

Franco Pasacantado – Representative at the World Bank group for Albania and other countries of the region.

### **Improving the business environment in Albania**

Thank you governor Cani, it's a pleasure for me to be here. I don't mind the weather as long as tomorrow gets better.

I'm happy enough to talk about improvements of the business and investment climate in Albania. I have been using for this presentation the results of a study that the financial investment advisory services (FIAS) of the World Bank have done recently on the investment climate in Albania and this study has been done through a survey of 500 companies and interviews with governmental officials. So, I will briefly present the results of this study and some of the recommendations that this and other studies have done. But before doing this, I would like to express a word of caution. Economists think they have a good understanding of the factors that promote, private sector investments, but there are still many areas of uncertainties, there are places and countries which seem to have more than an obstacle, where private sector development still flourishes and countries where everything is done right and there is no private sector. So there is an element of unknown, even though I will not mention those areas, I think we have to keep them in mind when we discuss these issues.

My presentation will first mention the broad policy and regulatory taxes that promote private sector development. Then, I will mention how business can be facilitated by the government. I will then look at government issues and broad economic development issues, and then I will draw some conclusions.

So let me first move to policy reforms and institutional development. Well, I will be talking about foreign direct investment (FDI), but this is also equal for domestic investment and in fact I think that they help the private sector. The private sector is developed where foreign direct investment and domestic investment both grow and prosper. FDI flows where the business opportunities are the greatest and the obstacles for business are small. So what are the main factors? First macro stability, of course the role of central bank that is very important, macro stability, low inflation, and political stability is important. Of course political stability has to be defined, and this is one of the areas where uncertainties arise, what we mean by political stability and certainty: a clear study of the rules of the game and institutional framework. It doesn't mean that the govt doesn't have to change, otherwise Italy wouldn't have been developing in the past 60 years, but it means the establishment and clear rules of the game. Furthermore, an adequate legal and regulatory framework is needed, good functioning of factor markets; finance, labour and land, a good system of property rights and contract enforcement, and low corruption or a mechanism to fight corruption.

From the point of view of the government: what can be done to facilitate direct investment and FDI? The traditional approach is to consider investment incentives: financial and fiscal incentives, targeting of investors and sectors to enhance competitive advantages of a country. These factors still need to be considered, even though one has to be careful because we often create serious distortions by using incentives of this nature, but they are used and can be used. But the most important

activity that the government can do to promote this investment is the action on the administrative barriers, the action to reduce corruption, the action to promote and develop solid sectors through a number of indirect mechanisms and creation of an attractive business environment, in terms of factor conditions; investment in human capital of course and investment in infrastructure. And rather than direct support more and more the emphasis is being done on these indirect factors that can promote development

So let me now give some brief assessment of how Albania has performed through the combination of these macro policies and structural policies in recent years. I will use a transition report of the European Bank for Reconstruction and Development, which is an excellent document that gives an indication of how different transition countries perform in a number of areas like: private sector, % of GDP, governance, privatisation, trade and competitive policy. Now the picture is that even though Albania is not at the top in a number of areas it has performed quite well first of all in trade and foreign exchange liberalisation, where it gets a 4+. Where less has been done is in competitive policy, in price liberalisation, and in banking reform it gets a 2+. I think you pass with a 2+, but there are countries which have done better. Infrastructure reform is slightly behind the average of the other countries, but is in line with the neighbouring countries.

Let us move to the other factors: the governance and rule of law measures which are quite difficult measures. Here you see that there have been improvements in accountability or regulatory quality. The rule of law is more mixed and control of corruption has been improved with ups and downs. But overall, the level even in 2002 is still below the average of the region, in all these areas.

So let me turn to the recommendations that can be derived from the analysis that we have made. First of all, what are the deterrents to private sector investment? First of all there is a lack of implementing regulations and guidelines. Laws that are introduced are not supported by force to set up procedures, criteria and responsibilities. Often there is a high degree of administrative discretion by regulatory agencies and their officials. This is the result of many laws that have been passed recently, but it is true that there is more promise on the introduction of laws than on the measures to implement them. The institutional structure, the responsibility of individual and agency responsibilities are often not properly indicated. Investors from this survey appear they do not know exactly where to go for what. So, there is some unpredictability in also in the responsibilities. Certainly regulations should be designed taking into account the administrative capacities. We don't need to build very detailed regulations, very sophisticated regulations if we do not have the administrative capacity to administer them. It is better to have a simpler regulation, more transparent regulation, if you know that you cannot implement rather than aim at perfection. Many countries with very tough laws and regulations usually are totally mitigated by the lack of compliance with them, so that it's better to have a simpler than a more complex. The enforcement, we know that the legal enforcement of laws and regulations is weak and the lack of effective settlement mechanisms creates informal settlement mechanisms of disputes and these create of course corruption and vicious circles, especially because once this mechanism is set in motion each agent behaves thinking that other agents work in that way too. So it is important to

strengthen these formal settlement mechanisms, which in turn can create a virtuous mechanism.

The FIAS study and the business environment study that we have done indicate three main areas of concern: the first is custom and tax administration, the second is land and construction permits and third is sector licensing. A number of recommendations in each of these areas have been developed in partnership with the government. Of course there are also a number of lower level irritants that are difficult to identify, but that sometimes are as important as the major rules, so this report also indicates some of them and especially also the importance of an attitude of trust towards the private sector. Sometimes the private sector is still viewed with some feeling of hostility from the government sector. Hence, it is important to develop an aptitude of trust and reciprocal respect.

In conclusion, first of all macro stability remains the most important thing, and Albania is a good example of high growth, low inflation and growing in private sector. Administrative and institutional areas of key importance especially as a country moves from the first stages of development. The competitive advantages of a country are particularly important in the area of FDI. Financial sector of course is important, but what is most important is to give priority to governance and accountability, to avoid duplicative, complex and non transparent procedures. In this light one can also think that what is done in the infrastructure including private sector communication should go hand in hand with the regulatory reforms, and reforms in the areas of judicial and administrative sector.

Thank you very much, this is all I have to say and I look forward to the discussion.