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DETERMINANTS OF FOREIGN DIRECT INVESTMENTS IN ALBANIA: A CASE STUDY

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Abstract

The aim of this paper is to analyze the main factors that influence the foreign direct investments (FDI) in the Albanian economy. In the first part of this study we analyze the main theoretical factors that determine the FDI, classifying them in 5 categories as follows: incomes factors, costs factors, technological factors, social and cultural factors and the last category include different economical factors. In the second part of the study we analyze the relationship between the FDI (dependent variable) and gross domestic product (GDP), governmental expenses and the level of remittances. To test the relationship between the variables we use a multiple linear regression (OLS) taking into consideration the period from 1993 – 2013 using annual data. From the regression results we found out a positive relationship between GDP and foreign direct investments (FDI) showing that when the economy grows the FDI tends to be higher. In the same time we noticed a positive relationship between governmental expenses and foreign direct investments (FDI). From the regression results was found out an absence of the relationship between the level of remittances and the FDI in the Albanian economy, showing that the FDI are not influenced by the performance of the level of the remittances.

Keywords: foreign direct investments, economic growth, remittances, regression

INTRODUCTION

Foreign direct investments (FDI) in Albania are a very important source of the capital flows. They have an important role in the economical frame of the developing countries, insuring necessary investments for the growth of economy and the development of technology, while inside savings can't ensure them. Moreover, capital flows serve as a signal to demonstrate that the economy of a country has changed, comparing with those outside it. These flows influence certain economical variables of a country, like in the deficit of the current account, in the exchange rate, in the savings and investment in the country, in the employment etc.

Many developing countries have benefited from the capital flows in the forms of FDI. Fighting the absence of the capital from which the closed markets suffered, they have favored the efficient use of these resources; also they have created a more competitive environment which offers to the investors a higher level of performance, as foreign direct investments direct themselves where the opportunities for business are higher and the obstacles lower.

However, the definition of foreign direct investments has changed during the years, its meaning historically has been related to an assigned limit of capital participation and the idea that the investor has about the influence or the control in the enterprise. FMN and OECD in their tries have come out with a common definition:

"…foreign direct investments reflect the purpose of insuring a stable interest from a resident unit of an economy (direct investor) in a resident unit of another economy (company of a direct investment)…"

Another meaning of FDI is given in the fifth edition of the Manual of Balance Payments in FMN (BPM5) *which "establishes as a direct investor the owner of the 10 % or more of the total capital of the enterprise".*

More specifically according to law nr.7594 "FOR FOREIGN INVESTMENTS" in Albania "foreign investments" include any kind of wealth and particularly any kind of investment in :

a) Movable wealth and real estate, and any other kind of wealth.
b) Rights that come from the participation in the shares, other securities or interest in the enterprises.
c) Loans, cash obligations and any other activity that has economical value.
d) Rights in the field of intellectual ownership, technical processes of know-how.
e) Economic rights gained by the law, including the right to require, discover and exploiting natural resources.

DETERMINING FACTORS OF FOREIGN DIRECT INVESTMENTS

Factors related to the incomes

A division of the theory also means the division of the factors based on the incomes, costs and other factors. These motives are typical for MNC, a multinational and international enterprise that operates in different countries, that tries to raise their incomes based in these ways:

- Withdrawal of the new resources of requests;
- Entering in new profitable markets;
- Exploitation of monopolistic advantages;
- Reaction to trade restrictions;
- International diversification.

Factors related to costs

- The use of foreign factors of production;
- The use of foreign raw material;
- The use of foreign technology;
- Response toward the fluctuations of the exchange rate.

Technological factors

One of the major problems in the developing countries today is the need for the latest technological equipment, which influence the economical growth. These products can be ensured by transferring the technology, or by investing the capital of the foreign investments for technical assistance.

Social and cultural factors

The attitude of the welcoming population toward the foreign capital must be positive in order not to be a possible risk for the foreign investors.

Another socio-cultural negative factor for foreign investments is the tendency that the host countries might have is to control the foreign capital, where the investors enter with the support of the politicians or parties. Fortunately, in Albania this phenomenon does not exist toward investors or foreign capital. On the contrary, our country is listed among countries which do approve western countries.

Other factors

Different economical factors support FDI which include: credits with low interests, tax mitigation, grants, subsidies, the removal of restrictions and limitations, etc.

METHODOLOGY

In this paper we use secondary data taken from different research journals and OEDC reports for the theoretical part. For the empirical study we use a regression model like the ordinary least squares analysis in order to test the relationship between foreign direct investments (FDI) and the independent variables.

We consider a period from 1993 until 2013 with a total of 21 observations with annual frequency. The data that we use in this paper are found in the official site of the Bank of Albania. We use FDI as the dependent variable while as independent variables we use:

- GDP – Gross Domestic Product;
- G – Governmental Expenses;
- R – Remittances.

ECONOMETRIC MODEL ESTIMATION AND REGRESSION RESULTS

After analyzing the data with Microfit 5.0 software we have the regression results as follows:

- The regression analysis confirms that the coefficient of determination, *R-Squared*, is equal to 83.30% and shows that the independent variables explain 83.30% of the variation of the FDI, while the remaining part (16.70%) is explained by other factors that are not included in this study.
- The *DW – statistic* is equal to 1.65 indicating that the residuals are not correlated having a value approximately to 2.
- The indicator of *F-Statistic* shows that the observed value (35.21) is greater than its critical value (7.61) so the alternative hypothesis wins and the model is globally significant.
- The *VIF* (*variance inflation factor*) indicator is used to measure if there is multicollinearity in a regression analysis. From the results is noticed that all variables have VIF values lower than 5, showing an absence of the multicollinearity in the regression analysis.

Table 1. Regression results

Variables	**Beta**	**t - value**	**p – value**
Constant	225.15	-3.47	0.0032
GDP	1.400	4.65	0.0003
G_EX	0.08	2.62	0.0282
REM	-0.52	-1.74	0.1019

Dependent variable Foreign Direct Investments (FDI)

Analyzing the results of table 1 we derive the econometric model that explains the dependent variable (FDI) and is shown as follows:

FDIi,t = 225.15 + 1.400GDPi,t + 0.08G_EXi,t + -0.52REMi,t + ui,t

To analyze the relation and statistical significance of Beta coefficients of the independent variables we review the values of the probability p. For p-values (*observed level of significance*) greater of 0.05 the influence of the independent variable on the dependent variable is unimportant when the other variables remain unchanged while for p-values smaller than 0.05 we refuse the hypothesis of the absence of relationship.

Beta coefficient of GDP is positive +1.400, showing a positive relationship between economic growth (GDP) and FDI in the Albanian economy. P-value is 0.0032 that is smaller than 0.05 and in this case we can say that the GDP has a statistically significant impact on the FDI. The positive sign of beta coefficient shows that the increase of GDP determines the conditions for higher levels of FDI. This conclusion is in line with other studies in this field showing that in case of good economic conditions the levels of FDI tend to be higher.

Beta coefficient of governmental expenses (G_EX) is positive +0.08, showing a positive relationship between governmental expenses (G_EX) and FDI in the Albanian economy. P-value is 0.0282 that is smaller than 0.05 and in this case we can say that the governmental expenses have a statistically significant influence on the FDI. The positive sign of beta coefficient shows that the governmental expenses growth would lead to higher levels of FDI. This conclusion is in line with other studies in this field showing that in case the government increases the expenses the level of FDI tends to be higher.

Beta coefficient of remittances (Rem) is negative -0.52, showing a negative relationship between the remittances (Rem) and FDI in the Albanian economy. P-value is 0.1019 that is greater than 0.05 and in this case we can say that the remittances have are not statistically significant on the FDI level in the Albanian economy.

CONCLUSIONS

The aim of this paper was to analyze the main determinants of the foreign direct investments in the Albanian economy in the last 20 years. After determining the main theoretical factors that influence the level of FDI we derived an econometric model to test the relationship between the FDI (*dependant variable*) and economic growth, governmental expenses and remittances (*independent variables*).

From the regression results we were able to arrive at some important conclusions as follows:

- There is a positive relationship between the GDP and foreign direct investments in the Albanian economy. This means that the economic cycle is positively related to FDI and enhances their level;
- There is a positive relationship between the governmental expenses and the foreign direct investments. From here we can deduct that when the governmental policies tend to increase the expenses the level of FDI tend to be higher;
- There is a negative relationship between the level of remittances and the foreign direct investments, but this relationship is not statistically significant and from here we can conclude that the remittances do not influence in the level of FDI in the Albanian economy.

At last, we recommend that the further researches for a better explanation of the factors that influence the FDI in the Albanian economy despite the variables that are taken in consideration in this paper (*GDP, Governmental expenses and remittances*) there can be added other factors like: cost factors, technological factors and social and cultural factors.

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