

## **FOREIGN DIRECT INVESTMENTS - A DRIVING FORCE TO THE ALBANIAN DOMESTIC ECONOMY**

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### **Abstract**

*An in-depth perspective on the economic history of Albania is substantial to analyze the role of FDI during the years. At the outset, the companies intending to invest in our country, as per rule, wage their information campaign on the market product offered, afterwards, by means of it, establish the basis of their entrepreneurship and further on build the due relations with the collaborators in the process of undertaking an international trade venture and simultaneously with the domestic entities involved. This article aims to present the FDI role in the Albanian economy, as a substantial and interrelated instrument to the very economic development of our country. It strives to bring a subsistent view of some crucial arguments favoring the FDI attraction, as a factor conditioning the domestic economic development. Among the key propounded issues are raised questions as: does a given piece of FDI involve Albanian firms in the technological integration? What are the key general conditions resulting in an effective economic integration? There are several important channels the inward FDI can grant benefits to the firms' innovation activity within the country, as being also well recognized in literature, thereof the article will attempt to draw upon these other issues as: the Albanian firms can learn about the products and technologies brought in by foreign investors, by means of reverse engineering. The Albanian companies can obtain the technological know-how by 'acquiring' the foreign skilled workers' abilities. On the other hand, the foreign products and/or technologies can inspire and stimulate Albanian innovators to develop new products and processes. Moreover the FDI can contribute to the innovation activity in the host country via spillover channels/effects, such as reverse engineering, skilled labor turnovers, demonstration effects, and supplier– customer relationships. Finally, on complying with the above purposes, the article will dare to make an overview on the theoretical and practical perspective of the FDI in Albania, over the years.*

*Keywords: Investment, Economic Integration, FDI Attraction, Innovation, Spillover Effects*

## INTRODUCTION

The Albanian economy began to open up to FDI only after the years 1990s, since then Albania has become a successful competitor for the worldwide foreign investments, but despite of that the total inflows volume has been very unevenly distributed. On yearly basis the country has received considerably more FDI per capita and the investments have contributed greatly to our economy in various sectors.

The FDI has been highly concentrated in and around the capital and main cities, meanwhile other outskirts/ locations has not been so much affected. The rural areas and depressed old industry regions have largely been excluded from the FDI inflows. The selective location of foreign capital has exacerbated the existing regional disparities reality. The FDI inflows in Albania have been high and their impact on the output was positively measurable in terms of productivity and exports.

This scenario can be attributed to the good economic performance of the FDI related enterprises (FIEs), particularly with regard to profitability, labor productivity and manufacturing exports. The transnational companies brought in their frontier technology, management techniques and skills. Albania, as a host countries benefited at least temporarily, from revenues of FDI based privatization.

The foreign exchange earnings helped to improve the balance of payments and reduce fiscal deficits as well. On the other hand, the benefits of FDI have sometimes fallen short of expectations, including its failure to significantly increase employment in the recipient country, which in turn can be explained by the fact that the positive economic effects associated with FDI may be limited.

Firstly, with few exceptions they failed to produce significant spillover effects on the domestic economy in terms of productivity growth, technology advancement, organization and management practices, competitiveness, and the creation of forward and backward linkages between FIEs and domestic firms. They contributed to becoming nodes to the international rather than to the domestic production networks. In some cases they have even crowded out domestic producers. Thereof, rather than leveling performance, FDI has tended to fuel dualism in the economic structure.

Secondly, FDI led only partly to the creation of new production sites. Often it was used for the acquisition of privatized domestic company shares. This produced neither positive effects on the domestic economic growth and employment, nor indirect effects insofar as it helped to reduce the under-capitalization and technological backwardness of domestic enterprises.

Thirdly, the absence of a pervasively positive impact on employment can be explained by the large margin of productivity improvement in the FIEs, resulting from the introduction of

labor saving technology, the elimination of slacks in staff utilization and the downsizing of staff in acquired companies. Meanwhile all this may have enhanced international competitiveness, but it rather constrained job creation.

### **WHY SHOULD FOREIGN COMPANIES INVEST IN ALBANIA?**

Any foreign company when deciding to invest in a country would previously test its interest and wage an informative campaign on getting acknowledged to a multitude of crucial factor and characteristics of the country's economy, analyzing the factors defined as 'mix' on the opportunities they aim to find exploring the new market. But which are the key factors that make our country an attractive destination for foreign companies, mentioned below:

1. Strategic Location in the Southeastern Europe- Access to Markets in Europe and the Balkan region simultaneously.
2. Free Market access.
3. Business legal framework in compliance with EU legislation.
4. Registration of opening a new business done within 24 hours at no cost incurred.
5. Investments opportunities in areas of stability and sustainable growing sectors: Renewable Energy, Tourism, Agriculture, Manufacturing, Transport & Logistics, ICT Services, Mining Industry.
6. No limitation or restrictions for foreign companies, 100 % foreign ownership possible.
7. No restrictions on profit and capital repatriation, special state protection.
8. Competitive skilled workforce. Foreign languages capacities (English, Italian and Greek are widely spoken. French and German included in the education system)

Another important feature to the FDI inflows is that they are more industry specific rather than country-specific. The paper tries to provide empirical evidence on the mix of opportunities that the European Union and other countries' foreign investors will find in Albania.

The FDI in our country will tend to improve the economic performance, which can be analyzed on the following grounds:

- The technology improvement,
- The production quality in the development process.
- The company's organization structure.
- The market organization. Etc.

### **THE FOREIGN INVESTMENT IN ALBANIA BY COUNTRY OF ORIGIN**

After opening our country's economy in 1990s, Albania became a host site and it was coveted by many countries. Our economy, stating before the '90-s consisted on a government

centralized capital economy, which meant that all the sectors were in the hand of the state-centralized government. The private sector almost did not exist. After the new democratization area the government hosted the power to start and change numerous laws, regulations and procedures on the overall economic operation, starting from the most trivial ones, to the most strategic sectors as privatization, which use to have an extremely old and consumed technology. The product of these old technologies did not meet the most imminent market needs and also their quality was too far from the required standards in order for the economy to start being functional. After the democratic changes in Albania the country opened up to the new interest of the foreign companies, which began to invest benefiting from privatization of a multitude of economic sectors, such as banking, insurance, iron factories, cement factories, brick factories, telephone companies, the mining sector, etc.. A country void of resource cannot attract any investor, but to the foreign investors doing business in our country proved more than lucrative. To a new investor it is vital to have a considerable vast know-how on the FDI flow, being before the actual year, in order to have a cadre of the odds on successfully investing in the respective market.

As it is indicated in the following table the countries having more investors in Albania are Greece, whose investment amounts to 1.070.43 million euros in 2013 and Austria with 377.94. In Albania in the year 2013 we have the below level of foreign direct investments:

Table 1: FDI origin by Countries

Values in millions of Euro

Countries	2013
Austria	377.94
Germany	106.86
Greece	1,070.43
Italy	(132.82)
USA	51.50
Lebanon	29.96
Turkey	279.34
Netherlands	350.01
Czech Republic	(307.53)
Others	720.97
<b>TOTAL</b>	<b>2,854.19</b>

Source: Bank of Albania and INSTAT

Table 2: FDI Values in millions of Euros, During the Years 2007 –2013.

Countries	2007	2008	2009	2010	2011
Austria	146.72	186.42	220.54	353.69	443.60
Germany	52.39	66.18	74.45	83.84	83.60
Greece	520.56	565.61	559.63	601.05	507.45
Italy	220.10	321.46	347.86	386.79	427.36
USA	72.44	74.91	24.10	(97.72)	(47.23)
Lebanon	29.72	40.45	36.07	28.05	29.36
Turkey	154.05	189.70	235.12	186.66	187.78
Netherlands	273.88	187.90	207.33	222.67	253.05
Czech Republic	-	0.01	55.38	(11.56)	(15.22)
Others	359.72	428.52	556.34	670.94	1,514.93
<b>TOTAL</b>	<b>1,829.58</b>	<b>2,061.15</b>	<b>2,261.44</b>	<b>2,435.97</b>	<b>3,399.90</b>

The list of top companies that have invested in Albania comprises: Raiffeisen, Devoll Hydropower, Calik Holding, EVN, Ernest & Young, Kurum, Locneed Martin, Gulf, TelekomSlovenia, CocaCola, AMC, Vodafone, Pwc, Bankers, Titan, Statoil, Conad, Bosch, Shell, Statkraf, Verbund, Kpmg, Carrefour, Uniq, Intesa Sanpaolo, Societe Generale.

## THE COMPETITIVENESS POSITION OF THE ALBANIAN ECONOMY

The actual progress is emphasized in the Index of Economic Freedom published by the Heritage Foundation and The Wall Street Journal. According to the 2012 Index, Albania's economic freedom score is 65.1 making its economy 57<sup>th</sup> freest in the world out of 164 countries/economies.

The level of economic freedom increased by 1.1 points compared to the last year's report wherein Albania was ranked the 70<sup>th</sup> freest economy with a score of 64 points.

Table 3: Regional Comparison to the Countries Growth Rate for the Year 2013

<b>Countries</b>	Annual GDP change	Annual Inflation	Unemployment rate
	2013/2012	2013	2013
Italy	-1.9	07	12.7
Greece	-3.0	-1.8	27.82
Macedonia	3.3	1.4	28.71
Serbia	3.7	2.2	20.12
Croatia	-0.6	0.3	17.41
Turkey	4.4	7.4	9.72
Kosovo	2.53	0.5	30.93
Albania	-2.3	1.9	12.81

Source: Bank of Albania; INSTAT, Ministry of Finance, IMF, CIA.AIDA

To the new investments is not so easy to be well-positioned in the market. The technology level is a highly relevant factor, accompanied by the quality of inputs and the labor force.

Moreover, since the products and technologies that FDI firms bring in have already been tested in previously operating foreign markets, the perceived risk of innovation along similar directions is considerably low to the local firms.

In order to have more possibilities they can create a higher number of alliances involving transition countries that have been forged in recent years. Alliances represent, by definition, voluntary associations of independent corporate identities. Wherein they have a genuine technological dimension, they should, therefore, reflect a common perception of scope for productivity increase in a way that cannot be assumed for foreign direct investments.

However, they want to have the chance for a big profit.

## **THE FDI RELATION TO THE ECONOMY DEVELOPMENT**

To the international financial institutions, politicians, and the vast majority of economists foreign direct investment appears to be a sort of panacea for every economic problem in the emerging market economies; its positive impact on economic growth has acquired the status of conventional fact. Economic theory namely suggests that unfettered international capital inflows foster efficient allocation of resources, which by itself should promote growth.

The economic benefits of FDI are considered to be two folded. First; FDI can help countries if domestic savings are insufficient to finance economic expansion; secondly, a foreign corporate presence is associated with positive externalities. The almost desperate efforts of many countries to attract as much FDI as possible indirectly support the theory.

However, substantial gains of inward FDI for the host countries have been much more asserted than confirmed by empirical evidence. The results of a rapidly growing number of empirical studies on the relation between FDI and economic growth differ, although most studies start with essentially the same benchmark cross-country growth model. The differences in the sets of the countries included, sample periods, data, and estimation techniques hamper comparisons across the studies (Edison et al, 2001). In many studies dealing with subsets of the countries, FDI or FDI in combination with some other factor or factors is positively related to growth, while several studies (Rodrik, 1998; Grilli and Milesi-Ferretti, 1995; Kraay, 1998) have found no significant relationship between FDI and growth. Most studies have stressed the differences among the sets of countries included regarding their trade policies, institutional characteristics, or level of development. More than three decades ago Bhawati (1978) suggested that impact of FDI on growth depends on the trade policy of a host country; in export-

promoting countries FDI would increase growth, while it would have no impact in a country with an import substitution trade policy.

His hypothesis was tested by Balasubramanayam, Salisu and Sapsford (1996); the outcome was mixed. Blomstrom, Lipsey and Zejan (1994) found that FDI only promotes growth in higher-income developing countries. Empirical studies on the subject have therefore not refuted the statement that “in general, the results of these studies indicate that the size of inward FDI stocks or flows, relative to GDP, is not related in any consistent way to rates of growth” (Lipsey, R, 2002, 55).

### **WHICH IS THE NATURE OF FOREIGN INVESTMENTS IN ALBANIA?**

Examining the data on country basis, the investments are mostly done in low-technology sectors of activity (both manufacturing and services). Foreign firms do not invest a lot in high-technology manufacturing sectors in the transition countries because of the lack of marketing and technical innovation in such fields. In Albania we have investment with lower or higher technology and some others which are a union between Albania and a foreign country.

They need to have a great position in the Albanian market. Attracting FDI in transition countries is important, but the economic condition which can block their entry. Industries that imply a higher level of technology require also a higher level of stability and certainty at macroeconomic and microeconomic level in the host country.

In the case of manufacturing activities, the methodology constructed by OECD uses two indicators of technology intensity reflecting to different degrees "technology-producer" or "technology-user" aspects: 1) R&D expenditures divided by value added; 2) R&D expenditures divided by production (OECD 2001, 2003).

In general, R&D expenditures capture the innovative and absorptive capacity of a firm. The classification of manufacturing sectors into high-technology, medium-high technology, medium-low technology and low-technology groups is made after ranking the industries according to their average over 1991-1999 against aggregate OECD R&D intensities. Industries classified to higher categories have a higher average intensity for both indicators than industries in lower categories. In the table below are showed all the percentage of level of technology which is used in sectors of activity.

Lagging behind its Balkan neighbors, Albania is making the difficult transition to a more modern open-market economy. The government has taken measures to curb violent crime, and recently adopted a fiscal reform package aimed at reducing the large gray economy and attracting foreign investment.



The economy is bolstered by annual remittances from abroad of \$600-\$800 million, mostly from Albanians residing in Greece and Italy; this helps offset the towering trade deficit.

Agriculture, which accounts for more than one-fifth of GDP, is held back because of lack of modern equipment, unclear property rights, and the prevalence of small, inefficient plots of land. Energy shortages and antiquated and inadequate infrastructure contribute to Albania's poor business environment, which make it difficult to attract and sustain foreign investment.

It is important to reach such a situation in the country that can create the possibility of economic development. It is important to achieve macroeconomic stability in order to create confidence and security for foreign investment. It is important to have economic growth, to maintain a stable level of inflation of 2-4% and not have a high level of unemployment. The possibility of approaching foreign investors in a market like ours will certainly allow development, but perhaps the other would cause a problem, that of attracting workers causing so in a sense a negative externalities. New companies established by foreign investors will tend to employ more qualified workers and more skilled, who may have been part of other businesses. On the other hand these newly created companies will not only affect the productivity of others, but the producer process too. But however we may think that this new company created by a foreign investment may have to use an advanced technology that will help their progress.

Therefore, the interesting questions that the data reveals are: why do multinationals from EU mostly invest in low-technology sectors in the transition countries? What are the factors that drive such a decision? Are there differences in the patterns of behavior of foreign investors, according to the sector of activity they are active in? We will attempt to answer some of these questions and we will check whether foreign companies behave differently according to the sector of activity. We believe that a firm and sector approach is important for the transition countries in particular.

The fact that FDI is concentrated in certain industries can affect substantially the process of economic transition and the rhythm of economic development of these countries. FDI is usually viewed as a transfer of new technologies, skills and managerial know-how between countries, but this transfer differs according to the sector of activity and it is more obvious for the high-technology sectors of activity. However, our analysis only opens the road. There are still many aspects and questions to be clarified. Previous papers on FDI in the transition countries investigated the question whether FDI is sector-specific. Altomonte (1998) points out those different sectors imply different and peculiar investment strategies by multinationals in the countries in transition.



## CONCLUSION

Upon presenting a tableau of the FDI flows in Albania, we reasonably consider the foreign direct investments to be an overwhelmingly prominent to the economic development of a country, moreover when it comes to our country which inherited a devastated centralized economy, highly problematic to foreign investors starting with the property-rights issues, the repeatedly changing laws and by-laws become a barrier to the investors creating unavoidable confusion and proceeding further on to the infrastructure, law and order, and other problematic scenarios.

But currently, with the economic and political stabilization of the country, we can now fearlessly state that our country meets all the indispensable criteria into being an eventual target and an investment-friendly environment to the foreign direct investments. On the other hand, it may be imparted that the FDI inflows are vital to a developing economy, since they are accompanied with high-tech practices and mechanisms, new prospective working culture, a considerable experience of development, foreign capital and other benefits.

Finally, we can state that the FDI inflows bring to a country the socio-economic and cultural development and integration, a similarly important indicator and a ponderous criterion to the Albania's EU integration. Thus, the remaining task to each of us and to the government in particular is to ensure and create the necessary preconditions and the due flexibility to the foreign investors as this is the only safe path to guaranteeing a sustainable capital investment contributing to the welfare and prosperity of our country.

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