

Foreign direct investment in developing countries: The case of Albania.

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Abstract

Foreign investments are considered to have played a very important role in rebuilding the economies of the countries of Eastern Europe and Central Europe during their transition from centrally planned economies to market economies. Of long was recognized that FDI brings benefits for these countries, FDIs are important because they include bringing new technologies and knowledge to domestic firms, increased competition, and further increasing access for exports abroad.

The distribution of FDI among developing countries is irregular: some of them have more difficulties to attract foreign investment than others. This study analyzes the development and distribution of foreign direct investment in the region, focusing on the case of Albania.

This paper analyzes the opportunities and weaknesses of Albania in the context of their impact on the current situation of incoming foreign investment and aims to recommend strategies for improvement of this situation.

I. Introduction

Over the last decade, has felt an increased level of Foreign Direct Investment (FDI) mainly in developing countries, and since 1989, also in terms of countries of Central and Eastern Europe. FDIs in transition economies of these countries are often studied recently for its innovation as a phenomenon and for its importance in growth and development of the region.

It is long accepted that the benefits of FDIs to these countries are important and include bringing new technologies and knowledge to domestic firms, "leakage" of productivity (spillovers), increased competition, and further increase access to exports abroad. Moreover, FDI is a preferred way of financing the deficit (which is quite high in countries in transition), since FDI flows do not create debt. Thus, despite some negative effects that FDIs may have on host countries, for the countries of Central and Eastern Europe, is considered an important source to help them to rebuild the economy and pass the period of transition to a market economy.

In this region, some countries have performed better than others in attracting FDI flows, especially when comparing the two main groups: Central and Eastern Europe. Foreign direct investments in Albania have been a very important factor for economic growth, changing over the years both in form and in figures. However, Albania is one of the least developed countries in the region, marking the smallest values of FDI during the transition.

"The successful transition [from planned economies to market economies] in Central and Eastern Europe can not be accomplished without the help of large inflows of foreign capital" (Schmidt, 1995). In an analysis of the economic survey in Europe in 2005, said that among various types of capital flows, foreign direct investment is generally considered more desirable. A country can benefit more

from FDIs, without being connected simultaneously by net capital inflows or without the need to increase net external debt to it (UNECE, 2005). It is known that FDI has a positive impact on economic performance of a country. FDI to have a major impact on macroeconomic indicators in gross domestic product, balance of payments and employment.

By Rugman & Hodgetts, (1995) "Foreign direct investment is the ownership and control of foreign assets, which means full ownership or part of a company in a foreign country. One of the main causes of the diversity of definitions of FDI comes from changes in the importance that attributed to the characteristics of companies operating in the International arena (Hood and Young, 1979). Interest in the phenomenon of FDI, which has motivated efforts continued to draw theories that explain the causes and effects of him, according to Moosa (2002), attributed to various reasons. The first reason is the rapid growth of FDI flows and their models, especially after 1980. Moose brings evidence that flows FDI continues to grow even if world trade slows; for example when trade growth is inhibited by trade barriers, FDI may increase as an attempt by companies to avoid these obstacles. The second reason for interest on FDI is concern that rises to the causes and consequences of foreign ownership. Another reason to study FDI flows from the fact that it offers the possibility of channeling resources to developing countries. Following this reasoning, FDI is an important source of funds at a time when the possibility of finding other ways of funding is always decreasing.

An important reason connected with the main purpose of this paper is that FDI is thought to play an important role in the transformation of former communist countries. This is because FDI with domestic savings contribute to the host economy's total investments. Also, FDI brings with it

advanced technology, managerial skills and access to export markets.

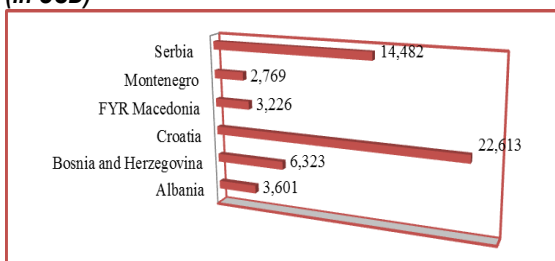
II. Foreign Direct Investment

With the EU expansion toward the east and the south of the continent, the Western Balkans is continuously considered from actual and potential investors as the next Europe high value location¹. FDI in the Western Balkans have been drawn mostly through the privatization process, while the level of Greenfield investments has been generally low². The services sector has attracted more FDI, while the home countries of most of the investing companies are Italy, Greece, Austria, Germany, Hungary and Slovenia. The following chart shows the level of FDI per capita in each of the Western Balkans countries for the period 1989-2008³.

Table 1. FDI total inflow (Euro million)⁴.

Year	2006	2007	2008	2009
Bosnia&Hercegovina	572	1,546	690	480
Serbia	3,516	2,272	1,879	1,100
Montenegro	644	1,008	832	520
Kosova	-	-	-	-
Albania	259	481	682	450

Chart 1. Cumulative flows of FDI per capita 1989-2009 (in USD)



Source: Data processed by Uruci & Borici based on EBRD (2008)⁵

FDI investments are those that give to the investor the control of a foreign company, a FDI consists of capital, personnel and technology. FDI in the recent years have been enormous growth. Firms make FDI for these reasons or for these factors:

- Marketing factors - such as market growth, the desire to advance the company's exports, competition tracking, customer tracking, etc..
- Cost factors - as are the desire to be close to raw materials, lower cost of labor, lower cost of transportation, capital and technology disponibilitetii etc..
- Investment climate - such as political stability, currency exchange facilities, stability of exchange rates, tax structure etc..

FDI inflows stimulate economic development and have helped developing countries as Albania when faced with economic hardship previously. FDI in Albania are considered as one of main contributors on the economic growth of the country. Our GDP and export growth rates were the fastest growing in South East Europe from 1997 to 2009 (Dragusha, Bejleri & Pulti (2010)).

III. The importance of foreign direct investment

Different historical periods of the states created several new forms of political involvement among the states. The need for reorientation of capital in the right places has become paramount necessity of every region on earth. The entry of foreign capital in the economy or in our economies has become a highly controversial and used term in this century. Our domestic natural resources, human and material resources are abundant, they need to be extracted and processing, to the benefit of humanity and in favor of economic development of our underdeveloped regions. Although it is important to encourage entrepreneurial logic among our youth, that they themselves start their own businesses and have a stable policy orientation taxes right strategic industries of our country.

What factors influence an investor to take his decision to invest capital abroad? However the primary motive is profit or gain. Capital transferred from place to place, or dream in a dream to realize greater profits⁶. Besides this factor there are a host of other factors that influence the behavior of foreign investors in our country, among them will be the mention a few:

- a) Political stability. Political stability is one of the factors that significantly affect the decision of foreign investors to invest in our country. Without political stability capitalists do not feel safe in his own goal or intention for greater profit.
- b) Macroeconomic stability. This is one of the important factors affecting the decision to the investor to invest in our country. Macroeconomic stability sights invalidation of domestic currency, the gross social product, the deficit or surplus of external trade of the host country etc.. Obviously these circumstances should be seen as directly affecting the business of our investors.

IV. An overview of the importance of FDI in Albania

- The flow of foreign direct investment (FDI) in Albania has increased significantly, from 258 million euros in 2006 to 705 million euros in 2009. Foreign direct investments have been developed despite global and

¹ Ranieri (2007), Redžepagić & Richet (2008)

² Dragusha et al. (2008)

³ Uruci&Borici (Begani) (2009) Foreign Direct Investments in the Western Balkans, paper presented in International Scientific Conference Economic Policy and EU integration, Aleksander Moisiu University, Durres, Albania, November, 19-20.

⁴Karvilas J., (2009) Global Financial crisis: Western Balkans, paper presented in the Fifth ECPD International conference National and inter-ethnic reconciliation, religious tolerance and human security in the Balkans, Brioni Islands, Croatia, October 29-30.

⁵<http://www.ebrd.com/country/sector/econo/stats/index.htm>

⁶ See: vlada.gov.mk

regional trends in economic and financial crisis, indicating a steady rise until 2009.

- According to the Performance Index of UNCTAD FDI for 2009's, Albania ranks instead of 25-to by 141 countries, which represents a rapid improvement from the 80-position of which Albania held in 2006. This improvement in ranking is partly a result of the rapid growth of FDI inflows in the country, mainly due to an improved business environment, as well as thanks to the opportunities created by privatization of state enterprises.
- Manufacture occupies a relatively low percentage of FDI in Albania, with less than a fifth of the stock of FDI in 2008. Greater share of FDI in services constitute, transport, communications and storage services with 23%, while financial services accounted for one third of the FDI stock in 2008.
- Foreign affiliates play an important role in the economy with regard to investment activities, value added, output and employment. Details of a survey of INSTAT for 2008 show that foreign owned enterprise with more than 50%, were responsible for 41% of total investments, 39% of total value added, 27% of total throughput and 16% of total employment.
- The introduction of foreign investors on a large scale in financial services and telecommunications has expanded and increased efficiency of these services.
- Participation rate of foreign affiliates in the Albanian economy is similar to that of Central European countries: for example Czech Republic and Slovakia to rank among the countries with the highest indicators of this participation in Europe. High participation of foreign companies is indicative of favorable conditions for FDI in some industries in the country, but at the same time the sign of the weakness of domestic companies, including the sector of small enterprises and medium enterprises SMEs that not have the appropriate level of development.

V. Effects of FDI in host countries

Host government should maintain close relations with foreign investors because they directly affect economic growth in that country. There are implications both positive and negative from the FDIs in host country. *Positive effects* - FDI form (create) capital in countries with limited internal resources. FDI also has the host country may attract local capital in various projects that previously was limited. FDI could affect the development of certain geographic regions or in the development of various sectors of industry. Through FDI's can lower unemployment in the host country that is the place where these FDI occurs. *Negative effects* - One of the negative impacts of FDIs in host country is the individual dominance, in many countries the majority of industry sectors is dominated by FDI's.

When there is an analysis of the effects of FDI in host economies, it often happens that must distinguish between two broad groups of effects: direct effects and indirect effects. "(Blomstrom, 1989).

Direct effects, as Blomstrom can affect:

-to the local workforce, adding more job opportunities and

higher pay;

-to consumers in the form of lower prices, and

-to governments through higher income taxes.

Within a host country, foreign-owned firms usually pay higher wages than domestic ones. they do not always cause the growth of wages in domestic firms, but their presence generally increases the level of wages in the host country.

Indirect effects are external effects, which otherwise are called "leakage" (spillovers). The term "leak" defines indirect effects generated by the presence of foreign companies in the host country's industrial structure and performance of local firms. These were discussed and were further grouped into "flow productivity" and "Flow entering the market" by Blomström and Kokko (1998).

According to this division "flow productivity" are created when:

- a local firm improves its productivity by copying some technology used by branch of Multinational Enterprise operating in the domestic market;
- introduction of a new branch leads to increased competition in the host economy and forces local firms to use more efficiently their resources and existing technology;
- domestic firms, forced by increased competition, start looking for new technology more efficiently.

Under this division, "flow entry into the market", when domestic firms have become better able to manage all the complex aspects of embodying the costs (marketing, distribution and maintenance), forced by the presence of multinational enterprise. This can occur because domestic firms may be subcontractors or supplier of multinational enterprise, and learn to do their job or simply because copying what makes a foreign company.

"FDI is desired by many countries, especially for" leaks "that generates, as management and better technology. The benefits are tangible. As is true for firms that trade and sectors where FDI is most prevalent, have higher average labor productivity and pay higher wages. Investments abroad stimulate exports of machinery and equipment and increase the demand for intermediate products, expertise of specialized services. "(OECD, 1998.)

VI. Problems of foreign direct investment

Causes of low level of FDIs in Albania are a result of:

- The perception of political and economic risk in the country from potential foreign investors;
- Poor functioning of public institutions, corruption, trafficking and poor law enforcement;
- Inefficiency and high cost of infrastructure (transport, energy, water), and lack of industrial parks for FDIs oriented, to export and tourism;
- Insufficient financial services, banking and non banking (low level of lending, poor quality financial services for international trade, high interest rates, high requirements for collateral etc);
- Problems and conflicts over land ownership, bureaucratic procedures for the registration of property rights, the approval and granting of

construction permits have always been a barrier for foreign investment.

SWOT Analysis

Opportunities <ul style="list-style-type: none"> European integration; Regional economic integration; Education system reform; Reconstruction of infrastructure. 	Strengths <ul style="list-style-type: none"> Geographical proximity to most of the regions and markets in Europe; A qualified workforce, with a relatively low cost; A working culture; An acceptable legal environment for investment.
Weaknesses <ul style="list-style-type: none"> Small domestic markets; Low income per capita; Poor infrastructure; Outdated industrial technology; Weak financial sector. 	Risks <ul style="list-style-type: none"> Competition from neighboring countries; Increase in wages and loss of competitive advantage of low labor costs.

VII. Role and impact of FDIs in services in Albania

During the past two decades, Albania has been transformed from an agricultural economy to an economy dominated by services. The share of agriculture fell by over 50% in 1992, to 23% in 2002, dropping further to 18% in 2008 (Table II.1). Simultaneously, the share of industry fell by nearly 10% in 2008, while construction rose to 14%. The rest of the country's GDP consists of services to approximately 58% (Table II.1). Increased productivity of services is explained partly by the increase in GDP and shift towards the demand for services. This was partially due to the opening of the Albanian economy and the growth of agricultural imports in particular, which led to a decline in industrial production. Non-tradable services can be offered only being produced where the customers are and their production should be increased to meet demand.

Table 1. Gross value added by economic activity, 1992 and the years 2001-2008.

	1992	2001	2002	2003	2004	2005	2006	2007	2008
Industry	17	13	7	9	10	11	11	9	10
Agriculture	54	34	23	24	22	21	20	19	18
Construction	8	10	12	12	14	14	14	15	14
Transport	3	10	7	5	9	5	5	5	5
Services	18	33	51	50	49	49	50	52	53

Source: Data according to INSTAT, Tirana, Albania.

Foreign Direct Investment arouse interest and be considered by multinational companies, because they can improve their profitability and increase shareholder wealth. In most cases, multinational companies engaging in foreign direct investment because they are concerned to increase revenue, reduce costs or both (Madura, 2004).

FDI represent real investments. Direct investments are realized through the establishment of a subsidiary by a firm in another country, or the laying of a firm control of a foreign firm. Foreign direct investment, being a transfer of resources also means taking control by a foreign firm (Mançellari, 2004).

Foreign direct investments are an important source of capital flows and development of an economy. Foreign direct investment, including investments of foreign individuals and institutions in the domestic economy, for the purchase of at least 10% of the equity of an enterprise.

Open date Albania has conducted research on the value of foreign direct investment (FDI) in Albania and the region, based on World Bank data. Foreign Direct Investment (FDI) are put in relation to gross domestic product (GDP) for each country analyzed. The data used to calculate the ratio based on FDI data and GDP measured in U.S. dollars (USD) by the end of 2009.

As can be seen from the chart, in late 2009, the share of foreign direct investment (FDI) 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 during the last three years in Bangladesh, is associated with reduced FDI to other countries in the region.

% IHD/GDP	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Bosnia and Herzegovina	2.65%	2.06%	4.03%	4.56%	7.08%	5.65%	6.27%	13.6%	4.98%	1.38%
Croatia	5.21%	6.92%	4.16%	6.05%	2.65%	4.02%	7.05%	8.53%	8.65%	4.61%
Macedonia	6%	13.01%	2.78%	2.54%	6.02%	1.67%	6.66%	8.83%	6.17%	2.69%
Serbia	0.85%	1.56%	3.76%	7.15%	4.34%	8.13%	17%	8.75%	6.13%	4.47%
Albania	3.88%	5.07%	3.03%	3.15%	4.57%	3.13%	3.56%	6.11%	7.23%	8.14

During the last decade in the region, the maximum value of FDI to GDP has reached Serbia in 2006 (17%), and it has reached the minimum value of FDI to GDP in 2000 (0.85%).

Foreign direct investment, are an important indicator of foreign investor confidence in a country, and they sit in terms of economic and political crises, and grow in terms of improving economic and political environment.

Recommendations

1. The improving of business climate can be achieved by taking several measures such as:
 - establishing a balance between the regulatory policies and market liberalization;
 - simplifying licensing procedures;
 - facilitation of customs procedures and tax;
 - solution of problems of land and construction;

- improvement of administrative appeals procedures;
 - reduction of the informal economy will have a positive effect on increasing investment in the country.
2. Development of a coordinated program for the promotion of Albania and its investment opportunities in new industries and areas.
 3. Promotional activities to improve the image of Albania.
 4. Identification of markets and investment opportunities in potential sectors as that of electrical power, mining, oil and gas, agribusiness and tourism.
 5. Implementation of a project to train our embassy staff abroad for economic and investment issues in Albania.
 6. Efficient functioning of public institutions, avoiding corruption and trafficking, and law enforcement.

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