree, in accordance with Albanian law. If the continuing existence of the Fund is not determined, two months prior to the end of the term indicated in Article 1 of this decree, the Prime Minister shall constitute a Committee to liquidate it, which shall have the following duties:

- transfer to the pertinent governmental bodies or institutions, the programs or projects not yet completed to comply with all the pending responsibilities;
- transfer all the financial resources and all other assets from the fund to the corresponding governmental bodies;
- submit the report of its activities to the Prime Minister and to the agencies he deems convenient.

Organizational Chart of
Albanian Rural Development Fund



* Members of Executive Committee

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

DRAFT RURAL DEVELOPMENT FUND REGULATIONS

A. Rural Public Works

1. Programming and Distribution of Resources

The RDF programs its financing according to regional distribution and distribution by sectors.

1.1 Regional Distribution

The program will be limited during the pilot phase to the 10 poorest districts, then extended progressively to the whole country. The funds will be assigned in two stages.

In the first stage, funds are allocated to the districts; in the second stage, and using the same procedure, funds are allocated to the communes of each district.

The funds are allocated on the basis of a formula taking into consideration population by commune corrected through three poverty indicators: arable land per capita, percentage of arable mountain and hilly land and the rate of unemployment.

Within the commune, mountain and hilly areas will be considered as priority areas.

These distribution guidelines will also be used to distribute the budget between the communes of each district.

The distribution will be revised before the end of each year and the allocations can be changed, not exceeding 10% of the total budget.

1.2 Distribution by Sector

During the first year, 60 to 70% of the financing of the RDF is allocated to rural works and mainly oriented toward:

- repairing communal dirt roads;
- rehabilitating village irrigation schemes; extending and repairing existing water supply system; in some cases completing water supply investments started before 1991;
- repairing or reconstructing school buildings;
- implementing new marketing facilities.

This program will be revised at the end of the first year, based on the needs expressed by the villages and the communes, and technical and financial considerations.

2. The Project Cycle

2.1 Promotion

As it is important that the Rural Development Program be demand driven, with the initiative being taken by the villages, a media information campaign will be undertaken and special documentation will be sent to the communes.

2.2 Request from the Village

Villages interested in Rural Works Program subprojects will present requests including general information about the village and an application form for the specific type of rural works to be financed. This request, signed by the head of the village, has to be approved and transmitted to the Fund by the commune, which sends a copy to the relevant district institution for reviewing the design and replying on a non-objection basis in a period no greater than six days.

Eligible subprojects are registered in the database of the RDF and filed according to their geographical location in order to optimize technical appraisal visits.

2.3 Appraisal of Subprojects

2.3.1 Technical Visits

Through its filing and planning system, the RDF ensures that all subprojects are adequately visited by its engineers. During these technical visits, the appraisers verify the information contained in the request for financing and complete this information if necessary. They meet the village committee, the commune representative, the designer, the contractor and the technical supervisor of the subproject.

2.3.2 Cost

The RDF engineers inquire also about the price of materials and labor in the region of the subproject in order to control the cost estimates based on this information.

The RDF will prepare progressively a cost database for the entire country. Unit costs tables will be prepared on a regional basis, for the most representative types of rural works subprojects financed by the RDF and updated periodically.

2.3.3 Appraisal

The RDF will design report formats for each type of subproject including basic information necessary for the analysis of each project such as labor force, target population, cost per job generated, operation or maintenance guarantees. The main objective of these appraisal report forms is the collection of basic information in a systematic way for each subproject to facilitate the decision process.

2.4 Subproject Approval

On the basis of the appraisal report presented by the appraiser, the Executive Committee approves, rejects or request the reformulation of the subproject. The Executive Committee meets according to the needs, at least once a week.

2.5 Contract Signing

After a subproject is approved by the Executive Committee, the RDF prepares a contract to be signed by the chairman of the commune and the Fund. The contract will be co-signed by the village head and the technical supervisor. Within the financial limits set in the contract, the commune signs agreements with subcontractors for labor, equipment, and materials.

The two conditions for RDF financing are that:

- A village Council be elected by the village, even on a nonformal basis in order to constitute a partner for the RDF;
- An agreement is reached between the village council, the commune and the RDF about the maintenance and the recurrent costs of the subproject.

2.6 Disbursements

According to the type of subproject and amount to be financed, the RDF disburses a percentage of the total sum as an advance to the commune. Subsequently, the commune requests periodic disbursements in accordance with the progress of the work being carried out.

- Regarding the purchased materials and equipment the RDF covers the invoices presented and signed by the village council, the chairman of the commune and the technical supervisor.
- As regards labor costs, payment will be done every two weeks according to a daily list of working people.

2.7 Supervision

The RDF implements a follow-up system with the assistance of its engineers who periodically visit the subprojects in execution. Each engineer is responsible for a region of the country.

3. Appraisal Criteria

3.1 Types of Subprojects

A preliminary list of different types of subprojects eligible for RDF financing has been established. Priority will be given to repairing existing infrastructure rather than to new investments, and to subprojects having an important social impact, high labor intensity and local organization impact.

3.2 Target Population

The resources of the Fund will be allocated to the communes according to poverty indicators. These general indicators will be confirmed by RDF officers during their field visits on the basis of village questionnaires.

The workers are selected by the village council on a voluntary basis along the following criteria: (i) inhabitants of the villages concerned, (ii) minimum legal age, (iii) priority given to the poorest families, (iv) one member per family employed.

3.3 Contractors

In most of the cases especially as regards roads repairing, water supply and school repairing, the contractor will be the commune. The subcontractors can be individual local specialists, or public or private enterprises.

In some cases (e.g., new construction), the contractor can be a private or state enterprise. In the first stage, the choice of contractor will take into account the price and access to the necessary materials.

As a private contracting market develops, bidding procedures will be applied. For the first year of the program, given the relative simplicity of subprojects and the lack of private operators, they will be prepared and executed under the supervision of the commune with the assistance of hired local technicians.

3.4 Salaries and Fees

For the manual labor, the salaries to be paid on RDF-financed subprojects will be defined according to unskilled sectoral market rates.

For some types of subprojects where the social impact is more important than labor intensity, salaries will be below market rates in order to allow for a contribution of the village to the financing of the subproject. This may be the case for water supply and school repair subprojects, especially in lowland areas where an additional cash income is not an absolute necessity.

The preparation of subprojects and technical supervision, will be remunerated according to the amount of time spent by local technicians and engineers rather than on a percentage basis. The RDF will constrain the administrative expenses and profit margins allowed under subprojects. These should be however adequate enough to interest contractors and ensure quality of works.

3.5 Labor Content

Labor content is one of the criteria of the subproject approval. Although the use of machinery, such as bulldozers, could lead to cheaper investment cost, priority will be given to manual work.

3.6 Materials

To help Albania's balance of payments and avoid supply problems, the RDF will favor subprojects with high local material content. Exceptions will be made for subprojects with large social impact, such as water supply.

Although contractors will be directly responsible for the supply of materials, some assistance of the RDF may be needed in the organization of imports.

3.7 Counterpart Financing

Counterpart financing of at least 5% of investment cost should normally be required by the RDF to ensure that:

- Good quality subprojects are presented by the communes,
- That the cost of the subprojects is as low as possible,
- Subprojects will be sustainable beyond RDF financing.

However, in the present situation, given the lack of local investment budgets this contribution may be not applicable in the first stage.

3.8 Cost Control

Given the extreme diversity of prices on local markets, one of the important tasks of the program is to ensure that the prices of materials and transport are as low as possible.

RDF will collect and disseminate information about the nationwide supply and prices of materials and services. This may have an important effect on the organization of local markets. Progressively, a computerized cost control system, based on standard unit regionalized prices, will be implemented and safeguard that selection of subprojects is undertaken according to transparent criteria.

In an inflationary situation rapid and efficient execution of subprojects will help protect against cost increases. In some cases (e.g., when the execution of a subproject must be organized over a relatively long period, due to climatic conditions) subprojects may have to be re-evaluated.

3.9 Technical Viability

Subprojects will be appraised according to standard engineering, environmental, and other technical specifications. Technical design will be done by local technicians (usually at district level), and technical and environmental norms, as set out in the RDF Operational Guidelines, will be used. The following recommendations are guidelines in project design.

- Roads will be only earth roads, 6m width (including shoulders and drainage ditch). Special attention will be paid to road drainage (ditches and related pipe culverts); graveling (3.5m width) can be done in the worst parts (muddy or sloping) of the road.
- Water supply will be based on public fountains, the average being one per four families. As most of the works will concern repairs and/or completion of existing galvanized steel pipes networks, this technique will be used, but new materials such as polyethylene pipes could be tested.
- Irrigation will be based on rehabilitation of the existing works, improvement of distribution networks (field outlets) and minimizing water losses (lining of the canals). Priority will be given to small gravity networks. The key question in irrigation works will be the Water User Association which will be the local partner, and creation of such associations will be a prerequisite for subproject intervention.
- Schools repairs (or construction) will be done according to the norms of the Ministry of Education. As far as possible, local craftsmen (brick layers, carpenters), will be hired.

3.10 Economic appraisal (Cost Effectiveness)

In the present situation, the economic rates of return on different subprojects would be purely artificial and very difficult to calculate. The RDF will therefore apply a very simple methodology to evaluate the economic impact of each kind of subproject. The main parameters used will be

- The cost per man/month employed,
- The unit cost per type of infrastructure subproject,
- The investment cost per capita and/or per beneficiary,
- The percentage of labor in the total investment cost.

These unit costs will be used to establish standard profiles for each type of subproject and will help define maximum and minimum parameters acceptable.

Cost effectiveness will be controlled in all cases through the elaboration of prototypes for each type of infrastructure subproject financed by RDF.

The impact of the investment on the village economy and the standards of living of the population will be assessed through a survey made before and after subproject execution.

3.11 Sustainability and Cost Recovery

The inter-institutional agreements between the RDF and ministries or line agencies should ensure that subprojects are within the sectoral priorities of the responsible institution.

In most cases the maintenance of the local infrastructure will be taken in charge by the commune. Creation of village councils responsible for the preservation and the daily maintenance of the infrastructure will help to ensure the sustainability of subprojects.

Cost recovery for some type of subprojects, such as water supply, should be considered within the framework of general tariff reform. Users fees should be progressively introduced.

4. Technical and Financial Oversight

4.1 Technical audit

Technical supervision of the works will be the responsibility of the local partner (commune), but the RDF will send technicians (infrastructure inspector) to check the quality of works done.

At least two oversight missions will be undertaken according to the payment schedule:

- Medium term payment will be made after a Technical Audit of the works done and supplies delivered on site.
- Final payment will be made after subprojects are completed and operating and local organizations have provided acceptable assurances that they will maintain the subproject works.

This technical audit will be carried out by RDF.

4.2 Payments

The RDF will finance and check the construction works according to detailed cost estimate of the works. Payments will be done in three stages:

- Advance payment calculated on the basis of supplies, transport and labor costs, not exceeding 60% of the total cost (This figure will be only for the works with high supplies component).
- Medium term payment will be made on the request of the commune according to the actual expenses and justified by certified invoices. Both advance and medium term payments will not exceed 80 to 85% of the total cost.
- Final payment will be not less than 15 to 20% of the total cost and paid according to the actual expenses of the commune and justified by certified invoices. Reductions in final payment can be made by RDF according to the actual works performed

4.3 Accounting

The local partner (commune) will keep records and provide all justifications for the expenses related to the works.

For supplies and transport, it will provide:

- At least two proposals before purchasing the goods or services,
- Detailed invoices of the goods and services purchased.
- For manpower, the local partner will provide payrolls.

4.4 Breaking of the Contract

RDF reserves its rights to break the contract if the local partner fails to fulfil its duties or it appears that the works cannot be properly carried out in due time and cost.

In these cases, a detailed account of the expenses will be made and delivered goods and supplies will remain the property of the RDF, the local partner being responsible for them by keeping them in safety until the RDF decides their new allocation.

Moreover, if the failure comes from the partner's side, it will lose eligibility for any other funding under the program.

B. Village Credit Funds

1. Description and Objectives

The Village Credit Fund Program is a partnership between the Rural Development Fund (RDF), the Albanian Bank for Agricultural Development (ABAD), and individual rural villages and towns represented by Village Credit Committees, to provide small-scale credit for farmers and micro-entrepreneurs

The Village Credit Funds represent capital deposited by RDF in accounts in ABAD for the benefit of farmers and micro-entrepreneurs in individual Albanian villages and towns. They are administered by Village Credit Committees, who act as agents of RDF in authorizing subloans to individual villagers or groups of villagers.

The objective of the Village Credit Funds is to provide poor rural producers opportunities to undertake or strengthen economic activities. All profitable economic activities, agricultural and non-agricultural, are eligible for subloans from the credit funds.

2. Eligibility of Villages

To be eligible for the Village Credit Fund program, villages must:

Create a Village Credit Committee in accordance with Article 4 of these regulations;

Remain in good standing under the program's rules and regulations, including timely repayment of all subloans.

3. Eligible Sub-borrowers

Access to credit will be available to both men and women, and to groups of borrowers. Individual and group borrowers must:

Have a real need for credit; village credit funds will not be used to finance initiatives that applicants could finance from their own resources;

Have the technical knowledge and land and/or labor resources needed to carry out the initiative proposed for loan financing;

Provide the guarantees or collateral required by the Village Credit Committee under Article 4.

4. Village Credit Committees

Village Credit Committees will be created to administer Village Credit Funds. These committees will consist of:

Village Representatives, who will either be the elected village council or a specially elected group of three or more villagers. The Village Representatives will undertake a training program to learn the program's rules and regulations;

A representative of the Bank for Agricultural Development;

A representative of the Rural Development Fund.

Within the context of its contract with RDF, The Village Credit Committee has the following decision-making powers:

Selection of loan beneficiaries, interest rates, loan amounts, and collateral or guarantees and other conditionalities needed to secure loans;

Loan repayment amounts and schedules;

The sanctions to be enforced for late repayment of loans, or defaults;

Follow-up on loan performance.

5. Loan Consideration and Approval

Village Credit Committees will meet regularly at least once a month to consider loan requests from village residents. Loan requests will be considered in the order submitted, and all requests must be acted upon within six weeks of their submission.

Village Credit Committee decisions must have the approval of a majority of the Village Representatives present, and the representatives of the RDF and the

Agricultural Bank. Their decisions will be delivered in writing and will specify the borrower or borrowing group, the amount and duration of the loan, the interest rate and fees to be charged, the amortization schedule and any anti-inflation mechanism to be applied to repayments, and the loan guarantees to be applied.

6. Loan Guarantees

Loan guarantees will be established by the Village Credit Committee for each loan granted. These guarantees will take into account the size and duration of the loan, the Committee's assessment of the risk involved. Loans may be guaranteed, inter alia, by goods (e.g., land, houses, livestock, equipment, crops) owned by the borrower or the borrower's family or other persons or groups of persons.

7. Amount and Duration of Loans

The amount and duration of each loan will be fixed by the Village Credit Committee. In order to limit risk and maximize the number of people with access to the Village Credit Fund's limited resources, loans will, as a matter of principle, be kept as small - and their duration as short - as possible.

8. Interest Rates and Fees

The Village Credit Committee will fix interest and other charges at a level that, at a minimum, maintains the real value of credit proceeds and fully covers loan administrative and management expenses. Mechanisms for maintaining value can include, inter alia, a fixed interest rate high enough to compensate for anticipated inflation, indexing to such norms as the price of livestock or the lek-dollar exchange rate.

9. Role of the Bank for Agricultural Development

The Bank for Agricultural Development (ABAD) is a partner to the Village Credit Committee and Rural Development Fund in administering and managing the Village Credit Fund. ABAD, through its local branches, is the repository of Village Credit Funds opened in the name of participating villages by the Rural Development Fund. An ABAD representative is a member of each Village Credit Committee.

ABAD is responsible for the financial management of the Village Credit Funds, and will receive fees, set by the Village Credit Committee, adequate to cover its administrative and management expenses. ABAD will report regularly, and at least quarterly, to each Village Credit Fund on the status of the Village Credit Fund and all subloans issued.

ABAD disburses subloan proceeds to - and collects subloan repayments from - beneficiaries designated by the written decisions of the Village Credit Committee. Disbursements will be contingent upon the execution of a subloan agreement between the Village Credit Committee and the sub-borrower, the

provision by the sub-borrower of the guarantees required by the subloan agreement, and adequate repayment performance on all outstanding subloans by the Village Credit Fund.

10. Default and Late Payment Provisions

Any delay or default in repayment of a subloan issued under the Village Credit Fund will result in an immediate stoppage of further ABAD disbursements against the Fund.

The Village Credit Fund will be responsible for investigating such delays or defaults and devising methodologies bringing repayments up to date, or calling in the subloan or guarantees made against it.

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

RURAL WORKS PROJECTS PRIORITIES

1. Setting Priorities

Priorities for the Rural Development Program's public works subprojects will be set in accordance with the program's key objectives: to improve rural infrastructure, create employment and provide support to local government and organizations. Table 1 ranks various types of works under these criteria, assigning a weight from 0 (No Impact) to 3 (Good), with the total setting the priority for each type of subproject.

Table 1. Priority of Works

	Rural Infrastructure	Employment Generation	Local Organizations	Total
Irrigation/Drainage	3	3	3	9
Roads	2	3	2	7
Schools	2	1	3	6
Water Supply	2	1	2	5
Electricity	3	0	0	3
Afforestation	1	2	0	3
Water/Soil Conservation	1	2	0	3
Telephone	2	0	0	2

1.1 Priority works

Given these rankings, the infrastructure component of the project will focus on:

- ◆ Rural Roads (Total Impact: 7), which have good social impact, high labor input and involve a high level of input at the communes level in choosing, designing, and supervising subprojects and organizing their maintenance.
- ◆ Irrigation/Drainage (Total Impact: 9) have even higher community involvement, as their implementation will involve organizing water user associations. As these organizations do not yet exist, however, subprojects in this category are likely to be started later in the program cycle than roads initiatives.

- ◆ Water supply (Total Impact: 5) and Schools (Total Impact: 6) have significant social impact, but less labor input. Local organizations (commune and village) will be in charge of the works and safeguarding the equipment.
- ◆ Other facilities not listed above can be selected at the request of the local population, including health centers, market yards or other social facilities.

1.2 Non-Priority Works

Other types of projects will have lower total impact:

- ◆ Electricity (Total Impact: 3) and Telephone (Total Impact: 2) subprojects have good social impact, but very low labor input and no impact on local organizations.
- ◆ Afforestation and Water/Soil Conservation works (both 3) have high labor inputs, but low immediate social impact, and, above all, the landholding aspects are not yet clear.

2. Proposed Works

The Public Works component of the Rural Development Program will, thus, focus on rural road repairs, water system repairs and completion, school construction and repair, and such other subprojects as building new market facilities. Table 2 shows the possible scope of such works that could be financed through RDF over the four years of the Rural Development Program.

Table 2. Potential Scope of Works

Works/ Years	1st	2nd	3rd	4th	TOTAL
Road	15	25	35	40	115
Water Extension	30	50	70	90	240
Water Repairs	40	60	70	70	240
Irrig/Drainage	2	10	15	20	47
School Repairs	40	20	10	70	140
School Building	2	5	10	15	32
Others	13	17	21	24	75
TOTAL	142	187	231	259	819

These estimates are based on a cautious appraisal of the capacity of RDF and local organizations to implement infrastructure projects. In the Program's first years, the number of operations will be limited as technical staff has to be trained; priority during this phase will also be given to

repairs, which usually involve smaller and easier tasks. The size of operations will grow with time: irrigation projects and school building will be undertaken mainly in the second part of the project. A total of 819 operations can be undertaken in four years, an average of one operation per 3.3 villages, which should have a significant impact on rural infrastructure and employment.

3. RDF Staffing Requirements

The RDF will hire two categories of technical staff: infrastructure field inspectors who will be in charge of identifying and supervising subprojects, and chief inspectors in charge of coordinating the field inspectors. The staff will be based in Tirana, and field trips be organized to identify and supervise projects. Inspectors will work in one to three districts to minimize transportation time and develop knowledge of local conditions.

Table 3 shows detailed staffing requirements. The calculation is based on the number of field days required for a single project (from 10 days for a school repair to 20 days for an irrigation project), and the number of field trips per inspector (165 days per year). The number of chief inspectors is calculated on the basis of one chief for 5 inspectors; 21 infrastructure field inspectors (10 the first year) and 4 chief inspectors (2 the first year) will be required to manage the works program described above.

Table 3. RDF Technical Staff Requirements

Works	Days/Project	1st	2nd	3rd	4th	TOTAL
Road	20	300	500	700	800	2,300
Water Extension	15	450	750	1,050	1,350	3,600
Water Repairs	10	400	600	700	700	2,400
Irrig Drain.	20	40	200	300	400	940
School Repairs	10	400	200	100	0	700
School Building	15	30	75	150	225	480
Others	15	195	255	315	360	1,125
TOTAL Inspector days		1,620	2,325	3,000	3,475	1,0420
Numb. Inspect. (Cum.)	165	10	14	18	21	
Numb. Inspect. (New)		10	4	4	3	
Numb. Chiefs (Cum.)	5	2	3	4	4	
Numb. Chiefs (New)		2	1	1	0	

Staff will be selected according to technical experience (at least 5 years). It would be advisable to choose various kinds of technicians as the project will deal with various kinds of works. We would propose the following specializations:

Road specialists	6
Water supply specialists	6
Irrigation/drainage specialists	4
Building specialists	5

Although each inspector will specialize in a specific geographic area (1 to 3 districts), they will all exchange information about their projects and, thus get technical advice through their colleagues. For specific problems (such as pumping stations or hydrogeology), the fund can hire technical consultants (short term mission) available in Albania.

In addition to their technical backgrounds, these inspectors will be trained by the project in the fields of local organization and intervention in rural areas: three two-week courses will be held each year to train project staff.

4. Investment Costs

4.1 Unit Costs

Given the economic changes under way in Albania, unit prices for works and supplies are difficult to estimate. As an example, the first cost estimates prepared by local technicians (on the basis of former official state prices) were multiplied by six to estimate roughly the actual prices

Prices of works listed in Tables 4-7 are based on actual prices discussed with local technician and, for road and water supply extension, these are the prices of contracts signed in September in the pre-pilot testing phase of the Rural Development Program. Table 4 gives September 1992 prices for works and a breakdown by categories such as labor, local and imported supplies, transportation, and other.

**Table 4. Breakdown of Costs for Public Works in September 1992
(In Percentage)**

	Road (5 km)	Water Extension	Water Repairs	Irrig. Drainage	School Repairs	School Building
Labor	55	19	27	55	20	30
Local Supplies	5	33	15	60	50	
Imported Supplies	28	50	5	5	3	
Transport	28	8	8	13	3	5
Other	12	12	15	12	12	12
Total	100	100	100	100	100	100

The 1992 prices cannot be kept for the whole project duration and Table 5 shows expected price increases for each cost component.

Table 5. Assumed Inflation Rates For Program Period

	Year			
	1st	2nd	3rd	4th
Labor	30%	30%	30%	20%
Local supplies	30%	20%	10%	
Imported supplies				
Transport	30%	20%	10%	
Other	20%	10%	10%	

4.2 Total Cost

Direct investments cost are shown in Table 6 for the number of projects proposed and the yearly cost of each type of work. The total investment cost will be US\$19.12 million (first year: US\$1.59 million). Out of this total, roads will represent 51%, water 18%, irrigation-drainage 14%, schools 7% and others 9%. The unit cost per subproject will rise from US\$11,000 in the first year to US\$32,000 in the last year (average US\$23,000) due to local inflation and the increasing size of the projects financed.

**Table 6. Cost of Works Over the Program Period
(US\$ 000)**

Works	Year				TOTAL	Percentage
	1st	2nd	3rd	4th		
Road	850.5	1,762.5	2,985.5	4,128.0	9,726.5	51%
Water Extension	252.0	485.0	756.0	1,080.0	2,573.0	13%
Water Repairs	136.0	228.0	294.0	322.0	980.0	5%
Irrig Drain.	76.4	471.0	852.0	1,368.0	2,767.4	14%
School Repairs	76.0	46.0	26.0	0	148.0	1%
School Building	51.2	155.0	359.0	622.5	1,187.7	6%
Other	147.9	312.5	527.5	749.5	1,737.4	9%
TOTAL	1,590.0	3,460.0	5,800.0	8,270.0	19,120.0	100%
Cost per project	11	19	25	32	23	

4.3 Break-down of the Investment costs

4.3.1 Foreign Currencies

Foreign currency cost has been estimated for each type of work. Table 7 gives the yearly foreign currency cost for each type of project; for the four years of the project, foreign costs will be about US\$1 million, 5% of total cost.

**Table 7. Foreign Currency Costs
(US\$ 000)**

Works	Unit costs	Year				TOTAL
		1st	2nd	3rd	4th	
Road	0	0	0	0	0	0
Water Extension	1,960	58,800	98,000	137,200	176,400	470,400
Water Repairs	1,500	60,000	90,000	105,000	105,000	360,000
Irrig Drain.	1,500	3,000	15,000	22,500	30,000	70,500
School Repairs	75	3,000	1,500	750	0	5,250
School Building	600	1,200	3,000	6,000	9,000	19,200
Other		12,600	20,750	27,145	32,040	92,535
TOTAL		138,600	228,250	298,595	352,440	1,017,885

4.3.2 Labor Cost

Labor is the main component of the cost, and its share of costs will increase as wages rise from US\$1/day in 1992 to an expected US\$2.60/day in 1996. Table 8 shows labor cost for each type of project over this period.

**Table 8. Labor Cost Increases Over the Program Period
Unit prices**

Works	92	93	94	95	96
Inflation	30%	30%	30%	20%	
Daily wage (US\$)	1	1.3	1.7	2.2	2.6
Road	24,200	31,460	40,900	53,170	63,800
Water Extension	1,330	1,730	2,250	2,930	3,520
Water Repairs	810	1,050	1,370	1,780	2,140
Irrig Drain.	16,500	21,450	27,890	36,260	43,510
School Repairs	300	390	510	660	790
School Building	6,000	7,800	10,140	13,180	15,820

The total labor cost of the project is shown in the table below. This cost will be US\$10.1 million i.e. 53% of the total investment cost (US\$19.1 million).

**Table 9. Total Labor Cost
(US \$)**

Works	1st	2nd	3rd	4th	TOTAL
Road	471,900	1,022,500	1,860,950	2,552,000	5,907,350
Water Extension	51,900	112,500	205,100	316,800	686,300
Water Repairs	42,000	82,200	124,600	149,800	398,600
Irrig Drain.	42,900	278,900	543,900	870,200	1,735,900
School Repairs	15,600	10,200	6,600	0	32,400
School Building	15,600	50,700	131,800	237,300	435,400
Others	63,990	155,700	287,295	412,610	919,595
TOTAL	703,890	1,712,700	3,160,245	4,538,710	10,115,545
Rounded to Thousands	704	1,713	3,160	4,539	10,116
Mandays in Thousands	542	1,008	1,436	1,746	4,732

The total labor hired will be 4.7 millions mandays, i.e., 16,700 years of works. Assuming that each subproject will last 2.5 month in average (65 days), 72,800 workers will be hired by the project during the 4 years.

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

TARGETING METHODOLOGY FOR RURAL WORKS COMPONENT

Objective

Poor families mainly residing in mountain and hilly areas with very small plots of land and without non-agricultural employment are most at risk during the transition period. Without a marketable surplus and unable to meet their subsistence needs with their own production, these families depend upon an unreliable ration system to purchase the staples of their diet (wheat, sugar and oil) at official prices that are 3 to 4 times higher than before the reforms. When these commodities are not available through the official ration system, they must purchase them in private markets at prices that are 2 to 3 times the new official prices.

The Rural Development Fund (RDF) will operate in all areas of rural Albania. However, the Fund will target a disproportionately greater share of resources towards the poorest families. An index of marginality is used to identify the districts where the poorest families reside and to rank the districts into 5 categories. The RDF's resources are then divided among the 36 districts on a per capita allocation weighted in favor of the poorest districts. The process is then repeated to divide the district's resources among the various communes. However, the marginality index is only based on the land and topography indicators, as the unemployment rate is not broken down by commune.

Selection of Variables for Marginality Index

The index incorporates 3 variables: arable land per rural capita; percentage of hilly and mountain arable land; and the official unemployment rate. The first indicator evaluate the amount of arable land per capita among the rural population (ex-cooperative members and state farm workers). The larger the per capita availability of arable the more likely a family will be to satisfy their subsistence requirements and produce a marketable surplus.

The second index is the percentage of arable mountainous and hilly land per district. This index reflects the level of marginality in a district as mountainous and hilly land is less fertile and farmers living in these districts have less access to inputs (especially water, pesticide and fertilizer) as well as higher transactions costs to market their produce.

The third index is the official unemployment rate per district. Theoretically, the rate is the number of people registered at the unemployment office who were previously employed and are without work. Students who graduated in 1990, 1991 and 1992 and have never worked are also included in the unemployment rate. The July 1992 unemployment rate, which is used to prepare the preliminary index, was not properly constructed as some districts include only individuals receiving social assistance (unemployed as a result of the July/August reforms) and exclude registered unemployed who are not receiving any compensation.

Methodology

The marginality index was formed by combining the above three indices. The first two indices are more heavily weighted as they are better estimates of rural poverty; people registered for unemployment are more likely to live in urban areas and secondly registration on the list enables them to receive unemployment compensation (during the first year of unemployment). Consequently, the land and the topography indices are more heavily weighted in the marginality index than the unemployment rate.

Based on the marginality index, the districts were divided into 5 categories of poverty: poorest; very poor, poor; less poor; and better-off. The per capita allocation of the RDF's resources among the 27 districts was then weighted in favor of the poorer districts: 120% for the very poor districts; 110% for the very poor; 100 % for the poor; 90% for the less poor and 70% for the better-off districts.

**Table 1. Agricultural Production, Land Holdings, and Incomes
by District, 1990
(In 1986 prices)**

	1990 Agric. Output (million l)	1990 Agric. Land ¹ (ha)	1990 Rural Population (000 persons)	Projected Area ² (ha/family)	Per Capita Agricultural Income (lek)
Coastal Districts	6,284	1,090,263	1,359.0	1.44	4,624
Shkoder	621	163183	157.1	1.1	3,953
Lezhe	236	37923	50.8	1.2	4,646
Kruje	330	48722	67.0	1.3	4,925
Tirane	486	88826	120.4	1.3	4,037
Durres/Kavaja	629	62871	125.7	1.5	5,004
Elbassan	623	103232	144.2	1.3	4,320
Lushnje	712	55141	106.1	1.9	6,711
Fier	821	90852	178.3	1.8	4,605
Berat	400	78438	110.1	1.7	3,633
Vlore	389	114404	92.2	1.4	4,219
Sarande	335	83552	62.7	1.6	5,343
Korce	702	163119	144.1	1.8	4,872
Mountain Districts	1,883	1,068,134	718.0	1.22	2,623
Gjirokaster	226	92277	39.8	1.8	5,678
Tepelene	121	60774	36.7	1.6	3,297
Permet	141	76468	30.7	2.2	4,593
Kolonje	102	67678	17.6	2.8	5,796
Skrapar	109	58741	30.5	1.9	3,574
Gramsh	101	55505	36.7	1.6	2,752
Pogradec	148	50700	30.1	1.4	4,917
Librazhd	116	77364	64.9	1.1	1,787
Diber	251	114762	133.8	0.9	1,876
Mat	129	75323	63.0	1.1	2,048
Mirdite	100	74168	43.9	0.7	2,278
Kukes	169	100986	86.9	0.9	1,945
Puke	80	91072	67.4	0.6	1,187
Tropoje	90	72316	35.8	0.9	2,514
Total/Average	8167	2158397	2076.7	1.4	3,933

Source: 1991 Statistical Yearbook of Albania, Ministry of Finance and Economy, Statistics Department.

¹ Includes arable, pasture and forest land.

² Projected area per family following full distribution of ex-cooperative land, scheduled for June/July 1992.

Table 2. Albania District Poverty Ranking

DISTRICT	LAND INDEX %c	UNEMPLOY. RATE %a (%)	TOPOGRAPHY INDEX %d	MARGIN-ALITY INDEX	RANKING	POPULATION ALLOCATION (US\$/district)	WEIGHTED ALLOCATION US\$/district)	SHARE OF POPULATION	WEIGHTED SHARE OF RESOURCES	% OF PER CAPITA ALLOCATION
Puke	0.82	0.18	0.87	0.78	Poorest	127533	153039	18%	22%	120%
Mirdite	0.77	0.12	0.80	0.72	Poorest	126122	151347			
Tropoje	0.67	0.17	0.85	0.70	Poorest	103572	124286			
Met	0.65	0.16	0.87	0.70	Poorest	182185	218622			
Kukes/Has	0.68	0.12	0.80	0.68	Poorest	251996	302395			
Librazhd	0.65	0.20	0.80	0.67	Poorest	187423	224908			
Gramsh	0.55	0.14	0.89	0.66	Poorest	105672	126806			
Skrapar	0.37	0.22	0.96	0.62	Very Poor	87437	96181	30%	33%	110%
Diber/Bulqize	0.66	0.23	0.66	0.62	Very Poor	385111	423622			
Pogradec	0.48	0.13	0.86	0.62	Very Poor	153499	168848			
Tepelene	0.44	0.04	0.86	0.59	Very Poor	105609	116169			
Tirane	0.57	0.08	0.71	0.58	Very Poor	350052	385058			
Eibasar/Peqin	0.49	0.14	0.75	0.57	Very Poor	425922	468514			
Berat/Kucove	0.41	0.11	0.78	0.55	Very Poor	317521	349273			
Permet	0.24	0.24	0.80	0.49	Poor	88565	88565	9%	9%	100%
Kavaje	0.41	0.17	0.56	0.45	Poor	173210	173210			
Vlore	0.35	0.09	0.60	0.44	Poor	265863	265863			
Korce/Devoll	0.30	0.09	0.52	0.38	Less Poor	412839	359170	35%	31%	87%
Fier/Mallakaster	0.37	0.24	0.42	0.38	Less Poor	511527	445029			
Kolonje	0.00	0.12	0.81	0.37	Less Poor	51378	44699			
Sarande/Delvina	0.35	0.06	0.45	0.36	Less Poor	179940	156548			
Shkoder/Malesia	0.54	0.17	0.21	0.35	Less Poor	453581	394615			
Gjirokaster	0.30	0.07	0.46	0.35	Less Poor	115197	100222			
Durres	0.30	0.09	0.40	0.32	Less Poor	190467	165706			
Kruje/Lac	0.40	0.15	0.26	0.31	Less Poor	194736	169421			
Lushnje	0.24	0.16	0.28	0.25	Better-off	306723	221986	8%	5%	72%
Lezhe	0.42	0.10	0.09	0.24	Better-off	146318	105896			
60043.62651										
Variable Weight	0.45	0.10	0.45			6000000	6000000	100%	100%	N/A

a. Official unemployment rate as of August 1, 1992.

b. Amount to be allocated (\$): 6000000.00

c. Index reflects per capita allocation among the rural population of arable land.

d. The percentage of mountainous and hilly land per district.

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

ALBANIAN RURAL DEVELOPMENT PROGRAM: CREDIT COMPONENT

1. Credit Demand

The determining factors in Albania's agricultural sector are the shortage of land and the insecurity felt by peasants in the face of food shortages, high inflation, and a lack of agricultural input and output markets.

In this situation many small farmers are reverting to subsistence strategies. This strategy, however, is limited by very small plot sizes that often do not allow sufficient wheat production to feed a family. Farmers are also quite cautious on credit; they have almost no experience with it and recognize that it can involve an additional risk that can endanger their survival strategy if the investment realized does not lead to the expected results. They primarily use credit for inputs (such as seeds, fertilizer, pesticides, or tractor services) to increase production on their plots, or animals (poultry, sheep, goats, and cows for milk and meat production, and traction animals) to diversify beyond the limits of their agricultural plots.

The rural market for services and processed products is not working at all, as low monetary incomes mean all cash is spent on basic needs, and there is little demand for credit for nonagricultural rural activities. Total credit needs do not exceed \$500 per family, and most loans fall between \$20 and \$300. While these amounts appear low, the income from a hectare of wheat does not exceed \$100 and the amounts of the required loans correspond to one-half to five times average annual incomes, a ratio close to the practice of agricultural credit in other countries.

While farmers also need larger loans for investments in irrigation, mechanization and off-farm activities, most of these loans should be met directly by the Albanian Bank for Agricultural Development (ABAD). Producers themselves say they would prefer to see available resources for the village funds concentrated on "small" individual credits.

2. Credit Supply

Non-formal Village Level Systems

Although traditional informal lending systems were common in the villages before collectivization, they completely disappeared over the four decades during which the state monopolized productive investment. Loans among villagers are today almost exclusively social loans, without interest and generally intended for emergencies in situations of crisis, such as illness, or social obligation, such as weddings.

A rapid reappearance of a significant supply of money from traditional borrowers seems improbable, as land has been equally distributed and the social and economic differentiation that was the basis of informal lending has largely disappeared. Also, the commercial and extra-agricultural activities that serve as instruments of socioeconomic differentiation between families have not yet developed in most villages, and the general economic climate of high inflation tends to lead those with money toward direct investments.

Peasants perceive high interest rates as a mechanism of exclusion, although discussions with farmers indicate that this is largely a problem of explanation; peasants - and even local ABAD agents - have no experience with inflation, which has been unknown in Albania for more than a generation, and had no concept of the relationship between interest rates - which they considered arbitrary - and the depreciation of money. They quickly grasp, however, explanations of economic mechanisms and the need for banks to protect their capital against inflation. Peasants facing an unknown future inflation rate have suggested the fixed interest rates of the Agricultural Bank be replaced by indexing capital and interest repayments to the dollar,^{1/} or the prices of agricultural products, which would allow them to evaluate and to better control the risks of credit.

The Albanian Bank for Agricultural Development (ABAD)

In September 1992 The Bank for Agricultural Development was considering four types of credit to the private sector:

- Loans of up to three months, at 25% interest, most of which would be channeled to rural tradesmen (food, inputs, clothing) and to private fertilizer traders under the USAID fertilizer program.
- Loans up to six months, at 32% interest, for use by peasants as credit for inputs.
- Loans of up to one year, at 39% interest, for inputs and processing industries such as bakeries and dairies.
- Medium-term credits of 3 to 5 years with an interest rate of 40% for cattle acquisition and rural enterprises (transportation).

ABAD has allocated the bulk of its available funds (lek 350 million) to private-sector credit^{1/}. In July 1992 ABAD raised interest rates from 8-10% to 25-40% to partially compensate for inflation. As potential customers were not familiar with inflation, this has led to a decrease in demand for new loans. In Albania's poorer hilly and mountainous areas demand is almost nonexistent and is limited to the very small commercial and non-agricultural sectors.

ABAD's weakness in small-scale rural credit stems from its roots in the State Bank, which was not a bank in the sense of a modern institution of

^{1/} As of June 1992 BAD had lek 350 million in outstanding loans to the private sector, and lek 2.8 billion outstanding to the public sector.

financial intermediation, but rather a state agency responsible for paying salaries and balancing accounts between state enterprises. Most rural ABAD staff are former cooperative cashiers; they are good bookkeepers but lack the training and experience to understand the mechanisms of inflation and its consequences on banking activities, analyze demand and conceive appropriate financial products, understand profitable financial intermediation, or build a rural banking service in a market economy.

ABAD staff also lack equipment, such as calculators, and have largely adapted the old cooperative ledgers as their means of keeping accounts. Fund shortages often restricts new lending for weeks at a time, particularly as the district banks are only allowed to recycle part of repayments into new loans.² ABAD's strengths lie in the motivation and commitment of a great number of employees, and its good bookkeeping capacities. ABAD's procedures also constrain small farmer access, as the documentation required for a loan can take several weeks with many trips to the district town, and the procedure for small loans is almost identical to that for larger ones.

Village Funds as an Alternative Source of Credit

The concept of village credit funds was developed from surveys, discussions and work sessions in Elbazan district villages to define with the farmers themselves a financial mechanism that would meet their need for easy and real access to small loans while insuring the sustainability of the financial system by covering transaction costs and preserving invested capital against devaluation by inflation. Another consideration was the inclusion of a savings mobilization element to allow withdrawal of external funding of the system over the medium term.

Peasant requirements for a new financial mechanism include:

- Procedures that make access to credit simple.
- Loan duration, amount, and the modalities of reimbursement must be adapted to the economic activity supported by the loan, and specific conditions should be set up for each sort of investment activity. In general, credit will be individual, but group credit could be considered for some purposes, such as irrigation systems.
- Credit should take into consideration the general situation of the village. In a village that is short of pastureland, for example, credit for cattle acquisition should be limited to poor families who do not have animals and not be used to increase overall herd size beyond carrying capacity. Credit also should not be appropriated by only one group in the community; the peasants feel credit should be an instrument for strengthening social cohesion and not the contrary.

2/ BAD interest rates are also a political issue, and Parliament excluded BAD the banking law so that it could lend at a subsidized rate. In the absence of necessary means for such a step, the BAD finds itself in an uncomfortable situation today between the political constraints on one hand and the budgetary constraints on the other.

- The system of loans to be set up must have moderate transaction costs. Villages are ready to contribute to this by taking over large parts of credit processing.
- Guarantees and collateral must be appropriate and modulated in according to the amount borrowed, the risk of the proposed activity, and the creditworthiness of the borrower. Rather than using mortgages for small loans, they suggested social or material guarantees (equipment, animals, crops, etc.). This will considerably reduce the cost of access to credit and delays in granting loans. Strong village structures can contribute to social control of repayment and allow appropriate conditionalities. Peasants think the village is the relevant unit for the organization of the loan system.

Peasants agree that interest rates must cover the costs of the service provided and preserve the value of borrowed capital in an inflationary environment. They seek, however, to minimize their own inflation risks, and have suggested indexing interest to dollar values or agricultural product prices.

Their preferred solution to their lack of accessible formal or informal credit is the creation of a fund reserved for the village, using ABAD's management capacity to handle bookkeeping and accounting. Thus, each village fund would have an account with ABAD, with individual loans expressed as subaccounts.

Most peasants have never been granted a loan in the past. All the peasants are preparing for their second growing season in a private economy. Most farmers recognize they will need to invest - at a minimum in agricultural inputs - to raise production. While pointing out the necessity of a credit system, peasants simultaneously express a need for education and training to enable them to make good choices, and say they would like to involve specialists, such as agronomists or veterinarians in their investment decisions. They want the credit system to be under local control and have predictable repayments.

Testing the Village Fund Concept

The Pre-Pilot Phase of the Albanian Rural Development Program set up model village credit funds based on these criteria in seven mountain villages in the Elbazan district in September 1992.

Village credit committees were established with one representative for each quarter of the village, with representatives of the working group set up as a predecessor to the planned Rural Development Fund and the Bank for Agricultural Development acting as advisors. The committees, based on the general regulations that govern village credit funds, make all decisions concerning fixing positive interest rates, loan recipients, guarantees to be provided by creditors, the fixing of reimbursement terms, and sanctions to be taken in case on arrearages or defaults. Any delay in repayments automatically blocks any new loans. Bookkeeping is provided by ABAD.

The village committees fix for each type of loan a guarantee to be provided by borrower. It can be a material guarantee or a joint security. The requirement will depend on the loan amount, its duration, the risk entailed by the undertaken activity and the borrower's situation. The aim of this flexibility in guarantees is to make use of the committee's knowledge of potential borrowers.

The system is also designed to improve ABAD's capacity to manage funds so that it, in turn, can sustain the Rural Development Fund with its management skills. Thus, RDF opens for every village fund opens an account in the nearest ABAD branch, where its funds are deposited at the interest rate commonly applied for deposits. For each loan, the village credit committee requests from the Bank the opening of a subaccount and the paying out of the corresponding amount, and peasants repay directly to the ABAD branch.

The village committees, thus, do not handle cash, and all accounting management is done by ABAD, which blocks payments to a village if there are delays in repayment. While ABAD pays interest on deposits, it is paid service charges for its account-keeping and the expenses of its agent in the villages.

The repayment rate fixed by the village committee covers intermediation fees, the costs of the working group, ABAD's fees, and inflation costs, which are pegged to the U.S. dollar. Transaction (and emergency fund) costs are set at 5% of the loan amount.³

The test village funds were set up on the basis of interviews and surveys in a number of villages in Elbazan. An Albanian credit officer was recruited and trained, regulations and loan request forms drawn up, and village committees established in the seven villages.

By mid-November 1992 84 loans totalling \$24,000 had been approved, and another 40 loans for some \$6,000 were in the final stages of processing. Loan sizes ranged from \$47 to \$209, and their duration was from 1 to 4 years, with most running 2 years.

Most loans were used to purchase animals, which, given uncertainty about inflation and wheat prices, seemed to farmers the most secure form of investment. Some 40% of the loans were used to buy small ruminants, 36% for milk cows, and 19% for oxen. The remaining 5% was used for irrigation improvement.

Establishing Village Credit Funds Under the Pilot Project

The village funds will be established using deposits by the Rural Development Fund (using resources provided by external donors) to ABAD accounts in favor of participating villages. The amount of each fund will

^{3/} The 5% fee has been calculated on the basis of one project employee handling 30 villages at a cost of about \$7,500 a year for salary, office space, and transport (motorcycle). BAD bookkeeping and account management costs are calculated at \$6,000. The work of the village committee is voluntary. Each village fund is expected to handle some \$10,000 worth of loans a year, and total costs of \$13,500 is 4.5% of the \$300,000 handled by 30 villages. A 0.5% fee has been added for an emergency fund. The fee structure will be reassessed as more experience is gained.

determined by RDF according to available resources and the specific situation of each village. If we assume that the need that must be covered with this system of credit is about \$100-300 for half the families in a village, this corresponds for a medium size village of 100 to 200 families to \$10,000-15,000 per village. A starting fund of 50% of the final amount seems to be sufficient.

Mechanisms for mobilizing rural credit from the villages - perhaps by adding a mandatory savings component of as much of 10% to loan repayments - will be tested during the pilot phase. The savings mechanisms would be deposited in individual interest-bearing savings accounts within the village fund, which would be managed in the manner of a savings and loan institution, which would be used to progressively replace RDF funds. This system includes an initial grant element, the planned mobilization of rural savings would provide a stable basis to the future rural credit system.

3. Conclusion

Farmers in Albania are going through a difficult period of transition from a state cooperative system to private agriculture. Credit can be a very important element in this transition. A system of village funds that combine local knowledge of creditworthiness with the management skills of the Bank for Agricultural Development can be an answer to this problem.

This system should be able to handle the very small loans that account for the bulk of demand through a mechanism that is clear and understandable to the farmers.

For the ABAD, the Village Funds can provide a new approach to poor private farmers and their families, for whom an individual and direct approach would require overly transaction costs due to the low amount of their loans.

The system, as it is proposed, fulfills all the durability conditions for rural financial systems, as it covers all transaction costs, has interest rates sufficiently high to preserve the capital value against inflation, and integrates a saving scheme that gives borrowers participation in the capital of the financial system.

ALBANIA
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ESTIMATED PROJECT COSTS

RDF Vehicles	Number	Unit Cost	Total (US \$)
Sedans	1	15,000	15,000
4-Wheel Drive	7	25,000	175,000
Minibus	1	40,000	40,000
Motorcycles	6	3,000	18,000
Total	15	---	248,000
 RDF Office Equipment			
Computers	4	3,000	12,000
Printers	2	2,000	4,000
Copiers	2	3,000	6,000
Telex	1	5,300	5,300
Fax	1	950	950
Telephone	3	300	900
Misc. Furniture	1	12,000	12,000
Total	--	--	41,150
 RDF Recurrent Costs			
Salaries			
Executive Director	1	15,840	15,840
Senior Staff	4	14,160	56,640
Infrastructure Staff	10	12,240	122,400
Credit Staff	5	12,240	61,200
Other Professional	3	12,240	36,720
Bookkeeper	1	10,920	10,920
Secretaries	2	10,200	20,400
Driver/Mechanics	9	9,720	87,480
Total Staff	35	--	411,600
 Vehicle Operating Costs	 --	 --	 73,100
Total Recurrent Costs	--	--	484,700

Training

Equipment	--	--	7,300
Courses for Staff	--	--	45,520
Study Trips	--	--	38,000
Commune Staff Course	--	--	96,660
Business Courses	--	--	32,220
Total	--	--	219,700

Studies & Technology

Village Profiles	--	--	5,000
Technical Support	--	--	22,600
Pilot Operations	--	--	40,000
Total	--	--	67,600

Technical Assistance

Rural Works Advisor	1	197,540	197,540
Rural Credit Advisor	1	197,540	197,540
Short-Term Consultancies (total)	0.5	197,540	98,770
Total	2.50	--	493,850

12 months additional

Recurrent Costs, Technical Assistance, Monitoring **870,000**

Public Works **1,590,000**

Rural Credit **750,000**

Grand Total **4,765,000**

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

ESTIMATED DISBURSEMENT SCHEDULE
(US\$ million)

Bank Fiscal Year and Quarter:	<u>During Quarter</u>	<u>Cumulative</u>
<u>1993</u>		
4th Quarter	0.50	0.50
<u>1994</u>		
2nd Quarter	0.50	1.00
4th Quarter	0.50	1.50
<u>1995</u>		
2nd Quarter	0.50	2.00
4th Quarter	0.40	2.40

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

STUDIES, TECHNOLOGY, TECHNICAL ASSISTANCE, AND TRAINING

1. Studies

While the far-reaching land reform achieved in less than a year shows the adjustment capacity the Albanian peasantry, the private farm in Albania is too new a phenomenon to be fully understood by policy makers. For farmers themselves, the only point of reference is the pre-war period that only old people can remember.

Albania has a 3,000-year history but the last 50 or 60 years were largely erased by the communist regime. The identity of a community is its history. Everybody needs it to build up his self-confidence and project himself in the future. Thus, the first component of the rural studies will consist in interviews of with older village inhabitants about local traditions of labor organization, land ownership, off-farm activities, village organization, informal credit, etc. before collectivization. Short video films presenting these interviews would be used in project's training, and may also be shown in local schools.

The second component of the studies will be an inventory of the village problems: access to markets, water and energy supply, land use, management of local resources such as irrigation, pasture, forest, which, for the moment still belong to the state. This study is essential to make policy makers fully aware of the constraints faced by farmers¹ and to define the responsibilities of the village head and the village council created by the law of September 15, 1992. According to this law, inspired by the old "Kryeplaku" and "Kryeplegesia e fshatit" system², the head of the village, elected by the representatives of the village quarters: (a) takes care of protecting public order in the village; (b) takes measures to meet needs such as burial services, maintenance of cultural and sports facilities, roads, sewage, telephone lines, electricity, etc.; (c) defines methods of using potable water resources, irrigation waters, and rules for exploiting pastures and forests; (d) reviews requests and claims of village inhabitants and tries to settle disputes; and (e) takes measures to improve and protect the village environment.

1/ One of these constraints is, for instance, the lack of farm buildings and the lack of space in the village to build them. The cows are kept in the garden, the crops are stored in the kitchen and the manure is piled up on the village road, creating a public health and environment problem.

2/ "The old head of the village" and "the old people council" grouping the heads of the quarters were the traditional local government of the village. The representatives elected in September 1992 are not necessarily old.

From the project's point of view, this part of the study, which would be carried out in all villages alongside rural works or credit components, is essential for prioritizing the infrastructure works and calculating proper maintenance and recurrent cost financing, which is a condition of RDF investment.

A sample farm survey (about 20 farms in each village benefiting from the village credit scheme) will focus on production factors (land, labor, equipment, inputs), choice of products (crops, cattle, ruminants, etc.), household budgets, and the attitudes and motivations of the farmers toward land ownership, employment, migration, services provided by the state and by the private sector.

This sample survey will supplement the International Fertilizer Development Center country-wide study financed by USAID. It will complete the urban population household study financed by UNDP in Tirana and provide valuable information for poverty assessment. Beneficiary assessment will be carried out at commune council, village council, and individual farm levels.

All the studies will be conducted in the villages by ex-cooperative staff, who are now largely unemployed. This will allow for very low costs but, above all, it will help the technical staff to take another look at the farmers who were, one year ago members of the cooperative "brigade" under their control. The output of the study will be essential for monitoring the project, and exposing the former cooperative technicians to potential future clientele will be important for the organization of a future extension service.

The studies component will be set up by RDF with the support of local research centers. It will help Albanian academics retrain themselves in a new anthropological approach. Cost estimates are in Table 1, below.

2. Technology Transfer

The technologies used in Albania's agricultural sector are large-scale and obsolete. The challenge is to introduce modern small-scale technologies, adapted to the new production and market pattern.

The main sectors where these technologies are needed are:

- Cereals processing (some small and very obsolete mills are already functioning under private ownership and bakeries will have to be modernized as rising farm incomes allow farm families to buy their bread rather than bake it themselves).
- The dairy sub-sector, which will require small milk processing plants supplying the urban markets and cheese plants for goat and

sheep milk which could be produced at very competitive prices for the export market.³

- Fruit and vegetables processing could be developed not only in the present canneries, but also using drying techniques at the village level.
- Tobacco is already being processed at the farm level, and techniques could be improved.
- Poultry, eggs and production could be developed in small production units for the local market.
- Wool processing and carpet making could be rehabilitated at village level in relation with the development of tourism.
- Local carpentry, blacksmith, mechanical shops could be modernized and put to work, as the former cooperative artisans are still in the village but generally jobless for lack of markets, raw materials, and equipment.⁴
- Rural tourism could be organized using methods applied in EC countries.

Transfer of small-scale technologies could be organized by the RDF in cooperation with the EC-supported SME Support Unit, and by using technical assistance from specialized institutions in EC countries and promoting direct exchanges or joint ventures with the EC. Ten pilot operations are budgeted for the pilot phase. Table 1 shows the cost of studies and technology components for the four-year program.

Table 1: Rural Development Program Studies and Technology Costs

	<u>1st Year</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>	<u>TOTAL</u>
Village Profiles	5,000	13,000	25,500	40,000	83,500
Technical Support	22,600	22,600	22,600	22,600	90,400
Pilot Operations	40,000	72,000	115,200	158,500	385,700
TOTAL	67,600	107,600	163,300	221,100	559,600

3. Technical Assistance

The Project includes 56 person-months of technical assistance that would include two full time expatriate advisors to RDF for two years, one to assist

3/ The present price of sheep cheese is 60 leks/kg (6 cents) as compared to \$16 on the EC markets.

4/ The price of a village produced ax is now 15 leks. It does not cover even the price of the raw material.

the rural public works component, the other to assist the small-scale rural credit component. The remaining funds would be used for shorter-term consultancies for such tasks as, inter alia, developing environmental criteria and training RDF staff in their application.

The rural works advisor will assist the Infrastructure Department of RDF and help organize liaison with the communes and villages to identify and inventory priority small-scale works suitable for labor-intensive subprojects that can be implemented at the local level. The advisor will assist in assessing local management capacities, creating materials lists and technical norms, and identifying local partners to carry out subprojects. The rural credit advisor will assist the RDF Promotion of Economic Activities Department in surveying villages to determine the sizes and types of initiatives likely to be put forward for loans, determining local credit and collateral traditions and adapting them to village credit fund mechanisms, and building working relationships with local branches of the Bank for Agricultural Development and village credit committees. Both consultants will undertake training of RDF staff, and help the agency develop its budgeting, accounting, and other operating procedures.

Table 2 shows estimated costs for technical assistance under the four-year Rural Development Program:

Table 2: Estimated Technical Assistance Costs

	<u>1st Year</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>	<u>TOTAL</u>
Rural Works Advisor	197,540	237,048	98,770	49,385	582,743
Rural Credit Advisor	197,540	237,048	98,770	49,385	582,743
Short-Term Consultancies	98,770	48,872	65,846	49,385	262,873
Total	493,850	522,968	263,386	148,155	1,428,359

4. Training

The first task of the RDF will be to recruit and train its own staff, organizing short training courses alternating with field work in the communes and the villages where actions have already started under Phase I and II of the program.

Infrastructure projects with the communes and credit operations with the farmers are a perfect carrier for training in new market economy skills: project evaluation, financial management for the commune staff, business planning, management and marketing for the private farmers and rural micro-entrepreneurs.

The training courses organized by the RDF will have an immediate application both for its own staff involved in rural works or small credit operations and for the commune staff or the individual farmers, what is the only way to enhance the real value of the training investment.

Table 3 shows training costs for the four-year program period:

<u>Table 3: Rural Development Program Training Costs</u>					
	<u>1st Year</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>	<u>TOTAL</u>
Equipment	7,300	-	-	-	7,300
Courses for Staff	45,520	49,460	4,990	9,630	209,780
Study Trips	38,000	76,000	76,000	76,000	266,000
Commune Staff Courses	96,660	124,320	159,280	174,160	554,420
Business Courses	32,220	71,040	79,640	87,080	269,980
TOTAL	219,700	321,000	369,910	396,870	1,307,480

ALBANIA
RURAL POVERTY ALLEVIATION PILOT PROJECT

LESSONS LEARNED FROM THE BANK'S EXPERIENCE WITH SOCIAL FUNDS

With the wave of structural adjustment programs and the increased focus on poverty alleviation since the mid-1980s, many countries have adopted special programs to deal with the impact of the reform programs on the poor. Lacking sufficient technical and administrative capacities to transfer resources rapidly to low income families, many governments have created autonomous Social Funds (SF) able to collaborate effectively with community groups, NGOs and local government institutions. The major areas of intervention of the SF are: labor intensive public works programs, support for micro enterprises basic social services, as well as training and placement services. The most important component tends to be public works, which often accounts for more than 50% of the fund's expenditures.

Bolivia's Emergency Social Fund (ESF), initiated in late 1986, was the first major SF supported by the Bank that aimed to alleviate the impact of a adjustment program on the poor. Since then the Bank has supported many other social funds in Latin America (Honduras, Guatemala, Nicaragua), Africa (Guinea, Mauritania, Senegal, Benin, Niger, Burkina Fasso, Mali, Zambia, Somalia, etc) and Asia (Indonesia). The proposed rural development fund in Albania will be the first SF for a transition economy in Eastern Europe.

Social funds are most effective when used in conjunction with a national strategy for poverty alleviation in the areas of health, education and basic sanitation. The attractiveness of SFs as an instrument of social policy reflects their ability to:

- disburse large sums of money rapidly with low administrative costs that are generally below 10% and often less than 5%;
- decentralize government functions by relying upon community organizations, local government institutions and NGOs;
- provide a channel to funnel large quantities of foreign and central government funds to many small projects;
- support the development of the private sector and in particular private contractors;
- build basic social and economic infrastructure with a high rate of return;
- provide low cost social services to the poor;
- provide a model of efficient delivery of public services for line ministries and
- finance visible accomplishments which shore-up the government's reform program and increase its sustainability.

The principal drawbacks of a social fund are that rapid disbursements and flexible decision are often at the costs of: a long-term development oriented social policy; high quality subprojects and; investments that do not

reach the poorest of the poor (often the most difficult to reach). Social funds cannot substitute for a national poverty alleviation strategy in the areas of health, education, and basic sanitation.

KEY INGREDIENTS FOR SUCCESS

Clearly Defined Objectives

Social funds with a few clear objectives and a well-defined target population are easier to set-up and implement than funds that try to respond to all issues and groups (rural poor, urban chronic poor, unemployed, etc) affected by the adjustment program.

An Autonomous Flexible Organization

To promote efficiency and accountability, the social fund should be free from political interference and exempt from the civil service law to benefit from flexible funding, procurement, disbursement and hiring procedures. To attract high quality staff, the fund must be free to offer private sector salaries and to hire its staff and appraise projects on strictly technical grounds. Much of the success of the Bolivian Emergency Social Fund and the Bolivian and Honduran Social Investment Funds was attributed to the exceptionally capable, hard-working, and honest staff and leadership of the funds. The role of individual managers was also important, and their personality and competence played an important role in motivating the staff.

Most governments have opted to create a separate institution under the office of the president or prime minister, reflecting their limited public sector institutional capacity and the desire to ensure the fund's full administrative, technical and financial autonomy (Bolivia, Guatemala, Honduras, Sao Tome and Principe). However, a new institution raises problems of competition for scarce management talent, rivalry with existing ministries, and concerns about how the work of the fund will fit into the overall planning, budgeting, and coordination process of the government. Some governments have established interministerial committees with broad oversight powers to assume responsibility for cross-cutting policy and strategy questions. In addition, granting the fund temporary status makes it easier to exempt it from standard civil service rules and limits problems of rivalry with other government institutions. On the other hand, a fund's temporary status can cause problems in assuring a smooth transfer of responsibility back to the relevant permanent public agencies.

Some countries have preferred to integrate the fund under a line ministry, usually the ministry of planning (Guinea and Somalia). This option reinforces existing institutions and allows government personnel to benefit from the training programs and overall experience with the Fund. However, unless clearly specified this type of fund can be more constrained by government regulations, especially with respect to procurement and operating procedures.

Unconventional procurement procedures facilitate rapid disbursement and are especially important to permit the fund support small projects in isolated rural areas and to use local contractors. A system of uniform unit prices and a schedule of standard rates for domestic materials and labor costs are used and regularly updated by the SF. This permits the sub-projects to use local contractors who lack experience with procurement and contracting procedures.

Development Local Government and Community Organizations

Social funds work with both governmental and private sector institutions, exploiting their comparative advantages and fostering the development of both sectors. The social funds focus on sub-project appraisal and supervision leaving the detailed work of project formulation and implementation to the soliciting and supervising agencies that supply untold person years of labor. This reduces the staff requirements and increases the size of SFs' subproject portfolio.

To compensate for the weak institutional capacity in many developing countries, particularly at the community level, SFs rely heavily on NGOs to carry-out sub-project preparation, implementation (procurement, administration of funds, etc) and supervision activities. In particular, NGOs have been very involved in the administration of local solidarity based credit funds (see below). They tend to be grass roots organization and have a comparative advantage in working closely with low-income groups; they often already have experience in the design, implementation and evaluation of small development projects at the community level. It is important to select serious NGOs who have a proven track record in the type of subproject presented.

A demand-driven institution is subject to the criticism that its spending patterns are subject to the whims of its potential beneficiary population and to the capacity of preparing and executing agencies. Many SFs offer a standard sub-project menu to provide the Government with some control over what they will finance, to link their investment program to the Government's social and economic public investment strategy and to facilitate project preparation and appraisal. Sponsors choose from a menu of subprojects (e.g. road repair, rehabilitation of primary schools and health posts, etc) based on the standard construction norms and plans of the appropriate line ministry. The use of a menu, together with extensive pre-screening, encouraged high quality subprojects and contributed to a low subproject rejection rate of about 2 percent for the Honduran Social Investment Fund (FHIS).

Poverty Focus

Resource targeting and subproject promotion activities are two instruments used by many SFs to ensure that their resources reach poor communities and that their principal goal of poverty alleviation is advanced. The methodology used by SFs to target resources towards poor communities should be simple, relatively easy to implement and should be used as a guideline for resource allocation and not as a strict standard which must be fully implemented. Targeting systems have obvious advantages but can also

raise administrative costs and increase sub-project identification and preparation times lowering disbursement rates. The targeting scheme of the Honduran FHIS distributed resources between the districts and municipalities according to a poverty index based on sanitation, water supply and child malnutrition indicators to ensure that poor communities received a higher per capita allocation than less poor communities.

The wage policy of SFs also helps to target their resources towards the poor. By offering market wages for manual labor SFs automatically attract workers who are predominantly poor, if not the poorest of the poor. Empirical studies have proven that social funds employ participating households where average income is below the poverty line.¹ The high content of wages in the sub-project costs, often required to be least 50%, also assures that the poor are the principal beneficiaries of SFs.

The type of project financed by SFs also determines whether the poor will benefit from the infrastructure investment. Social funds also tend to focus on the provision of small-scale, technologically simple basic infrastructure (water and sewage systems, rehabilitation and expansion of basic social services, etc.) that is most lacking in poor neighborhoods. Basic infrastructure projects are also easier to prepare, implement and maintain thereby increasing the access of poor communities to the resources of SFs. Finally, the use of a project menu also simplifies project preparation and decreases preparation costs which facilitates the access of poor communities to sub-projects.

The experience of the Bolivian ESF has shown that poorer communities have the least capacity to prepare subprojects. Despite the plethora of unmet demands, prospective projects from the poorest communities are either poorly conceived, inefficient in their use of funds or lacking in know-how. Special efforts should be made with poorer communities to: disseminate information on the objectives and procedures of SFs; provide technical assistance to local organizations to assist in project identification and preparation; and reimburse certain project preparation expenses. Promotion activities should be an integral part of the SF's operations; the Honduran FHIS had a separate promotion unit for infrastructure, basic needs and informal credit sub-projects. In addition, UNDP supported a institutional development program in 40 of the poorest municipalities in Honduras to help train local officials in subproject evaluation and supervision.

Sustainability

Many SFs structure subprojects to ensure the sustainability of the investment and its benefits. First, SFs tend to support subprojects with low recurrent costs and give priority to rehabilitation subprojects, and in some cases expansion, rather than new construction. When they do engage in construction, before the subproject contracts are signed, the fund requires confirmation from the appropriate line ministry or government institution that

^{1/} Martin Ravallion, "Reaching the Rural Poor Through Public Employment: Arguments, Evidence and Lessons from South Asia," The World Bank Research Observer, Vol. 6, no. 2 (July 1991): 154-175.

the recurrent costs (new teachers or nurses, etc) are included in the budget.

Social funds have also undertaken considerable efforts to ensure the sustainability of water and sewerage subprojects, which have major maintenance requirements. All subproject contracts in Honduras have a clause requiring the final owner of the project, the National Water and Sewerage Service, to provide for cost recovery and maintenance. In addition, before the contract is signed the community must create a local committee to raise fees to cover the operation and maintenance costs of the water and sanitation systems. The FHIS has contracted with a NGO to provide technical assistance to the poorer municipalities to setup and strengthen the water committees.

The involvement of communities in the design and implementation of sub-projects also helps to ensure the sustainability of the sub-projects at the local level. Counterpart financing or contributions in kind (labor or raw materials) should be required from beneficiaries as agreed upon when the subproject is appraised, to ensure that good quality subprojects are presented and that they will be sustainable beyond SF support.

Accountability

Accountability mechanisms help keep the SFs "honest" without taking away operational flexibility. Many funds regularly report subproject lending commitments on an ex post basis to the President, the Congress and the press, which increases the transparency and accountability of the funds lending operations.

An efficient management information system facilitates subproject administration and monitoring, helps sponsors and donors track the status of their subprojects, and ensures the transparency of the Funds' lending operations. In addition, an MIS helps social funds to easily monitor the implementation of their targeting program.

Regular audits monitor the quality of sub-projects and also ensure the accountability of SFs. Despite the fact that IDA only requires annual audits, the Honduran FHIS is audited every six months by a private, independent external auditor. In addition, there are more in-dept quarterly audits that combine financial revisions with the physical inspection of works in the field.

Other Characteristics

A Pilot Demonstration is effective to fine tune project operations and to attract cofinancing. The Bolivian ESF started operations with a commitment of only US\$10 million, a fraction of its investment goal of US\$180 million; as the ESF demonstrated that it could effectively absorb large quantities of resources, additional commitments from a number of donors, as well as a second World Bank credit became available.

A monitoring component is useful, especially during the pilot phase, to receive feedback to improve project performance and design and to allow for the diversification of or modifications in the SF's subproject menu. In

addition, regular beneficiary assessments improve subproject quality and sustainability by ensuring that the subprojects are planned and implemented with a knowledge of people's values, are responsive to their needs and adapted to their behavior.

Public Relations. From the start the SF should have a public relations component which uses radio, newspapers and television to disseminate information on the SF, its goals and procedures, and to build confidence in its ability to deal fairly and promptly with the soliciting communities. This raises the demand for subprojects, improves the image of the fund, and highlights the government's efforts to alleviate the social costs of adjustment.

Donor Management. Social funds should have a uniform set of procedures that donors must follow, the latter should not be allowed to design their own program and procedures. Donors' funds should be disbursed against SFs' overall portfolio, or to certain categories of projects therein. This will reduce staff time spent on managing donor funds.

Technical assistance and training are required to increase the capacity of the social fund. Training courses should include: administration, public relations, community development, project design, appraisal, supervision and evaluation. In addition, there should be resources for local and international seminars and study trips. An internationally recruited technical advisor and consultants with experience in project financing and social funds might also be hired to assist the project director. Local staff from social funds in other countries are often used as short-term consultants to provide training and to set up the fund's procedures and manuals during the early phases.

Credit Funds

Several SF have included credit support to micro-enterprises. The overall size of the credit programs is often very small and many of the programs are pilot operations. The credit component of the Honduran FHIS has been very successful in supplying credit to urban and rural micro-entrepreneurs who do not have access to commercial banks. The project's mid-term review identified several key factors behind the success of the FHIS program:

- FHIS does not do the lending itself, but delegates this role to NGOS specialized in credit to the informal sector;
- market rates are charged to final beneficiaries, providing sufficient incentives to the NGO to undertake the subloan evaluation and ensure proper recovery and adequate capitalization of the revolving fund;
- NGOs assume the full credit risk vis-a-vis the FHIS which gives them incentives to collect subloans;
- FHIS requires significant cost sharing (about 20%) from NGOs which incites them to present quality subprojects;
- the NGOs must have recovery rates of at least 95 percent; and

- solidarity group lending ensures loan recovery without requiring physical or fiduciary guarantees.

Lessons Learned for the Albanian Rural Development Fund

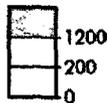
The Albanian Rural Development Fund (RDF) will be the first Bank sponsored social fund in a transitional economy and it will serve as an important test case for their use in Eastern Europe. Given the above review of social fund characteristics, the following general recommendations are proposed:

- The target population of the RDF should be well defined. The project should focus on assisting former cooperative workers particularly in mountainous and hilly areas and fired state farm workers.
- To ensure its transparency, effectiveness and the ability to disburse funds rapidly, the RDF should be autonomous and authorized to adopt flexible procurement practices and offer private sector salaries to its staff.
- To ensure the Fund's accountability it should: report regularly on its activities to the President, Parliament and the press; carry-out regular audits of its financial statements and physical investments; and have a management information system that tracks the implementation each subproject.
- The government should consider an interministerial review committee that would meet bi-annually to coordinate the work of the RDF between the different involved ministries and levels of government.

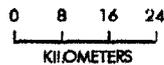
ALBANIA RURAL POVERTY ALLEVIATION PILOT PROJECT 10 POOREST DISTRICTS

- MAT** 10 POOREST DISTRICTS
- SELECTED TOWNS AND CITIES
- ⊙ NATIONAL CAPITAL
- MAIN ROADS
- RAILROADS
- ✈ AIRPORT
- ⚓ PORTS
- DISTRICT BOUNDARIES *
- INTERNATIONAL BOUNDARIES
- ~ RIVERS

ELEVATIONS IN METERS:



*While Albania's districts were increased from 26 to 36 in mid-1992, exact boundaries for the new districts have not yet been drawn. The Pilot Phase selection of the lowest income districts is based on the old districts.



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