

Foreing direct investments in Albania

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Abstract

Foreign Direct Investments are a very important segment in the economic activity of a country, due to the effects they bring with. This is mainly because of the trade liberalization, as well as other advantages such as higher returns on investments, potential resource seeking, new market seeking, or cheap labor force.

The issue of Foreign Direct Investment is very broad, but in concrete terms, the main goal of this article is the theoretical analysis and its impact in related policies in Albania. Another objective is closely connected with the help of government authorities to better understand the potential and effective impact of FDI in the Albanian economy and use this information in their decision-making.

Keywords: Foreign Direct Investments, FDI inflow & outflow, domestic investments, economic growth.

Introduction

Foreing Direct Investment is a new ecomic concept, and had a rapid increasing development in the last years. Driven by technological change, global competition and market liberalization, foreign direct investment can play a key role in the process of global economic integration. They create effects in the host countries as well as in the investing economies. Effects on host countries are important for the diversity and the economic, political and social importance that they generate. The benefit of these effects does not come automatically but is affected by the implementation of some specific conditions. FDI bring the necessary capital; increase the productivity of the economy through the transfer of knowledge and technology. They increase the competitiveness of the economy, reduce the impact on the current account deficit, increase employment and above all affect the welfare of the population. The increase of FDI is a key objective for the economic development of a country and the strategic priorities of governments.

FDI in theoretical perspective

Foreign Direct Investment (FDI) is a key element in the international economic integration. They create direct links between economies, and allow economies to

promote their products in the international markets. FDI is also an additional source of financing. As part of GDP (GDP) in national accounts of a country, and about national income equation:

$Y = C + I + G + (XM)$, where I is investment plus foreign investment.

FDI flow is defined as net investment (inward flow minus external leak) to buy a long term management interest (10% or more voting stock) in an entity (undertaking) that operates in a country different from that of investors. FDI is the sum of equity, other long-term capital, other capital term, as shown in the balance of payments. Usually FDI include participation in management, joint-venture, transfer of technology and skills (expert knowledge).

The definition of FDI

FDI is defined as an investment by an entity (entity) resident (direct investor) with the objective of ensuring a steady interest in an entity resident in another country (foreign direct investment unit). Sustainable economy understands the existence of a stable long-term relationship between the direct investor and unit of investment (direct investment unit) and a significant degree of influence by the investor directly to the unit's management. The main criterion used is the ownership of at least 10% of the voting power (OECD).

Another way to define them is to consider them as a net input of investments to ensure sustainable management interests (at least 10% of the voting shares - ordinary shares) in an entity that operates in a country different from the investor. It is the amount of its capital, re-investment of earnings, other long-term capital or short-term capital as indicated in the balance payments.

FDI classification

FDI nuances have taken different shapes by classifying them in 5 types (Millar, Clegg and Chrysochoidis, 1997). Below we will describe the classification based in the theoretic treatment of these three authors, along with the shapes that FDI have in the Albanian market.

The first type of FDI is made to gain access to specific factors of production, e.g. resources, technical knowledge, patent or brand names etc. owned by a company in the host country. This case is applicable when such assets are difficult to transfer or are not found in the country of origin of the investment. In Albania this can be illustrated by the example of the Turkish company "Kurum", which deals with the production and export of Albanian steel products.

The second type includes FDI made to gain access to cheaper factors of production like the workforce. The second type of FDI is developed by Raymond Vernon in his product cycle hypothesis. Such FDI are encouraged by host country governments when they apply incentives by providing some form of tax concessions or subsidies. A typical example for Albania are the clothing companies like the Italian company "Tremaglia" in Durrës, which is using the Albanian qualified workforce because it ensures minimal costs as a consequence of the relatively lower salaries. The fact is

that the cost for 1 shirt does not go beyond 2 euro/unit (official website Tremaglia). If the government is using an import substitution policy instead, foreign companies may only be allowed to participate in the home economy if they possess technical or managerial know-how that is not available to domestic industry. This case does not apply to Albania because it is largely known that our country has a long lasting dependence from imports, independently from the fact that exports have had a significant increase during last years (INSTAT).

The third type of FDI involves international competitors undertaking several investments in one another through the establishment of Joint Ventures in order to gain access to each other's product ranges. This type of FDI is largely spread as a consequence of stronger competition between similar products and achievements in research and development. This is the case of the leader Albanian company in aluminium "PESPA AL", which has performed FDI in neighboring countries like Italy, Bosnia-Herzegovina and FYROM.

The fourth type of FDI concerns the access to customers in the host country market. In this type of FDI, efforts are made to ensure the same products and services for the customers of the host country and even for the ones of the investing country. It often turns out to be almost impossible because of certain services or the inability to meet a certain kind of demand. The inability of trading some products and services in the host country has been a key factor in the growth of this type of FDI. Here we can mention companies like AMC Cosmote or Vodafone Albania, which in a short time managed to provide in Albania the same mobile services that they offer in their home country, Greece.

The fifth type of FDI relates to the trade divisionary aspect of regional integration. This type occurs when there are location advantages for foreign companies in their home country but the existence of tariffs or other barriers of trade prevent the companies from exporting to the host country. The foreign companies therefore jump the barriers by establishing a local presence within the host economy in order to gain access to the local market.

Some economists like Caves, Kojima and Narula (1971), have provided their classification of FDI from the investor point of view (the country of origin of the FDI). Caves (1971) divides the FDI in: horizontal, vertical and conglomerate. *Horizontal FDI* aim to produce the same or similar products with those produced in the home country. *Vertical FDI* on the other hand, consists in geographical division of different phases of the product life cycle. By doing so trade across borders is encouraged (within the company), and increases the likelihood of branches to export. *Conglomerate FDI* can be a mix between horizontal and vertical FDI, which involve the investment in another type of industry in the host country.

From the host country point of view they are divided into:

- *FDI import substitutes*. These include the production of goods originally imported in the host country. This type of FDI are influenced by the market, transportation costs and market barriers. FDI incremental export. Mainly related to the search of raw materials or intermediate goods.
- *FDI initiated by governments*. This has to do with government policies that offer incentives for foreign investments done in order to eliminate the deficit in the

balance of payments.

- *Initiated by the direction of investment*, FDI divided into two types: internal and external. Investments are called internal investments made by a foreign entrepreneur in the reporting economy, then the stock induction in a given moment of time refers to all direct investments by non-residents in the reporting economy. Foreign Investment are called investments made by a local entrepreneur in another country different from that of residence.

So, from what is listed above, FDI is the voice of the new century economy. Many authors have recognized several other forms of FDI which are:

"Greenfield investments"- new foreign capital which is invested under the form of shares in a company. This form of foreign investmet is the most preferred because it creates new jobs in the host country.

- *"Reinvested profit"* – although in this case the foreign capital that is provided is not entirely new, investments of this kind create opportunities to increase the capital stock, assets and productive capacity in the host country. Investments of this kind are a good indication that investors are comfortable with the business climate in the host country.

- *Loans between companies* - are capital transfers by a company abroad to another company in the country,

against the respective interest rates. This form of investment helps foreign investors to finance their

businesses and create more opportunities for them to contribute to the economic development of the country.

- *Mergers and acquisitions* - are a less acceptable form of FDI as long as they are not necessary like in the case where a state owned company with negative performance for a long time goes towards privatization. Other forms of FDI which have nothing to do with the transfer of capital and play a role in the economic development of the host country are: outsourcing, licensing, franchise agreements, etc.

Elements determinant of FDI

Terms of factors. A country creates its own important factors as resources and technology base. The position of the factors in a given time is less important than the fact that they are improving. Disadvantages local production factors cause newness. Opposite conditions as deficiencies in labor or raw materials force firms to develop new methods, and this innovation leads to a national comparative advantage.

Terms of the request. When the market for a particular product is locally wider than in foreign countries, local firms should pay more attention to the product than foreign firms,

resulting in a competitive e advantage to local firms at the time of exporting this product. A local market with higher demand leads to a national advantage. A strong local market, trend setters helps local firms to accelerate global trends.

Supporting and related industries. When local supporting industries are competitive, the

firm enjoys more cost effective and innovative inputs. This effect is enhanced when

the suppliers themselves are strong global competitive.

Strategy, structure and competition of firms. Local conditions affect in the strategy of firms. For example, German firms tend to be hierarchical, while Italian firms tend to be small and are run more like extended families. This structure and strategy helps to determine which type of industry in a national firm will be known.

Foreign direct investments in Albania

According to the UN report, foreign direct investment in the five Western Balkan countries were under 3.7 billion dollars. About a third of them, or 1 billion and 225 million dollars were invested in the economy. According to the UN, for two years, Albania has had the highest level of foreign investment in the region. But more than enhancing them here, this is a result of the strong decline of foreign capital in the region since the beginning of the crisis. The data show that compared with 2008, foreign investment in the Western Balkans have been reduced by nearly 47 percent. According to the UN, the trend has affected all countries, except for Albania, where foreign investment has not only maintained the pre-crisis growth rates, but even last year reached the highest historical level. Although according to the UN, some of them were a result of the privatization of four hydropower from "Kurum" and the resell of "ARMO" company to Heni Asset Azerbaijanis. In the recently published report on foreign direct investment in 2014, the UN notes that Albania has a positive perspective. According to the report, the TAP pipeline will generate revenue also from other chain economies, including manufacturing and transportation.

Most of the FDI in Albania, particularly in recent years have been mainly in the energy sector. But often their figures have caused debate, as some experts are sounding ones from foreign concessionary companies to reduce the burden of tax they have to pay. During 2005-2008, foreign direct investments (FDIs) in the Albanian economy had rapid growth rates. In general, foreign direct investments had a significant impact on the increase in employment, exports, introduction of technologies and modern production methods, and on services quality and variety. Foreign direct investments inflows in 2010 yielded EUR. 827.4 million, up by about 17.1% year-on-year. Foreign direct investments in 2010 were oriented mainly to the hydropower and hydrocarbon sectors. The ratio of net foreign direct investments (inflows - outflows) to nominal GDP for 2010 is estimated at about 9.4% or about up 1.6 percentage points from the previous year. Excluding privatization receipts, the inflows of foreign direct investments in 2010 increased by 66.4% compared to 2009. This change was due to a higher level of privatization receipts and the important role they played in FDI growth in 2009. In 2011, although FDI inflows increased year-on-year, a significant amount of foreign capital was repatriated resulting in a sharp drop in net FDI. FDIs made an important contribution to the financial sector, particularly in banking. Out of 16 commercial banks operating at present in Albania, 14 are foreign-owned. Following the entry of foreign banking groups into the market, the performance and competitiveness of the financial services industry has been enhanced, thus contributing to the improvement of the quality of banking services. The telecommunications sector has also undergone a rapid development, thanks to foreign investments. Three foreign capital companies

are currently operating in the field of mobile telephony.

The number of mobile phone users has reached 3 million, at an increasing level of about 92%. Due to competition in this sector, the quality and quantity of services has increased and service costs have significantly declined. After the privatization of the state-owned fixed telephony company, even in this area there is an increasing number of subscribers, significantly contributing to the spreading of internet services in the country.

Important investments have been carried out in the energy sector. Investments in search and production of oil and gas have increased due to petroleum agreements with foreign investors and companies operating in this sector, thus contributing to an increase of oil production in the country.

Important international companies have approached the electric power sector as partners in public/private cooperation, with a view to bring about by way of concession large electricity works. Concession projects in this sector aim at almost doubling the current electricity production and diversifying the energy resources by using renewable power.

Table 1 Composition of FDI inflows, in form, 2006-2011 (in million Euros)

Components	2006	2007	2008	2009	2010	2011
IHD -Total	259	481	665	717	793	742
Shareholders capital	199	487	420	516	600	755
Reinvested earnings	0	0	182	229	186	64
other capital	60	-6	63	-27	7	-77

Source: Bank of Albania

Construction Industry. Albanian investors are the most interested in investing in the construction sector. They finance about 87.1% of the total value of construction. During 2009- 2010, insufficient demand and higher financing costs caused a slowdown on this sector of the economy, which relies on domestic demand. Activity in this industry in terms of new construction fell by 22.5% for 2009 according to the Bank of Albania³⁶. Nevertheless the house price market had a slower decline. In such circumstances, investment pace was relatively lower, compared with previous years.

Mining Sector. Albania is a rich country in minerals. The most frequent ones are groundwater resources, carbonate minerals, industrial minerals, mineral rocks, sedimentary industrial minerals, chromites etc.

Albania is well known for chromium, copper, nickel and copper reserves. Both the quantity and quality of chromium are high. Before 1990 Albania was the 3rd country in Europe for chromium reserves and now it ranks as the country with the highest level of reserves in Europe³⁷. Mining industry in Albania is currently being privatized and the government is also offering concession for construction and operation in this sector. In 2000 the government signed a 30-year concession with the Italian company DARFO to exploit 50% of chromium reserves and 100% of ferro-chromium.

Power and Utilities Industry. The successful privatization of the electricity distribution

company in 2009, supported by transaction advice by the International Finance Corporation (IFC), and with a World Bank Partial Risk Guarantee, was a critical reform that is increasing the reliability of electricity supplies and ease fiscal pressures in the future. The World Bank, together with the European Bank for Reconstruction and Development (EBRD) and European adopting the principles established in the EU regulatory framework for communications. The market's growth potential has attracted international investment into both the incumbent and alternative operators. Future network development is expected in order to support the growing popularity of broadband services.

Albania's Internet market offers much growth potential due to currently low penetration levels. Internet access is available through a variety of means including dial-up, leased line, microwave radio, ADSL, WiFi and fibre. Broadband uptake is rising in response to increased availability and drastic tariff reductions. Recognizing the potential of applying information and communication technology (ICT) to improve both social and economic development, Albania has taken steps to develop a knowledgebased society, principally by improving ICT literacy. Albania's mobile market has undergone rapid growth due to competition, initially with the entrance of Albanian Mobile Telecommunication, Vodafone and later through the entrance of Eagle Mobile and Plus network. The majority of mobile users utilize prepaid services. With the mobile voice market maturing, mobile network operators are turning their attention to increase average revenue per user levels. Foreign direct investments are known to have effects on economic growth and conversely. So the higher foreign direct investment, the higher the economic growth of a country, but also the higher economic growth, the higher will be the foreign direct investment.

There is a positive relation between FDI and GDP (the amount of all goods and services produced in a country in a given time). The higher the level of GDP and the higher the level of FDI. This notes once again that the more stable economic climate is a country, the greater will be the investments made in that country.

Latest Developments in FDI Trends

For the analysis of the importance of FDI in the region of Western Balkan, we can use the data from Table 2 showing FDI inflows by host countries. Cumulative inflows of FDI are shown on a per capita basis. There is a diverging trend among selected countries. As you can see, over period of 2006-2012, Montenegro has attracted the highest inflow FDI per capita in the region (\$ 9,136.17) followed by Croatia (\$ 4,817.33) while Bosnia and Herzegovina and Macedonia have attracted the lowest levels of inflow FDI per capita.

In spite of fact that Montenegro became the first FDI destination in terms of per capita in 2011, Croatia remains the first FDI destination within region of WB (hereinafter: Western Balkan Countries) in absolute terms. Namely, Croatia has attracted more than \$ 33.3 billion, followed Serbia \$ 23.61 billion and these countries are still the top investment destination in the region. FDI flows to Croatia exceeded those in Albania, Bosnia and Herzegovina, FYR Macedonia and Montenegro, together, by some \$8.48 billion. FYR Macedonia recorded its highest level of FDI inflows at \$ 19.9 billion.

Albania registered significant growth in FDI flows in last for years. In the same period, highest level of FDI inflows is recorded in Albania. FDI inflows to Albania increased by almost 4 times.

Table 2, FDI Inflow per capita for selected countries

	Cumulative inflow FDI per capita (2006-2012)	Inflow FDI per capita 2011 (SAID \$)	Foreign direct investment, net inflows (% of GDP) (2011)	Foreign direct investment, net inflows (BoP, current US\$ in billion)
Albania	2307.44	433.85	10.55	8.77
Bosnia and Herzegovina	1330.07	98.52	2.07	7.62
Croatia	4817.33	294.45	2.04	33.38
Serbia	2636.08	372.02	4.74	4.7
Macedonia	1501.51	235.32	12.39	4.74
Montenegro	9136.17	899.16	6.23	23.61

Source: Authors calculation on Worldbank database

Although the inflow of FDI in the countries of WB in recent years has increased, most of the benefits of FDI had Croatia and Montenegro, while inflow of FDI in Bosnia and Herzegovina and FYR Macedonia was negligible. The largest portion of FDI flows to the region was associated with the privatization of telecommunications and banks. Interestingly, there was little new manufacturing investment.

The countries of WB have benefited from recent private capital inflows. Private capital flows as % of GDP to some countries exceeded 10 percent of GDP. Strong growth in private capital inflows into the country of WB from 2002 onwards is supported by the privatization of public enterprises, large-scale projects which are based on low-cost production. The upward trend in private capital flows has continued over the period from 2005 to 2007 when it reached a record level in some countries (Bosnia and Herzegovina, FYR Macedonia, and Montenegro). Meanwhile, firstly the global and EU debt crisis as well as a fact that process of privatization is coming to its end influence that since 2008 onwards recorded a drop in private capital flows. When talking about the major investors in the region, then it must be said that these transnational companies from the European Union. According to the data from Table 3 it can be seen that Montenegro has attracted the most private capital flows, as% of GDP, followed FYR Macedonia, Serbia and Albania recently. It's also interesting to note that Albania, Bosnia Herzegovina and Croatia received a similar amount of private capital flows.

Table 3, Private capital flows, total (% of GDP) over the period 2000-2011

	Average	St.Dev	min	max
Albania	4.69	2.97	2.21	11.91
Bosnia and Herzegovina	4.49	3.5225	0.26	13.36
Croatia	4.88	3.2402	0.09	8.74
Montenegro	25.52	8.0941	18.5	36.88
FYR Macedonia	6.49	3.0567	3.23	10.57
Serbia	5.68	3.4202	1.39	13.09

Source: Authors calculation on Worldbank database

The presence of foreign investors and the growth of inflow FDI in the region of WB was motivated by many factors including:

- geographical proximity to EU market that allowed favorable conditions for attracting foreign investors who relocated part of its production to countries with cheaper labor and less stringent work regulation. In previous years it has been shown that the effect of geographic proximity is an important factor that influenced on high level trade exchanges with the EU gave companies from EU a major competitive advantage in initiating the international expansion of their activities in neighboring countries.
- opportunity to expand their market share to the organization of production in WB (and thereby reducing transportation costs) or to use in the production of these countries as a platform for expansion into larger markets in other regions.

Thanks to the reforms and the promising economic outlook region of WB become a place where investors with regional ambitions had the greatest potential for cross border expansion. This is especially important in the context of the region's aspiration to join the EU.

There are considerable differences in FDI flows between countries of WB. The following figures below show the inflows and outflows of FDI over the period 2005-2011 for the WB.

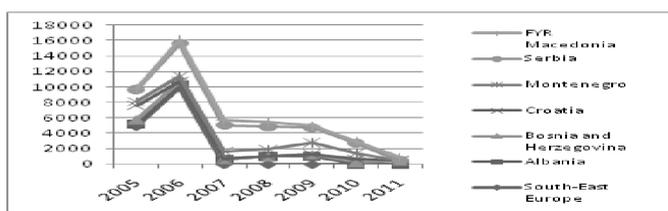


Figure 1 FDI inflows economy, 2005-2011 (Millions of \$)

Source: Derived from the UNCTAD, FDI/TNC database

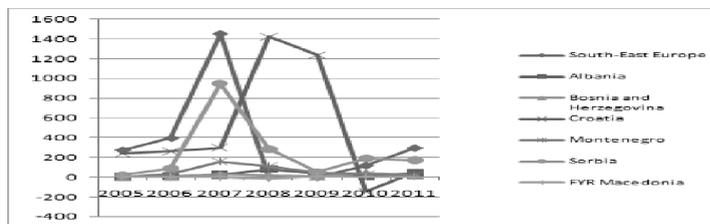


Figure 2 FDI outflows economy, 2005-2011 (Millions of \$)

Source: Derived from the UNCTAD, FDI/TNC database

Expansion of capital flows on a global level over the period of 2005-2007, has influenced the significant growth of capital flows into the countries of WB region. FDI inflow was significant and had a positive effect on the whole economic and political environment of the countries in the region. However, the global financial crisis has affected these flows. In 2008 most countries of the region have been hit by the effect of the global crisis caused fall in investment flows.

Another way of looking at difference in outflows of FDI across selected countries is presented in Figure 2. Among analyzed countries, FDI outflows increased only in Serbia Bosnia and Herzegovina. The first growth interval of FDI is represented by the period of 2005-2007 when FDI gradually grew from 4876 mil.\$ in 2005 to 5725 mil.\$ in 2007 and second one when FDI recorded decline from 5475 mil \$ in 2008 to 857 mil. \$ in 2011.

Conclusions

According to the report of UN, foreign direct investment in the five Western Balkan countries were under 3.7 billion dollars. About a third of them, or 1 billion and 225 million dollars were invested in the economy. According to the UN, for two years, Albania has had the highest level of foreign investment in the region.

In the recently published report on foreign direct investment in 2014, the UN notes that Albania is positive perspective. Foreign direct investments had a significant impact on the increase in employment, exports, introduction of technologies and modern production methods, and on services quality and variety.

Almost all the service sector FDI in Albania has resulted from the privatization process or from companies establishing in Albania to access the domestic market. The Government of Albania has played an important role on improving the business climate in Albania. In order to increase FDI, the GOA has developed a set of fiscal and legislative policies.

The WB countries have not enjoyed the benefits of the globalization process, and feel the consequences of its major defects. Macroeconomic stability in these economies is still very fragile. When it comes to overall FDI flows, it becomes apparent the growth in FDI is far less pronounced or several times lower than in the more advanced transition economies.

In addition, the increased competition in the free trade area should be to create conditions to facilitate the integration of the Western Balkans into the EU. FDI would have the effect of changing the structure of production and exports, which had an effect on the increase of exports to GDP and increase the competitiveness of companies in foreign markets.

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