

FDI in Albania: Rule of Law as a social Requisite for the development of a fair and not predatory market economy

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Abstract

Foreign Direct Investment (FDI) plays an important and growing role in global business. For the host country, it can provide a source of new technologies, capital, processes, products, and management skills, thus providing it with a strong impetus for economic development. In its classical definition, Foreign Direct Investment is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment.

Proponents of foreign investment point out that the exchange of investment flows benefits both the home country and the host country. Opponents of foreign direct investments stress that multinational conglomerates are able to wield great power over smaller and weaker economies and can drive out much of local competition.

Of extreme importance in deciding to invest in a foreign country, is the 'new market access. Any decision in investing is thus a combination of a number of key factors, including:

- Assessment of internal resources;
- Competitiveness;
- Market analysis;
- Market expectations

Two categories addressed by World Bank's 'Doing Business' in ranking economies on ease of doing business are 'protecting investors' and 'contract enforcement'. The concept of Rule of Law and its presence in a business culture impacts both of these topics.

The basic premise of the Rule of Law is that no one is above the law. This applies to government as well as the common people, and it is contrary to authoritarian governments and arbitrary rules of processes of law. In order for businesses to succeed, Rule of Law is vital. It requires the equitable application and enforcement of legislation, and safeguards of the rights of individuals. It is also a concept that is not strongly embedded in the business culture of developing countries.

Keywords: FDI, Albania, Rule of Law, social Requisite, market economy.

Introduction

Politicians, lawyers, economists and policy-makers, all different actors, often use the term "rule of law" to characterize a certain type of legal-political regime. As the pace of globalization has increased in the past two decades, many developing countries have prioritized their policy agendas to promote the rule of law.

The rule of law does not have a precise definition, and its meaning can vary between different nations and legal traditions. Generally, however, it can be understood as a legal-political regime under which the law restrains the government by promoting certain liberties and creating order and predictability regarding how a country

functions. In the most basic sense, the rule of law is a system that attempts to protect the rights of citizens from arbitrary and abusive use of government power.

1. Elements of the Rule of Law

In his book *The Morality of Law*, (first published in 1969 by Yale University Press) American legal scholar Lon Fuller identified eight elements of law which have been recognized as necessary for a society aspiring to institute the rule of law. Fuller stated the following:

- i. Laws must exist and those laws should be obeyed by all, including government officials.
- ii. Laws must be published.
- iii. Laws must be prospective in nature so that the effect of the law may only take place after the law has been passed. For example, the court cannot convict a person of a crime committed before a criminal statute prohibiting the conduct was passed.
- iv. Laws should be written with reasonable clarity to avoid unfair enforcement.
- v. Law must avoid contradictions.
- vi. Law must not command the impossible.
- vii. Law must stay constant through time to allow the formalization of rules; however, law also must allow for timely revision when the underlying social and political circumstances have changed.
- viii. Official action should be consistent with the declared rule.

Standing alone, these eight elements may seem clear and understandable. But they are actually difficult to implement in the real world because governments are often compelled to prioritize one goal over another to resolve conflicts in a way that reflects society's political choices. For example, making too many laws that are too detailed and specific may make the legal system too rigid. Inflexibility could cause the courts (judiciary) to neglect the human element of each particular case. Additionally, instead of only applying prospectively, some laws are meant to apply retroactively, or to past conduct, because they were passed with the specific intent of correcting the conduct in question. Fuller recognized these conflicts and suggested that societies should prepare to balance the different objectives listed above.

The conventional wisdom correctly argues that FDI is a vital aspect of economic development. Rather than a pernicious force, foreign investment is generally beneficial to a host country. The conventional view is also correct in recommending that developing and transitional countries undertake measures to encourage and promote FDI.

However, the view that attraction of FDI can occur only by "modifying and, sometimes, completely overhauling the legal and institutional framework and firmly establishing the rule of law," at least as it relates to post-communist countries, and probably Albania is not correct. A legal and judicial system that includes consistent, modern legislation and effective and efficient courts and regulatory institutions that interpret and enforce the laws in a fair and transparent manner is a desirable and laudable goal and, all things being equal, a country that has such an ideal system will attract more FDI than one that does not. Additionally, a foreign investor will generally prefer a country whose legal system is developed, fair, open, and transparent to one

in which the rule of law is absent. Nevertheless, many argue that the existence of such a good system is often not the decisive factor in attracting foreign investment.

2. Issues and problems associated with RoL

In Albania, as in most of former communist countries, who transformed from centrally controlled, into free market economies, there were several hurdles along the way of reform.

Legislative Reform. Reform of commercial legislation proved to be for Albania, a tedious process characterized by a continuous and seemingly unending series of small, incremental changes.

The Role of Inexperienced Legislators. Very few legislators and drafters of commercial legislation have had the necessary understanding of how business transactions were carried out in well-established market economies. Often parliamentary drafting committees or governmental agencies were staffed with civil servants or academics with a limited theoretical understanding of how a market economy functions, but with little practical business experience or understanding as to how private actors would respond to poorly drafted or enforced legislation.

Laws Lag Behind Actual Transactions. The legal system is generally several steps behind what is occurring in real world business transactions. This is not surprising: it is a rare legislator or government that is capable of foreseeing future trends in the marketplace. As a result, legislation dealing with cutting-edge legal issues in the commercial context almost always follows actual transactions taking place in the market.

Inadequate Consultation with Foreign Investors and Other Affected Parties. Although many changes in legislation were either induced by pressure from the investment community or were intended to reflect new innovations occurring in the host country's marketplace, very rarely did the drafters of the legislation consult with foreign investors or the lawyers and accountants representing such investors.

Foreign Investors—The Ideal Source for Identifying Legislative Deficiencies. The foreign business community and its legal and accounting advisors have represented the most efficient and accurate mechanism for identifying inadequacies and problems in existing commercial legislation and regulations. Foreign investors have put their own funds at risk in transactions and spent considerable sums on legal and accounting advice in order to understand the *exact* deficiencies in the existing legislation as it relates to their investment. If one purpose of legal reform efforts is to create conditions that attract foreign investment, then no actor is better placed to understand and explain the precise necessary changes in a given country than those entities investing in that country.

3. Investment Climate in Albania

With its developing market economy, Albania offers many opportunities for investors - property and labour costs are low, the young and educated population is ready to work, and tariffs and other legal restrictions are low in many cases and being

eliminated in others. Albania's location offers a notable trade potential, especially with EU markets - it shares a border with Greece and is just across the Adriatic Sea from Italy. Albania has also entered into free trade agreements with all Balkan countries creating the opportunity for trade throughout the region.

The Albanian economy in recent years has experienced an economic increase in real terms of approximately 5-6%. Inflation had been kept under control at 2-3% with an average inflation rate of about 2.4% in 2007.

Unemployment for in 2006 decreased by approximately 0.3% compared to 2005 when unemployment was 4.3%. The national income per capita estimate for 2006 is US\$2.903 per capita.

The Albanian economy is now an open economy with fully liberalized trade and a completely privatized banking sector. Some of the best known international banks currently operating in the market include Raiffeisen International, Société Générale, and San Paolo. Their presence and the strength of the banking sector have boosted financing in the economy.

Albania offers a considerable amount of natural resources including oil, gas, coal, iron, copper, chrome, water, and hydroelectric potential. In Albania there are more than 1,000 foreign owned companies from Italy, Greece, Germany, Austria, Turkey, Bulgaria, UK, USA, etc...

The Albanian Government has signed agreements on FDI promotion and protection with several countries of the region and others worldwide such as: Ukraine, Macedonia, Slovenia, U.S.A, Turkey, Austria, Bulgaria, Denmark, Egypt, Germany, Russia, Sweden, England, Czech Republic, Netherlands, Malaysia, Romania, Croatia, Poland, Tunisia, and Switzerland, but not Italy.

Business Climate Improvement

Taxes and fiscal burden

The Albanian government has applied a set of liberal fiscal policies during the last few years, drastically reducing fiscal burden, social security, and health contributions. These policy measures consist of:

- Reduction of corporate and personal income taxes, implementing a "Flat tax" of 10% by the end of 2007.
- Unification of the simplified profit tax and the tax on small business as defined in the new Law no. 9632, "On local taxes in the Republic of Albania", dated 30.10.2006. According to this law, local authorities are now responsible for the collection of the new tax.
- Reduction of the fiscal burden of social security paid by employers from 29% to 20%.
- A 30% reduction of electricity rates for businesses.
- A tax exemption of dividends designated for investments.

Business registering procedures

- In the framework of Regulatory Reform, businesses in Albania are only required to register once with the country's tax authorities.
- A new Law on business registration reform was enacted by the Parliament on May

3, 2007. Law no. 9723 “On the National Registration Center” establishes the National Registration Center (NRC) as a new central public institution.

- The National Registration Center has opened in September, 2007 and all business activity can be registered in one day with a cost of 1Euro at the One-Stop-Shop Office.

Business Licensing

- Albania’s entire legal licensing system is under revision. The purpose of this process is to adjust licensing legislation to the “Acquis Communautaire” as well as to reduce administrative barriers for businesses operating in Albania. The Albanian Parliament has already ratified the revised licensing legislation on mining and public works while those of other sectors are still in progress.

- A broad simplification of licensing procedures has been completed in many sectors including, hydrocarbon, mining, public works, health, and the environment.

Concession Law

The new Law no. 9663 “On concessions”, dated 8.12.2006, has been approved by the Albanian Parliament. Its primary goals are to establish the necessary framework for the promotion and facilitation of concessionary project implementation, increased transparency, and project sustainability. The law applies to several public sector services including transportation, power production and distribution, telecommunication, etc.

FDI Situation

Foreign direct investments play an important role in covering current and fiscal deficit. These investments promote technology transfer, improve employment opportunities, as well as help domestic businesses further expand their activity in foreign markets.

The total amount of FDI in 2006 reached approximately 260 million Euros, a 20% increase from 2005. This figure does not include contributions from strategic privatizations.

FDI by sector 2004 – 2006 (in million USD)

Sectors	2004		2005		2006	
	value	%	value	%	value	%
Industry	35	10.3	70	28.6	130	32.5
Transport	40	11.7	55	22.5	30	7.5
Telecomm.	100	29.3	40	16.3	140	35.0
Services	151	44.3	40	16.3	47	11.8
Others	15	4.4	40	16.3	53	13.2
Total	341	100.0	245	100.0	400	100.0

FDI Legal Provisions

In 1994, Albania enacted law no.7764, dated 02.11.1994 “On Foreign Investments” which creates a favourable investment climate for foreign investors. The law offers guaranties to all foreigners (either physical or judicial persons) willing to make business investments in Albania. The provisions include:

- No prior government authorization is needed and no sector is closed to foreign

investment.

- There is no limitation on the percentage share of foreign participation in companies - 100 percent foreign ownership is possible.
- Foreign investment may not be expropriated or nationalized directly or indirectly, except in special cases, in the interest of the public, defined by law.
- Foreign investors have the right to expatriate all investments in the form of funds and contributions in kind.
- The most favorable treatment according to international agreements.

No distinction is made between foreign and domestic investors in law no.7638 dated 9.11.1992, "On Commercial Companies" which regulates the activities of companies and establishes the type of legal structure under which companies may form Albania's tax system also does not discriminate against foreign investors. Legislation concerning the public procurement process makes little distinction between foreign and domestic firms.

Dispute Resolution

Investors in Albania are entitled to judicial protection through rights related to their investments. Should there be a dispute; parties may submit claims to an arbitration institution for consideration. Foreign investors also have the right to submit disputes to an Albanian court or to the Arbitration Court in Tirana. Provisions on domestic and international commercial arbitration can be found in the Code of Civil Procedure.

Laws and Regulations on Foreign Direct Investment

The Law on Foreign Investments seeks to create a hospitable legal climate for foreign investors and stipulates the following:

- No prior government authorization is needed for an initial investment;
- Foreign investments may not be expropriated or nationalized directly or indirectly, except for designated special cases, in the interest of public use and as defined by law;
- Foreign investors enjoy the right to expatriate all funds and contributions in kind from their investments; and
- Foreign investors receive most favored nation treatment according to international agreements and Albanian law.

There are limited exceptions to this liberal investment regime, most of which apply to the purchase of real estate. Agricultural land cannot be purchased by foreigners and foreign entities but may be leased for up to 99 years. Investors can buy agricultural land if registered as a commercial entity in Albania. Commercial property may be purchased, but only if the proposed investment is worth three times the price of the land. There are no restrictions on the purchase of private residential property.

To boost investments in strategic sectors, the government approved a new law on strategic investments in May 2015. Under the new law, a "strategic investment" may benefit from either "assisted procedure" or "special procedure" assistance from the government to help navigate the permitting and regulatory process. To date, no major foreign investors have taken advantage of the law. Several projects proposed by domestic companies or consortiums of local and foreign partners have been designated as strategic investments, mostly in the tourism sector.

Major laws pertaining to foreign investments include:

- Law on Strategic Investments: Defines procedures and rules to be observed by government authorities when reviewing, approving, and supporting strategic domestic and foreign investments in Albania;
- Law on Concessions and Public Private Partnerships, amended in 2019;
- Law on Foreigners, amended in February 2020;
- Law on the Foreign Investments, amended by the Law;
- Law on Entrepreneurs and Commercial Companies: Outlines general rules and regulations on the merger of commercial companies;
- Law on Cross-Border Mergers: Determines rules on mergers when one of the companies involved in the process is a foreign company
- Law on Protection of Competition: Stipulates provisions for the protection of competition, and the concentration of commercial companies; and
- Law on Collective Investment Undertakings: Regulates conditions and criteria for the establishment, constitution, and operation of collective investment undertakings and of management companies.

Authorities responsible for mergers, change of control, and transfer of shares include the Albanian Competition Authority (ACA: <http://www.caa.gov.al/laws/list/category/1/page/1>), which monitors the implementation of the competition law and approves mergers and acquisitions when required by the law; and the Albanian Financial Supervisory Authority (FSA: <http://www.amf.gov.al/ligje.asp>), which regulates and supervises the securities market and approves the transfer of shares and change of control of companies operating in this sector.

Albania's tax system does not distinguish between foreign and domestic investors. Informality in the economy, which may be as large as 40 percent of the total economy, presents challenges for tax administration.

Visa requirements to obtain residence or work permits are straightforward and do not pose an undue burden on potential investors. The government amended the Law on Foreigners in February 2020. The amendments remove restrictions on foreign employees and streamline the visa and work permit processes for foreigners and foreign workers by introducing online visa application process, simplifying and accelerating the working permit process, and providing the same access to the labor market for citizens of Western Balkan countries as the United States, EU, and Schengen-country citizens have.

The Law on Entrepreneurs and Commercial Companies sets guidelines on the activities of companies and the legal structure under which they may operate. The government adopted the law in 2008 to conform Albanian legislation to the EU's *Acquis Communautaire*. The most common type of organization for foreign investors is a limited liability company.

The Law on Public Private Partnerships and Concessions establishes the framework for promoting and facilitating the implementation of privately financed concessionary projects. According to the law, concession projects may be identified by central or local governments or through third party unsolicited proposals. To limit opportunities for corruption, the 2019 amendments prohibited unsolicited bids, beginning in July 2019, on all sectors except for works or services in ports, airports, generation and distribution of electricity, energy for heating, and production and distribution of natural gas. In addition, the 2019 amendments removed the zero to 10 percent bonus points for unsolicited

proposals, which gave companies submitting unsolicited bids a competitive advantage over other contenders. Instead, if the party submitting the unsolicited proposal does not win the bid, it will be compensated by the winning company for the cost of the feasibility study, which in no case shall exceed 1 percent of the total cost of the project. There is no one-stop-shop that lists all legislation, rules, procedures, and reporting requirements for investors.

Conclusions

There is a proverbial story often mentioned by the current prime minister of Albania to foreign investors. Back in 1992, when he was president of the country, immediately after the fall of communism, some people from an international organization just stationed in Albania went to talk to him about the creation of free economic zones. He did not know what they're talking about. The president asked his economic advisor what the free economic zones were, but received no answer. Neither the minister of economy was able to give the answer. Such was the situation in Albania 15 years ago. Today, Foreign Direct Investment in Albania has increased systematically over the years and the country has turned into one of the most attractive ones in the region. Certainly there is still much to be done, but the country has managed to create solid institutions that in turn guarantee the respect of the two elements of the rule of law: (a) protecting investors and (b) contract enforcement.

References

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