

FOREIGN DIRECT INVESTMENTS IN ALBANIA

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Abstract

Foreign direct investments are very important for the implementation of strategic reforms, transfer of advanced technologies and managerial methods, thereby stimulating economic growth in developing countries and in particular, transition economies such as Albania is.

During the last years, Albania experienced an increase in foreign investors' interest in a wide range of sectors, with energy generation, telecommunication, cement production, mining, oil and industrial parks heading the list. However, the major obstacle factors for FDI inflows seem to remain the same: pervasive corruption, weak law enforcement, poor rule of law, lack of developed infrastructure, lack of a reliable energy supply and insufficiently defined property rights. Determining the factors that attract FDI, and furthermore identify the main characteristics of the host country's economy, are essential to understand the reason of FDI inflows to a country or region. In the empirical perspective, various studies give different results. More specifically, this paper has focused on determining the factors for and against FDI in Albania.

Introduction

Albania is a country with great potential to attract Foreign Direct Investments, which can considerably increase its opportunities for further development. FDI-s constitute a very important element on providing a direct impact on the economic growth, which is very important for Albania.

After the fall of the communist bloc, Albania is trying to establish a democratic system and to realize the painful and difficult transformation from a centralized economy to a market one.

Year 1991 marked the beginning of a positive change in this regard to the privatization of agriculture, the introduction of financial autonomy of state enterprises, liberalization of prices and the signing of bilateral treaties on investment aid, creating a favorable climate for foreign investments.

Despite the efforts made and measures taken by the Albanian government since 1990, Albania still remains a country which attracts a low level of foreign direct investments compared to the other countries in the region, while it has considerable natural and human resources.

After year 2000, the volume of foreign direct investments in Albania has increased but still remains low compared with most Western Balkan countries. This paper analyses the performance of FDI-s in Albania trying to identify the main positive and negative factors influencing foreign investments.

FDI-s and their importance for the economic development of a country

A foreign direct investment in the economy of a country not only provides indirect effects on the technical structure of production but also in the management and organization of activities that it undertakes.

Foreign direct investments should be considered as a foreign penetration in each instance of the economy in the technological as well as in the organization aspect. So FDI-s have the restructuring ability and this is the main channel through which are transmitted the effects on the economic growth and development. Their effect is especially important in the case of transition economies, making the attraction of FDI-s in the country one of the primary economic policies. The main effects of FDI on the economy of a country are:

- *The most stable version of an investment*

This is because they are not easily transferable investments within a short period of time, thus presents less risk than financial capital for a country's stability.

- *Influence on employment growth*

This is the direct impact of FDI-s, therefore it is a direct mean of reducing unemployment in the country. Although this is a purely quantitative aspect it is particularly important because the welfare of a country increases.

- *Transfer of production technology*

Introduction of a more advanced technology through a foreign firm has a transformative effect on the entire sector because this technology will begin to be used by local firms as a response to the increasing competition in this sector.

- *The transfer of more efficient methods of industrial organization and management*

Foreign investors have technological , financial and managerial advantages, for a deeper and faster transformation than those in the domestic sector where they invest. This is more evident in economies that are in the process of transition towards market economy, where it still lacks the organizational ability of a scale capitalist industry of international standards.

- *Increased productivity*

This happens not only at the company's level but also in the whole sector where it operates. Stimulation of increased productivity in the whole sector happens as a result of rising competition. So domestic firms are beginning to imitate those through an indirect process of learning. Certainly it is very important here the ability of the local firms to get and adapt to the new technology. Among the most important effects of FDI-s in the host country is the economic growth of the latter. Attracting FDI-s helps significantly the long-term development of the host country. Effects of FDI-s on the growth target have obvious political implications. If FDI-s have a positive impact on the economic growth of a country, then many countries will encourage their flows by offering tax incentives, improving infrastructure and many other incentive measures.

Benefits of Albania from FDI-s

FDI inflows stimulate economic development and have helped developing countries such as Albania when faced with economic hardship previously (Economy Watch 2009).

FDI in the tourism industry, energy sector, road construction and the service sector are going to generate increased employment.

FDI into Albania permits the transfer of technologies and assists in competition between producers within the local market.

Gains in the economy include the development of skills, and human capital resources by Albanian employees of Energy, Construction and Engineering firms receiving training on the operations of a business. The creation of new jobs, and increases the salaries of workers leads to lifestyle enhancement. Previously, Albanian professionals would immigrate to other nations. "Brain drain" is used to describe the phenomenon of emigration of highly qualified professionals from Albania to other EU nations. FDI in Albania contributes to positive economic growth, and professionals are a source of capital for developing countries such as Albania. Reversing the brain drain has had positive effects on education, income distribution and economic welfare (Centre for Social and Economic Studies, 2006).

Foreign Direct Investments in Albania

Political regime in Albania was communist for more than four decades, and compared with other countries of Eastern Europe, Albania has had a very rigid economic and social system. In the early 90's, Albania was one of the last countries of Southeast Europe that accepted political pluralism and also started the process of transition towards the market economy.

History of FDI-s in Albania

After the fall of communism, the Albanian government took measures in favor of foreign investments by firstly reversing the 1976 law according to which, any form of FDI-s in Albania was forbidden. The Albanian government allowed

the establishment of joint ventures between Albanian companies and foreign ones.

Thus, Albania, with its rich natural resources, unexploited tourism potential and weak competition in the local markets started to attract the first foreign investors.

Early in the transition, the government of Albania created a lot of facilities to foreign investors, trying to attract a high level of foreign investments. Lack of laws, experience in the field of investments and efficient fiscal policy were very favorable conditions for foreign investors during that period of time.

History of the FDI-s in Albania after the collapse of the centralized economic system can be divided into two periods: FDI-s up in 1996 and FDI-s after 1997 until today. FDI-s in Albania experienced a steady growth until 1996, ranging from 0 in 1990 to 90 million dollars in 1996, as indicated by the table below:

Table 1. FDI-s in Albania 1992-1996 (in million \$)

Year	1992	1993	1994	1995	1996
FDI	32.0	45.0	53.0	70.0	90.1

Source: Bank of Albania

During the years 1992-1993 started the first foreign investments from the Italian companies, because the neighboring country had more opportunity to control the Albanian market, and to decide which areas were suitable for investments.

In 1997, Albania experienced almost a civil war because of the failure of some informal financial schemes. These serious problems marked a profound collapse for the Albanian economy creating a situation of high uncertainty for foreign investors. During this period, foreign investments decreased 3-5 times compared with other Balkan countries. The 1997 troubles were followed by the war in Kosovo in year 1999 which caused great uncertainty and a high level of political risk in the region of Western Balkans.

As a result, there was a significant decline in foreign investments during the year 1997. A lot of foreign investors left Albania during that period of time and did never come back again.

Lack of political stability and economic development, high level of informal economy, uncertainty and lack of infrastructure caused many investors to leave Albania and move into other countries economically and politically more stable than Albania.

During the years 1998 and 1999, FDI-s increased by over 40 million dollars per year or 1.5% of GDP, most of which resulted from the privatization of state enterprises. In '99 some Italian companies intended to buy mines, or to use them in the form of concessions to the state.

In year 2001 the level of foreign investment was worth about \$ 207 million. Success in improving this indicator was largely the result of the privatization process of state enterprises. However the problems of 1997 and the high political risk from the Kosovo war, continued to influence FDI flows in the Albanian economy. Thus, in 2002, even though there were some large privatizations in strategic sectors of the economy, the level of foreign companies was 30% less than in 1996.

According to official data from the Bank of Albania and the IMF, the cumulative foreign direct investments during the years 1992-2001 amounted to 1437.3 million dollars, or about 33.7% of GDP. Main privatization programs undertaken during the year 2001 made this indicator to mark the value of 207 million dollars, or about 14.2% of the cumulative figure of foreign direct investments. Whereas in 2002, according to the official data, foreign direct investments reached 149 million dollars. According to (EBRD, 2002), progress is mainly due to the process of privatization. FDI-s in particular contributed to more than half of capital inflows through the successful privatization of various SME-s, mobile telecommunication companies and financial institutions.

After year 2000 there was an increase in foreign investments, which continue even today to exercise their activities in Albania. Dominant sector of the FDI-s in Albania has been and continues to be the productive sector. In general, products are not consumed in the Albanian market, but exported abroad again.

This fact highlights the main reasons of investing in Albania: cheap labor force and favorable geographical position.

FDI performance in 2010

In late 2009, the share of foreign direct investments to gross domestic product (GDP) in Albania has been the highest in the region (8.1%), followed by Croatia (4.6%), Serbia (4.5%), Macedonia (2.7%), and Bosnia and Herzegovina (1.4%). It is noted that the increase in FDI-s during the last three years in Albania, is associated with reduction of FDI-s for other countries in the region.(UNTAD 2010)

In 2010, foreign direct investments in Albania increased for the first time more than 1 billion dollars, ranking it in the second place behind Serbia and the only Eastern European country where investments have increased despite the negative global trend. In the global context, Albania ranked 18-th in the world for FDI performance index from the 78-th in 2006. Albania has made significant improvements on indicators related to physical infrastructure, electric power supply and other conditions for investments. The flow of FDI in Albania has followed a different trend and almost independent from the regional and global trend showing a steady rise in recent years. More concretely: from \$ 325 million that was in 2006, have been steadily growing in the years: 2007 - \$ 656 million, 2008 - \$ 978 million , 2009 - \$ 989 million and in 2010 reached \$ 1097 million. Increasing participation of foreign companies in the Albanian market is a clear indicator of favorable conditions for FDI-s to continue developing in some sectors of the Albanian economy like the extraction of minerals, energy sector, banking sector and telecommunications. (UNCTAD 2011)

Favourable incentives for FDI-s in Albania

- *The geographic position of Albania*

Albania has a very favourable geographic position. Albania has two ports in the Adriatic and the Ionian Seas.

- *Natural resources*

Natural resources are generally under-utilized especially in rural areas, including minerals, forests, plenty of water resources, mountainous and seaside tourist places. Extractive industries belong to the private sector and as a result there are opportunities for new investments (Greenfield) in this sector. New investment opportunities also arise from the withdrawal or termination of existing concessionary contracts. (Development strategy 2007-2013)

- *The low labor price*

It should be noted that the most appealing factor of human resources in the eyes of foreign investors is the low cost of labor in Albania. Albania offers not only skilled workforce but also one of the cheapest labor force in the region of Western Balkans. Minimum wage based on the decision of the Albanian Council of Ministers Nr.235, dated 27.02.2008 is 16 000 ALL (about 130 Euros). Since September 2006 the social security contributions are reduced by 9 points, which has reduced by 30% the total cost of employees for social and health security.

- *The lack of domestic competition*

Competition between domestic enterprises is poor. This results from the immature state of enterprises in Albania and because they are mostly small and medium enterprises.

- *Signing of SAA and membership to NATO*

The signing of the Stabilization and Association Agreement with the EU in June 2006, Albania's transition into a NATO country and the European Union (EU) prospective membership are considered as important factors contributing to the increased FDI inflows even during the financial crisis period.

- *Measures taken by the Albanian Government to attract FDI-s*

In order to increase FDI inflows, the Government of Albania has intensified its efforts to implement a number of fiscal and legislative reforms to improve the business climate in Albania. In order to attract FDI, the Albanian Government has developed a range of incentives for foreign investors in Albania, such as the “One stop shop for granting licenses”, tourism and energy sector incentives as the most interesting sectors for investment actually in Albania. GOA has also applied a set of liberal fiscal policies such as the law of concessions, VAT credit on machinery imports, etc.

Disincentives to FDI-s in Albania

- *Unresolved conflicts on land property in Albania*

Bureaucratic procedures for registering property rights and for the approval and issuance of building permits which have always created a barrier to FDI-s in Albania.

- *Political risk and the instability in the region of Western Balkans*

Conflicts and ethnic wars in the region of Western Balkans after 1990, the 1997 unrest in Albania and the war in Kosovo had a negative impact on Albania's image in the eyes of foreign investors.

- *Slow and bureaucratic procedures of state owned enterprises privatization.*

As in other transition countries, the implementation of privatization programs in Albania is considered one of the main priorities during the transition process. The transformation of state ownership to the private one creates a competitive economic environment in which businesses make every effort to maximize the benefits (Saving, 1998). If the Albanian government had followed a more intensive process of privatization of large and medium state owned enterprises, probably FDI inflows would have been higher. This has happened in all those transition countries that have been able to quickly and successfully implement the privatization of former state enterprises.

- *High level of corruption and informality of the Albanian economy*

The informality of the Albanian economy is one factor that has negatively affected the fair competition in the Albania market. The implementation of anti – corruption reforms in Albania has resulted as very difficult because often these reforms collide with the interests of politicians, officials and bureaucrats self activities. Albania remains one of the countries with the highest corruption level in Europe.

- *Poor material infrastructure of Albania (roads, energy and water)*

Lack of proper roads, electric power and water are essential problems faced by all foreign investors in Albania. This certainly is an additional cost of their business in Albania. Also an important fact is the lack of industrial parks which negatively effects FDI-s in Albania too. Albania has the lowest Internet penetration rate of the SEE region. Also the fixed line penetration is the second lowest in the region. Albania records one of the lowest level of annual investments on the rail maintenance in SEE. The time needed to get an electricity connection is 162 days, the second longest wait in the region.

- *Small market size*

Market size can be measured in function of the number of its residents and purchasing power. Albanian domestic market is small with a population of about 3.2 million inhabitants and the population's purchasing power is limited. Despite a GDP growth during 2000-2010, the figures remain low compared to other countries of the region. These features make Albania a less attractive place for foreign investors. However, after year 2003, Albania has signed free trade agreements with other Balkan countries. For this reason, Albania is considered as an integral part of a larger trade area, and not as a small and isolated market from foreign investors.

Statistical Analysis

Given the positive and negative factors influencing the level of FDI-s in Albania, it has been prepared and distributed a questionnaire. This questionnaire is distributed to foreign businesses actually operating in Albania (about 200 businesses). Questionnairy analysis is done by using the method of factors analysis by SPSS approach. This analysis is used mainly to measure the relationship between the positive and negative factors affecting FDI inflows in Albania.

At the beginning of this analysis, KMO and Bartlett test is done to assess the accuracy of the factors analysis.

Table 2 - KMO and Bartlett test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		0.728
Bartlett's Test of Sphericity	Approx. Chi-Square	694.789
	df	45
	Sig.	0.000

The questionnaire distributed to foreign investors in Albania, included 10 questions designed to measure the positive and negative factors influencing FDI. Foreign investors were asked to apply the Likert scale (1-no, 2- a bit, 3-average, 4-above average, 5-many), the level of acceptance or rejection of the 10 claims. We applied the factors analysis to the data. The method of factors analysis, according to the main objectives of the study, is based on developing a conceptual model for determining the positive and negative factors for FDI inflows into Albania.

Kaiser (1974), recommends accepting values greater than 0.5. Moreover, average values of 0.5-0.7 are acceptable. In our case, this value is 0.728, so the analysis results can be considered. Also, according to Kaiser, factors analysis is appropriate if Bartlett's test is less than 0.05. In our case this value is 0.000, which means that factors analysis can be used. Further on, the analysis of the main components through the rotation matrix Varimax with Kaiser Normalization

has been used. In the following table it is presented the analysis of the grouped components:

Table 3: Analysis of the main components

	Components			
	1	2	3	4
<i>Political risk and instability in the region of Western Balkans</i>	0.859	-0.236	-0.126	-0.214
<i>Slow privatization procedures of state owned enterprises</i>	0.813	0.189	0.103	0.174
<i>Unresolved property conflicts</i>	0.738	0.277	0.294	0.192
<i>High level of corruption and informality</i>	0.666	0.161	5.125E-02	-0.550
<i>Natural resources and geographical position</i>	1.564E-02	0.945	-6.186E-02	-9.129E-03
<i>Poor infrastructure</i>	0.511	-0.734	0.184	-0.126
<i>Signing of SAA and NATO membership</i>	0.146	-3.888E-02	0.876	-0.147
<i>Implementation of incentive local and central policies for foreign investors</i>	-1.568E-02	0.315	0.759	0.297
<i>Low labour cost</i>	-6.399E-02	-0.401	-0.303	0.679
<i>Small market size</i>	0.118	0.193	0.309	0.659

The method of Rotation : Varimax me Kaiser Normalization

In this analysis we used the Varimax rotation, which minimizes the number of variables that have a high load for each given factor. It is noted that the total percentage of the explained variation is 77.33% (sum value for Factor 4 in Table 4). So the selection criteria of Kaiser is fulfilled, which means that after the rotation, each factor extracted is calculated for a different percentage of the explained variation, apart that the total variation explained is the same.

Table 4. Total explained variance

Compon ents	Initial Values			Extract of the sum of the load squares			Rotation of the sum of the load squares		
	Total	% of Variation ce	Cumul ative %	Total	% of Variation ce	Cumulativ e %	Total	% of Variance	Cumulativ e %
1	3.460	34.604	34.604	3.460	34.604	34.604	2.689	26.885	26.885
2	1.915	19.146	53.749	1.915	19.146	53.749	1.924	19.242	46.127
3	1.351	13.507	67.256	1.351	13.507	67.256	1.684	16.837	62.963
4	1.007	10.074	77.330	1.007	10.074	77.330	1.437	14.367	77.330

Summary

Based on the above analysis, the negative and positive factors influencing FDI-s in Albania are divided into four groups:

- Negative factors for FDI inflows

Political risk and instability in the region, slow process of privatization, unresolved property conflicts , high level of corruption and informality, are factors that negatively affect the attraction of FDI flows into Albania. All these factors have a correlation greater than 0.5 with FDI flows, which means that they are tightly related and have a negative impact on these flows.

- Natural resources and infrastructure

From the factors analysis of its geographical position and natural resources and the poor infrastructure, it is evidenced that the correlation of these two factors with the FDI inflows are opposite. This means that regardless of natural resources and favourable geographical position of Albania are very attractive for foreign investors but poor infrastructure to achieve the benefits of these resources is often an obstacle to FDI inflows in Albania.

- Signing of integration agreements and the implementation of local and central incentive policies

These two factors are positively correlated with FDI inflows. This means that the signing of SAA, membership to NATO and the implementation of central and local incentive policies, has strongly positively effected FDI-s into Albania.

- Low labour cost and small market size

From the analysis of these two factors it results that they are both positively correlated with FDI inflows. This result was expected for the low labor costs, but not for the small market size. Apparently, the opening of Albania to the market economy and the signing of free trade agreements with all the countries of the region, has made it possible for the Albanian market to be considered an integrated market in the region rather than an isolated one.

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