

Human resource as a determinant of Foreign Direct Investments (FDI)

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Abstract

Foreign direct investments (FDI) have a great importance both in transition and in economic development. The collapse of communism in Albania and the emergence of a market economy have led to a large inflow of foreign direct investment (FDI) since the mid 90's. The FDI usually goes to the countries where it is possible to combine the ownership advantages with the location-specific advantages of the host countries through internationalization advantages of foreign investments

The inflows of FDI to less developed countries are associated with vertical investments; this one takes place when a firm relocates only a part of its production process but not the whole production. Foreign investors are motivated when they find different factors of production, like natural resources, inexpensive labor, infrastructure and specific skills.

But, an important determinant of foreign direct investments is the human capital, too. In this paper, we are focused on this determinant and in the ways that led to a skilled work force. The hypothesis is that a cheap and abundant labor force is not the only determinant to attract foreign direct investments to a country.

Overview of Foreign Direct Investments (FDI) in Albania

During the period of communist isolation to 1991, our economy has been closed by not allowing the entry of foreign capital in the country. The years of a centralized government caused many gaps in economic development, bringing low levels of production and non-productive sectors. To ensure a competitive edge in the international market, it was necessary financing through FDI. The economists and international institutions argue that "the transition from a closed economy to an open economy, based on the free market, can be successful if it provides and attracts large flows of FDI."¹

"Foreign direct investments contribute to a rapid restructuring; technology transfer; workforce training; transfer of practices and policies of the product."²

After years '91 and '92, with the opening of the market, in the country began a run of FDI flows. By '96, it was the tendency of an increased number of foreign-owned firms. Furthermore, since '91 until '99, '96 year has been one in

which the level of FDI was the highest, with a value of \$ 90 million, then, in '97, because of a non stable political environment caused by the activity pyramid, FDI experienced a drastic decline, reaching \$ 48 million.³ Below we are presenting a trend of FDI in Albania since 2004 until June 2012. It is noted that there is an increasing trend of FDI from 2006 to mid-2009, and then there is a declining trend, also because of the global crisis that affected all countries, especially the countries of origin of foreign investment in our country, such as: Italy, Greece.

From the perspective of foreign investors' participation, there are two types of firms: those completely foreign owned and joint-venture (union, domestic and foreign capital). In many cases, firms are controlled by foreign investors (86%) and foreign capital occupies more than 50%. These companies are subsidiaries of foreign companies where foreign investors control, directly or indirectly (through other subsidiaries) more than 50% of the voting power.⁴ Investors from the European Union (EU) are the leading foreign investors in the country, accounting for

¹ Pavlinek, P., (2004)

² Pavlinek, P., (2004)

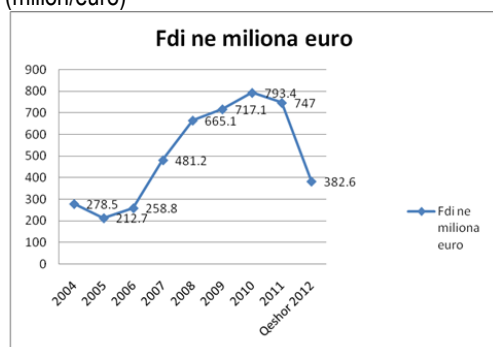
³ Bank of Albania, (1999)

⁴ Bank of Albania, (2008)

77% of foreign firms. First place is occupied from Italy, then Greece, also because of its proximity to us, but, apart this factor, there are also other factors, such as: these two countries are the key partners and the bulk of exports directed towards these countries.

Also, the largest number of foreign investors is represented by the production, textiles and clothing industry. Foreign investors (especially Italy and Greece) have targeted our country to benefit from the advantages in cost, for example the low labor force in the country.

Fig. 1 Trend of Foreign Direct Investments (FDI) in Albania (million/euro)



Source: <http://www.bankofalbania.org/>

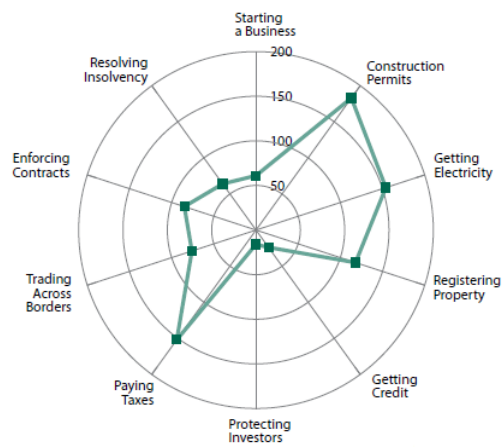
Policies and measures affecting Foreign Direct Investment (FDI) in Albania

According to the country's global ranking for ease in doing business, Albania is ranked 82th. It ranks among the group of Western Balkan countries and Italy and Greece. The country has a satisfactory ranking relating to the Protection of Investors (16) and starting a business (61) (figure 2), but the country has a ranking not very positive about the Property Registration (154) Payment of Fees (152) and construction permits (183).⁵

According to the Economic Forum's Global Competitiveness Report 2011-2012, Albania is included in the group of countries that are in the second phase of competitiveness, taking 78th place in 2011 among 140 countries. Figure below shows the ranking of our country according to the main areas (fig. 3):

Fig. 2 Albania's ranking by the main indicators of doing business, 2012

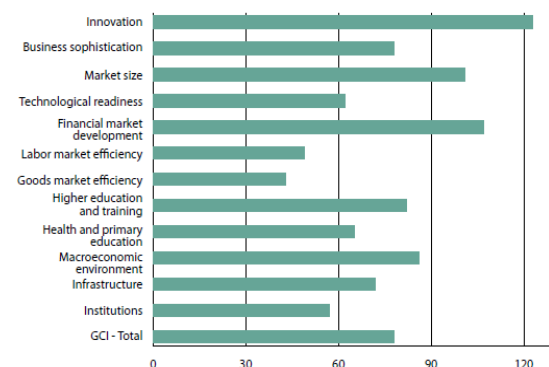
Albania's ranking by the main indicators of Doing Business, 2012



Source: World Bank and IFC, Doing Business 2012

Fig.3 Albania's competitiveness ranking

Albania's competitiveness ranking by major areas



Source: World Economic Forum, Global Competitiveness Report 2011-2012

In a more favorable ranking are the following components: goods market (43) and the labor market (49). Whereas, with a low ranking are these components: innovation (123), financial market development (107), macroeconomic environment (86), higher education and training (82).

Negative opinions appear in areas such as:⁶

- Progress on EU accession
- Functioning of the judiciary
- Corruption
- Building permits
- Inefficient functioning of industrial zones

⁵ World Bank and IFC, Doing Business 2012, Economy Profile Albania (Washington D.C.: World Bank, 2012).

⁶ World Economic Forum, Global Competitiveness Report 2011-2012

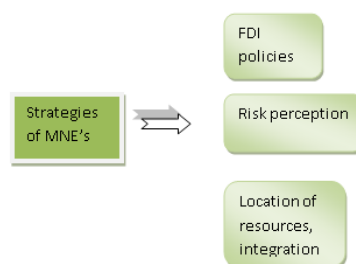
Since 1993, Albania has identified policies and laws to attract foreign investors. Under these policies in the field of foreign investment, we can mention:⁷

- Our economy is open to all investors and all sectors are open to foreign investment. The law guarantees equal treatment for all investors.
- Law on Foreign Investment provides that foreign investment cannot be expropriated except in specific cases where it is in the public interest service. In these cases, the procedures should be followed without any form of discrimination and getting compensated on the basis of fair market value.
- Foreign investors registered in Albania as legal entities have the right to own any kind of land.
- Companies that invest in Albania have the right to employ foreign nationals.
- Funds related to these foreign investments can be transferred abroad translated at the exchange rate which is the day of transfer.
- Albania has in force 40 bilateral agreements on investment.

Determinants of Foreign Direct Investments (FDI)

Identification of factors that attract FDI and furthermore identifying the main characteristics of the economy of the host country, are key factors to understand the FDI flows into a country or region. According to several studies conducted by Merlevede and Schoors (2004), Janicki and Wunnava (2004), Bevan and Estrie (2000) concluded that the main determinants of FDI flows in transition economies are: the host country's market size, host country risk, labor costs and the openness of the market.

According to UNCTAD, there are usually three categories of factors that attract FDI in a host country: economic factors; government policies and strategies of MNE's (Multinational Enterprises).



Burimi: UNCTAD (2000), fq. 19

Factor / determinant market include: his size; income level; urbanization, stability, etc. Factor / determinant resources include: natural resources, location.

Factor / determinant competition include: manpower availability, the cost of labor, workforce skills, technical skills / managerial, technological support, financial market, etc. Low cost of labor is a feature of almost all the countries of East Central Europe and Eastern Europe, making both of these regions having a comparative advantage in terms of flows of FDI.⁸

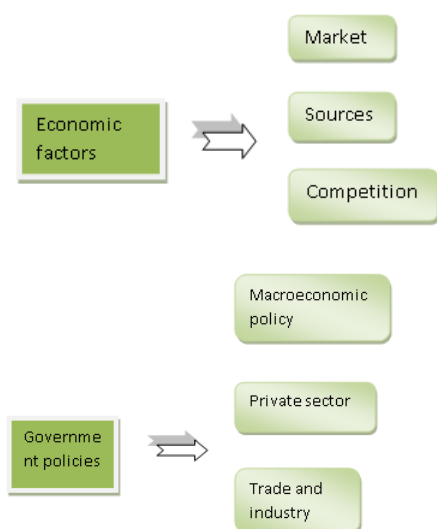
Factor / determinant macroeconomic policy include: management of key macroeconomic variables, remittances, ease access to foreign sources, etc.

Factor / determinant private sector include: promoting and encouraging entrepreneurship, clear and sustainable policies, efficient financial market, other support.

Factor / determinant of trade and industry include: regional integration and ease of entry into new markets, competition policy, support to SMEs, etc. Factor / determinant FDI policies include: access to inputs, transparent and stable policies, and non-financial incentives, etc.

Factor / determinant risk perception include: political risk, labor market, etc. Factor / determinant resource location and integration include: alliances, training, technology transfer, company strategies regarding location etc.

Fig. 4 Determinants of FDI in developing host countries



Human resources and the impact in attracting Foreign Direct Investment (FDI)

In terms of globalization and liberalization of markets, firms have to compete not only in domestic market but also in the foreign market where are exceeded the limits of a single state. Today, firms, both in developed countries and in developing countries, face a more competitive environment where technology is developing very fast and has very significant impact on firms' activity. More competitive and attractive is the economy of a country, the more the participants in the international market place. There are many factors that determine the competitiveness of an economy, such as: costs, opening of markets, human resource capacity, the advancement of technology, etc. We will stop here to human resources factor. In the case of FDI, the competitive environment is a key factor to ensure the flow of foreign capital in a host country.⁹

⁷ UNCTAD, (Maj 2012), "Report on FDI in Albania, 2011"

⁸ Resmini (2000)

⁹ Yussof, Ismail (2002)

A very important factor that attracts foreign investors (as mentioned above) is the cost of labor and productivity. It is normal that foreign investors will choose those countries with a lower cost of labor. But, from the results of a survey in Korea and Singapore, despite an increase in the cost of labor in the country, the flow of FDI has been increasing. This is as a result of another competitive advantage that find foreign investors in these countries and that is the existence of a qualified workforce (skilled workers), especially in the fields of science, which attracts foreign investors carrying advanced technology from their countries. In conclusion, we can say that low labor cost is not the most important factor that attracts FDI.

The prosperity of any country depends on how many people are employed and how much productive they are. But their productivity is affected by the formation, their skills and their use in the best way possible. This important conclusion that touches the topic of foreign direct investment, led us to find some ways to create a skilled workforce.

The globalization of markets has accelerated the spread of technology in different countries. Also, new jobs are replacing older work. Within each work, skills, competencies required have been changed. From a meeting of G20 countries was concluded that "countries should pay more attention to the development of education and training systems, so the labor force of each country will suit to market requirements"¹⁰

Policies for the development of a skilled workforce are: quality education and training systems; recognition and adaptation of firms and market requirements; adaptation of the workforce to changes in technology; preparation of the workforce with the necessary skills that serve for the future. Quality of primary and secondary education systems, followed by professional training courses, prepare and provide human resources with the necessary skills required in a job market.

Training and education are the main factors of economic growth, because higher levels and better quality training create a more productive workforce, which produces higher quality products and services.

From a survey it appears that four of the five German companies in China consider the lack of a skilled workforce as one of the biggest obstacles of competitiveness and development.¹¹

From various records it appears that a combination of systems of education with vocational training serves the labor market:

- By creating a skilled workforce to cover new positions
- By increasing productivity of employees and firms, too.
- Contributing to the development of innovations for the future
- By attracting foreign and domestic investors, this brings new jobs and reduces unemployment.
- By increasing wages, etc.

According to a forecast made in relation to the requirements for skilled manpower in the European Union till 2020,¹² it turns out that between the years 2010-2020 will be increased the employment opportunities (will be created around 7 million new employment opportunities). Employment requirements will be increased especially for senior positions (i.e., will be required more skills, training, qualifications). During this decade, it is predicted that the share of workers who will be employed in high positions, which requires high qualification, will increase from 29% to 35%. The positions that will require a middle qualification will continue to be approximately half of the total employment and the positions which will require low qualifications is expected to drop from 21% to 15%.

Summary

Foreign Direct Investment (FDI) has a very important role for the economic development of a country. FDI in less developed countries appear in the form of vertical investment, which means that the firm transfers only a part of the manufacturing process in a host country, but not all. In this case, investors are encouraged and attracted more from the natural resources they find, from a low labor force, from the infrastructure, from specific skills, etc.

In our country are taken and also improved the policies to foreign investment, such as: the opening of the market for all foreign investors, eliminating the risk of expropriation etc. But anyway there is much to be done to promote and attract foreign investment.

One of the main factors and crucial for any firm (domestic or foreign) is the human capital. It is this factor that often makes the difference and gives companies a competitive advantage in the market. Also, this factor is one of the determinants of FDI. Studies have proved that foreign investors are willing to pay more and to recruit a qualified and skilled workforce to produce quality products or services. So, it is important not only the existence of a low cost labor in a country to attract foreign investors, but also the existence of a workforce equipped with the skills and qualifications.

A major role in the training of human resources has not only the state with his policies, but also the presence of international firms (foreign investors) who can train employees, who may transfer managerial and technical skills in host countries etc.

¹⁰ http://www.ilo.org/wcmsp5/groups/public/---dgreports/-integration/documents/publication/wcms_151966.pdf

¹¹ http://www.ilo.org/wcmsp5/groups/public/---dgreports/-integration/documents/publication/wcms_151966.pdf

¹² CEDEFOP, (2010) "Skills supply and demand in Europe: Medium-term forecast up to 2020"

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