

The impact of foreign direct investments on economic growth and employment in Albania

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Abstract

Albania has experienced a growing performance of FDI inflows after the 1990s. This has been due to the fact that Albania has managed to create a liberal regime for foreign investment. This positive attitude towards these financial flows derives from the prospect of benefiting from them. These positive effects driven by foreign investors are diverse in terms of economic growth, the spread of technologies, the improvement of deficits, employment, technology, and so on. The purpose of our paper is to investigate some of the effects of foreign direct investment. We will analyze the impact of FDI on economic growth, technology transfer, gross capital formation, budget deficit financing through a descriptive analysis of data published by various institutions such as World Bank, UNCTAD and Ministry of Finance etc. The impact of FDI inflows into employment levels will be investigated through an econometric analysis based on secondary data.

Keywords: foreign direct investment, technology transfer, employment, economic growth, gross fixed capital formation.

Introduction

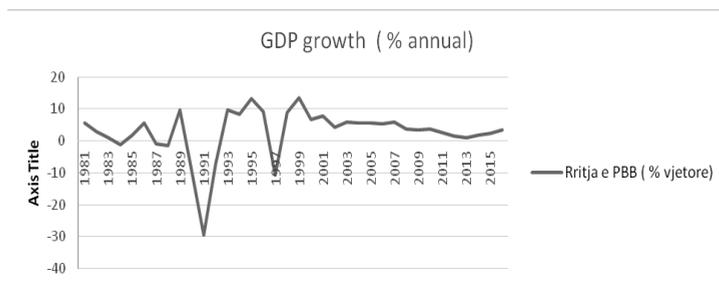
Albania, like other developing countries, is characterized by friendly policies in the absorption of foreign direct investment flows. This is because of the absence of domestic capital. Foreign investment is one of the most important sources of economic development in the country. The expected positive effects in the host country spread in many dimensions. Foreign investment brings advanced technology, helps in gross fixed capital formation, helping the country's economic growth. But one of the most desirable effects is the level of employment. This is because employment is an indicator of economic condition and it is also a social indicator. Albania is characterized by low levels of employment. After the collapse of communism, employment became a plague for the Albanian economy. Although Albania has absorbed a satisfactory share of foreign investment in the region¹, employment performance has not reflected this trend.

¹ According to: The Vienna Institute for International Economic Studies, Albania was ranked second in the region, after Serbia for the volume of inflows of foreign direct investment in 2016. <https://wiiw.ac.at/press-release-wiiw-fdi-report-2017-english-pnd-36.pdf>.

1. The economic situation in Albania in recent years

Albania, like almost all countries in Southeast Europe, has begun the path toward free market economy relatively late. After the collapse of communism in the 1990s, Albania was a poor country with many bearing problems. In these years, Albania experienced a negative economic growth.

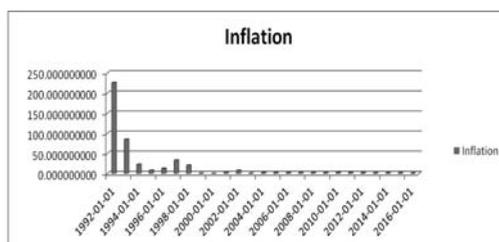
Graph 1.1 GDP growth (% Annual)



Source World Bank, <https://data.worldbank.org/country/albania>

The industrial sector, which had been a promoter of the economic performance of communist Albania, for Albania already in an open economy was very outdated and not competitive. In these first years of transition, Albania had to undertake a number of important reforms. These reforms were numerous and multidimensional. They spread in all spheres, in political, legal, and institutional economics. Since the late 1990s and so far, the government has undertaken a number of structural reforms, including land reform, financial market reform, price liberalization and privatization (Luci, Frasheri, 2015). Through these reforms, the goal was to restore a macroeconomic equilibrium in the country. An indicator of Albania's situation in the early years of democracy is the level of inflation in the country. Inflation in 1992 was 226%. Albania's good economic performance was reflected in lowering inflation.

Chart 1.2 Inflation rate (% of annual change)



Source: World Bank, <https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>,

As a result of all efforts undertaken by Albanian governments over the years and the support of international organizations, Albania's economic growth has marked

satisfactory levels.

The main objectives of Albanian governments in these years have focused on achieving a fast economic development and membership in the European Union. For these purposes, the policies developed focusing on improving business conditions and absorbing foreign direct investment (FDI). Nowadays Albania can be considered an economy with an open regime for trade and foreign investment.

Table 1.1 Data on the Albanian economy

	2012	2013	2014	2015	2016	2017
GDP per capita(USD)	4,232	4,342	4,584	3,926	4,523	4,805
GDP (USD Billion)	12.3	12.6	13.3	11.3	11.9	14.4
Economic Growth (GDP, annual change in%)	1.4	1	1.8	2.8	3.4	3.8
Composition						
Consumption	0.1	1.4	2.5	-1	0.9	1.1
Investment	-2.8	-0.6	-1.2	2.9	2.8	2.5
Exports Net	4.7	-1.6	-2.1	0.8	-0.5	-0.1
Exports	-0.4	-7.2	0.9	-0.1	1.6	3.2
Imports (-)	-5.1	-5.6	3	-0.9	2.1	3.3
Inflation, consumer prices (annual change in%)	2	1.9	1.6	1.9	0.9	1.5
Exports (% of GDP)	15.4	17.6	9	8.3	7	6.9
Imports (% of GDP)	35.6	34.9	29.9	29.6	31.6	32
Trade Balance (% of GDP)	-18	-17.5	-20.9	-18.2	-20.8	-21.6
Incoming FDI (% of GDP)	6.5	9.2	8.2	7.4	7.1	7.1

Source: INSTAT, Bank of Albania, World Bank.

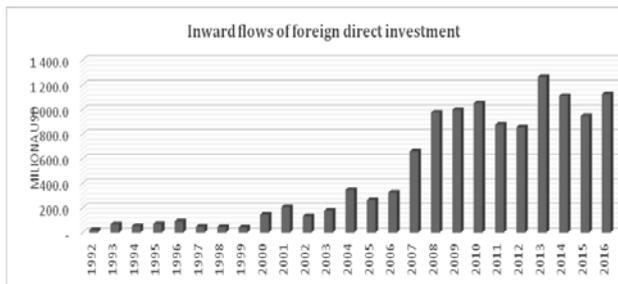
In 2016-2017, Albania experienced an upward rate of economic growth. In these years, economic growth went from 2.8% to 3.8%. An important contribution to this improvement in terms of economic growth has been the growth of the construction sector and the formation of gross capital from the Trans Adriatic Pipeline project and the increase in exports of goods and services. Albania's economic growth in 2017 was 3.8%. This increase came as a result of increased investment and private consumption. Net exports impacted by 0.1% in economic growth. By the end of 2017, the Albanian economy experienced a slowdown in growth. This is partly attributed to the fact that the investment from the Albanian Pipeline is coming to an end. The economic forecast for Albania is generally positive, but not so optimistic, with an average growth of 3.6% for 2018-2019. This effect is attributed to the completion of two major projects in the energy sector,²⁴.

²⁴ "World Bank Group. 2017. Western Balkans Regular Economic Report No. 12, Fall 2017 : Job Creation Picks Up. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org>

2. FDI inflows into key economic indicators

For Albania, as well as for all countries in transition, foreign direct investment represents one of the new forms of financial capital, especially during the transition period to the market economy. Foreign Direct Investments in Albania began to appear mainly in the 2000s, at the beginning of this new century. Initially, the number of FDIs was relatively small, but over time they began to grow significantly.

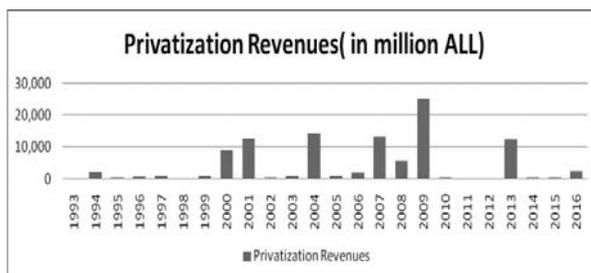
This is due to the adoption of laws focused on foreign investors since the first years of transition, As can be seen from Chart 1.3, the value of foreign direct investment (measured in USD has been fluctuating over the last 25 years).



Graph 1.3 Foreign direct investment inflow, 1992-2016

Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

After the 2000s, the Albanian government focused mainly on privatization reforms as a potential source for attracting potential foreign investors. This effort proved to be successful as one after the other privatized several important enterprises, thus increasing the participation of foreign capital in Albania. During these years an important part of state-owned enterprises was privatized. Year 2009 marks the highest value of privatization incomings.³ The sale of shares of the power distributor (OSSh) to the Czech company CEZ helped maintain a positive FDI performance and recorded almost the largest share of privatization proceeds. Privatization proceeds helped to finance the budget deficit.



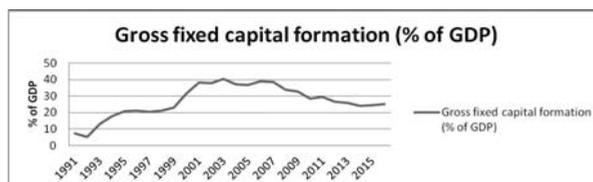
Graph: 1.4 Revenues from privatization over the years

[org/handle/10986/28883](https://doi.org/10.2478/10986/28883) License: CC BY 3.0 IGO.”

³ In a study by Boubakri et al. (2011), it has been suggested that privatization could create an opportunity to improve the investment climate.

Source: Ministry of Finance.

Also, these numerous privatizations positively influenced the formation of gross fixed capital in Albania. Gross fixed capital formation is a very important measure of a country's economic performance. In years of successful privatization, almost the vast majority of foreign investors, there has been a sharp increase in GFCF as a result of investments in the modernization of production lines privatized by foreign investors.



Graph: 1.5 Gross fixed capital formation over the years

Source :World Bank , <https://data.worldbank.org/indicator/NE.GDI.FTOT.ZS?locations=AL>
 After 2010, foreign direct investments emerged in the form of Greefield Investments. These investments were directed towards the energy and oil and gas sectors. The Hydropower Plant on the Devoll River by "Statkraft" is a major investment in the production of renewable energy. This project increases the ability to attract other investments in the energy sector. In 2016, foreign investments again marked a significant increase. A significant part of this value is investment for Trans Adriatic Pipeline. This investment also changed the structure of FDI by sectors, significantly increasing the energy sector. Tap and Statkraft's investment effects are such that affect Albania in the short term and may affect the long run.

Table 1.2 Impact of two TAP and Statkraft projects in the short term

Project	Infrastructure added	Project Cost (Bn euro)	% of GDP	Employees in 2017 (in thousand)
Statkraft Devoll Hydropower plant	: Two hydropower plants 256 MW (17% of the country's capacity)	0.5	4.7	1.7
Trans Adriatic Pipeline	Natural gas pipeline: 252 Km (capacity to supply 7M households)	1	9.3	1.8

Source: IMF

After construction in the short term, Albania is not expected to benefit from the Trans Adriatic Pipeline investment to promote the creation of new jobs, as there is no infrastructure for its use. In order for Albania to benefit from the project, the government should make it possible to build an internal gas transmission network.

This will make the domestic business reduce production costs. Otherwise with the end of these projects, the impact on economic growth will disappear. Thus, the situation of Albania, which supports investments with foreign capital, is problematic as it presents very low levels of savings.

Table 1.3. The impact of two TAP and Statkraft projects on economic growth

	2014	2015	2016	2017	2018	2019	2020
% of GDP							
FDI related to TAP/Statkraft	0.8	2.7	3.8	3.8	2.3	0.8	0
from which imports	0.5	1.9	2.7	2.6	1.5	0.45	0
from which internal expenses	0.3	0.8	1.2	1.2	0.7	0.35	0
%							
The effect on GDP growth	0.3	0.5	0.3	0.1	-0.5	-0.4	-0.3

Source: IMF

Another positive effect of foreign direct investments in Albania is that of bringing new technology. In fact, foreign direct investments are considered to be the best technology distributor, rather than export or direct sales. Albania being a predominantly importing country has the potential to increase the import of technology. This import is also made by direct foreign investors. A technology transfer rate in the host country is also the technology transfer index. In Albania, this index has been increasing.



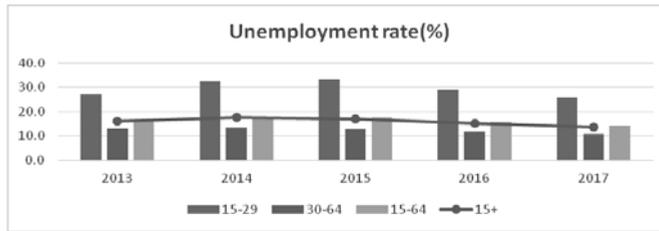
Graph: Technology transfer index in Albania

Source: worldbank/tcdata360.worldbank.org/indicators/h2b4ffaf7?country=ALB&indicator=717&viz=line_chart&years=2007,2017

3. Impact of FDI in employment level in Albania

Albania has a relatively young average age, which means that active force should be an indicator of a positive approach to economic development. But Albania is characterized by low levels of labor force participation.⁴ Albania is also characterized by a high unemployment rate.

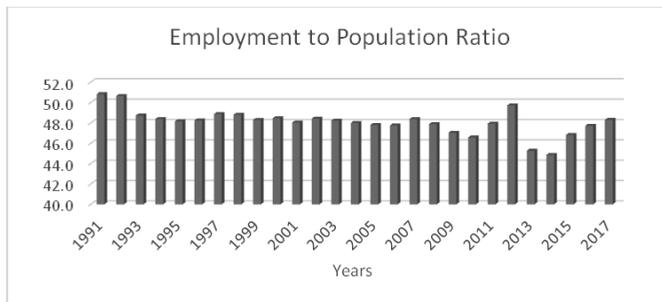
4 <http://www.ippm.al/wp-content/uploads/2017/06/Raporti-i-Tregut-t%C3%AB-Pun%C3%ABs-Final.pdf>.



Graph 3.4. Unemployment rate by age groups, Period 2013-2017

Source: Labor Force Survey 2013-2017

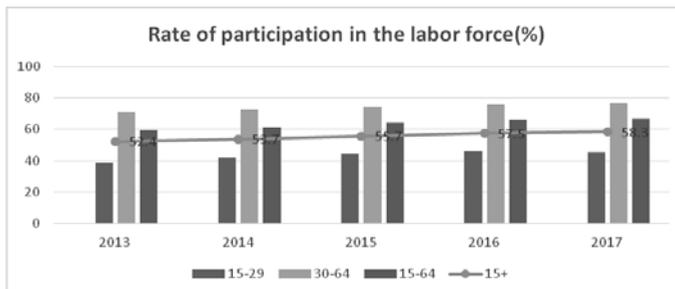
According to the figures published by the World Bank and the statistics institute data, in Albania in the period since 1990 the employment rate has been declining. Only in recent years the employment rate has been upward.



Graph:Employment to population ratio for Albania

Source: World bank, <https://data.worldbank.org/indicator/SL.EMP.TOTL.SP.ZS?locations=AL>

Based on the Labor Force Survey estimates, during 2017, the number of persons in the labor force is 1,385 thousand. The participation rate in the labor force for the population aged 15-64 is 66.8%.



Graph 3.3. Rate of participation in the labor force, Period 2013-2017

Source: Labor Force Survey, 2013-2017

One of the desired effects of FDI in the host countries is that of increasing employment. A large number of scholars support the view that FDIs stimulate growth and increase the employment rate of a host country (Waldkirch, Nunnenkamp, & Alatorre Bremont, 2009; Chinyelu, 2014). This effect becomes very important for countries with less domestic capital (Kurtishi-Kastrati 2013). However, there is a possibility that these effects are unfortunately short-lived (Balcerzak & Żurek, 2011).

Even, the effect can be negative (Onimisi, 2014). Thinking that the expectation of FDI impact on employment is positive, the negative effect of FDI on employment levels would be a reflection moment for improving the foreign investment monitoring process.

Empirical analysis

We have applied an OLS model to see if foreign direct investment inflows affect employment rates. The OLS model is based on the following equation:

$$EMP = \beta_0 + \beta_1 FDI_t + e_t$$

Where: β_0 = constant

β_1 = Independent variable coefficient

FDI = independent variable foreign direct investment (FDI)

EMP = Dependent variable employment to population ratio

e = residual of regression

Data on foreign direct investment are inflows of foreign direct investments, measured in million dollars, published by Unctad. Employment to population ratio are data published by the World Bank.

Results of influence of Fdi on Employment

Source	SS	df	MS	Number of obs =	24
Model	11.6137247	1	11.6137247	F(1, 22) =	16.43
Residual	15.5487008	22	.706759127	Prob > F =	0.0005
				R-squared =	0.4276
				Adj R-squared =	0.4015
Total	27.1624255	23	1.18097502	Root MSE =	.84069

EMP	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
FDI	-.0016001	.0003947	-4.05	0.001	-.0024187 - .0007815
_cons	48.63115	.2598829	187.13	0.000	48.09219 49.17012

The model itself is reliable because Prob > F = 0.0005 is less than 0.05. We see that Adj R-squared = 0.42. This indicates that 40% of the Y (Employment) variation is explained by Fdi. And FDI is an important factor because P> |t| = 0.001, it is therefore less than

the level of importance 0.05.

While the coefficient $B = -0.0016$ means that if FDI increases by \$ 1 million, the employment rate will be reduced by 0.0016%. According to the econometric analysis in Albania, FDIs negatively affects the employment rate.

Conclusions

Foreign direct investments in Albania, in absolute value, have increased over the years. Foreign direct investment has taken the form of "Mergers and acquisitions" as a result of the privatization process of former state-owned enterprises. The short-term effect of privatization has been positive, as it has resulted in increased privatization incomings. These revenues have helped finance the budget deficit. Also foreign direct investments have positively impacted the spread of technology, as the technology transfer index of technology has been growing. Also recent foreign direct investment in the energy sector has helped to increase gross fixed capital formation in Albania. The effect of these projects on economic growth unfortunately is short-term. In order to benefit in the long term from these projects, Albania government should create opportunities to be a natural gas user from the Trans Adriatic Pipeline. Use as a raw material of natural gas would help reduce production costs for domestic businesses. The conclusions of the econometric model that investigated the impact of foreign direct investment in employment to population ration showed in fact a negative effect. This can be explained by the fact that privatized enterprises were enterprises with a large number of workers. At the moment of privatization, for reasons of increased efficiency, multinational companies have increased the production automation. This has negatively affected the level of employment. The privatization process in Albania has created two opposing forces. On the one hand, it has created new jobs, and on the other has reduced the number of jobs. The later has been preminent. Albania has not implemented structural reforms effectively and the privatization process has not provided the desired effects. Albania needs to review the policies of absorbing foreign direct investment, with the focus being on employment growth, especially the long-term effect.

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