

The Determinants of Foreign Direct Investment in Albania

Alma Zisi¹

Armela Anamali²

¹University "Aleksander Moisiu" Durres, Lagj. Nr 1, Currila, Durres, Albania

² University "Aleksander Moisiu" Durres, Lagj. Nr 1, Currila, Durres, Albania

Doi:10.5901/ajis.2015.v4n3s1p524

Abstract

The growth of FDI in Albania has been significant in recent years. The paper analyses most of determinants factor of FDI in Albania. It's not so easy to identify all the determinants factors of FDI because depends on several characteristics that have country. In this paper, we analyze the theoretical determinants of FDI and then we focus to determine the determinants of FDI. It's very important to determine the main determinants of FDI because in this way Albania can attract more foreign direct investment. The main determinants factors that we analyze are the size of our country, natural resources, quality of workforce, privatization process etc.

Keywords: FDI, literature review, determinants of FDI, developing country.

1. Introduction

Nowadays, every country that wants to attract the largest number possible of foreign investors should promote and advertise its own main advantages. The right determination of such advantages is necessary for the foreign investors to make the best benefit out of it. Many studies point out different determinants. This perhaps is due to the specifics of such countries, or to their economic development.

2. Literature Review

Various studies emphasise different determinants of FDIs, which are related to the different characteristics of the countries. In the following review, different scholars cover different determinants in their studies.

Lim (2001) outlines the key factors attracting FDIs. The distance between countries that have an impact on the transport costs, the market size, business climate, economic and political stability and openness of the country are some of the determinants have an impact on attracting FDIs. In his study, Lim deals with the effects of these determinants on economic growth.

Chakrabati (2001) argues, in his study, that the market size is one of the main determinants of FDIs. The bigger the host country market, the more opportunities have foreign investors to exploit the natural resources available in these countries or the main factors of production, such as labour forces. In addition, as another important determinant of FDIs, Chakrabati (2001) identifies the level of salary that can be a driving factor. The salary level would be attractive to investors if their activities are mainly concentrated in manufacturing (thus, contributing directly to minimize the cost of production). On the other hand, Merledeve and Schoors (2004), as the main determinants of FDIs, mention the market size of the host country and the degree of openness of the country to the international market.

The degree of openness of the host country (the ration between exports and imports) is an important determinant of FDIs. For example, in their study Lipsey and Kravis (1982) found a significant positive relation between openness and FDIs. If the host countries have such factors, the number of foreign investors willing to invest in these markets would be relatively higher, compared to those countries with a smaller market size, or with a smaller openness to markets.

In the past, foreign investors were encouraged to invest in countries with low economic development, because they exploited the low-cost labour force of such countries. Today, we notice that human capital is one of the main determinants of FDIs.

De Mello (1997), in his theory, deals with the positive correlation between human capital and FDIs, even though host countries should have a certain minimum level of human capital. On the other hand, Campos and Kinoshita (2002)

argue in their empirical research that there is a positive correlation between FDI and human capital, and in the countries with a certain level of human capital such correlation is significant. In addition, Noorbakhsh *et al.* (2001) argue that human capital is an important determinant to attract FDI in developing countries. In their study, they emphasize that human capital is a significant indicator, and with time the countries that have a great number of graduated people are more likely to benefit more foreign investments.

In his study, Cho (2003) determines the economic conditions and policies of host countries as the key factors to attract FDI. Cho mentions the market size, natural resources and competitiveness as key factors of economic conditions. While in the policies of host countries, Cho (2003) includes macroeconomic policies, the private sector, and FDI-promoting policies.

Matev (2008) examines the key determinants in the Central and Eastern European countries, by dividing them into two main groups. In the first factor group, he includes factors such as market size, and in the second factor group, the infrastructure and human capital. According to Matev, these countries should have trade liberalization regime, foreign exchange and improve the general infrastructure. In addition, Matev (2008) emphasizes that the fight against corruption and bureaucracy will directly contribute to increasing the number of FDI.

Another important determinant, observed recently by foreign investors, is the quality of infrastructure in a country. Many scholars ground such conclusion on the results of empirical evidence that they have. The term infrastructure comprises roads, ports, railways and telecommunication systems, which have an impact on the economic development of a country. The quality of infrastructure is one of the main determinants to attract FDI. If the host country doesn't have a regular and good infrastructure, it could result in an inevitable obstacle to investors. For this reason, the government of every country must take measures to improve the quality of infrastructure.

Easterly (2001) argue that the host country infrastructure plays an important role in attracting FDI. The model of Easterly foresees that the initial income and inflation affect negatively on the real GDP growth, while human capital, FDI, telecommunication infrastructure and OECD expansion have a positive effect on the real growth of GDP.

As a key determinant of FDI, Walsh and Yu (2010) mention also the potential and size of host market, economic sustainability, openness level of host country, income level, and quality of institutions and economic development of the host country.

From the above studies, we see that some of the key determinants that the host countries should have to attract FDI are the market size, business climate, economic and political stability, the level of salary, natural resources, human capital etc.

For the case of Albania, we can say that after 2006, the country has absorbed a significant number of foreign direct investments, and this is thanks to the country's advantages. Several reforms were undertaken to improve and facilitate the conditions of doing business in Albania. The privatization reform of state enterprises had a positive effect on the economy. Due to A privatization, the country benefited an increase of foreign direct investment. The continuous improvements of infrastructure, energy sector, decrease of different legal and administrative obstacles have stimulated foreign investors to invest in Albania.

According to various report¹, Albania has made significant progress in economic and institutional terms, since late '90. Such reports stress the opportunities that Albania has for higher economic growth in the coming years. Taking the status of candidate country to the European Union is also an advantage for the development of economy, in general, and in promoting foreign direct investment.

The geographical position of Albania and the favourable climate are advantages that can be exploited by investors. The main ports of the country and the proximity with other Western Balkans countries have a positive impact on transport costs. The modernization of maritime ports has made the country market even more competitive. In addition, the construction of the Durres-Kosovo highway has effected on the improvement of infrastructure, thus, contributing to the facilitation of trade between the countries.

Albania is a country rich in many mineral resources, such as chromium, copper, nickel, coal, phosphorus, oil etc. These natural resources have encouraged foreign investors to enter into agreements with the government to exploit such resources. For example, "Kurum Energy" (Turkey) and Sichuan Jiannanchun International Group Ltd (China) which have signed agreements to use the chromium resources².

One of the factors that encourage FDI is the level of wages of the host countries' economies. Lower wages

¹Global Rating Agency, 2012

² FDI Report, 2012

decrease the overall cost of production. Albania has a low level of the minimum wage (compared to other countries of the region). It is the outsourcing companies (clothing and garments) that are using such advantage, thus employing the largest number of persons in the sector. Besides the low wages, the young age of employees is a strong preference for FDIs. According to the official statistics, Albania has a relatively young population which is a promising indicator for foreign investors.

The entirely open economy is a good opportunity for all domestic and foreign investors who want to invest in Albania. As some of the best advantages that our country offers to investors are: the tax system, registration of business activity, the opportunity to invest in many sectors etc.

In studies abovementioned, we saw that the market size is a major determinant to attract FDIs in the country. In Albania, the small market size and the low purchasing power are perceived as the main barriers to attract mainly the medium and large investors. Despite the good economic growth, the GDP per capita still has remained low.

The business environment is another important factor affecting the decision-making of foreign investors. However, for Albania we cannot speak yet for a favourable business environment.

However, several policies and measures are taken to create a better climate for foreign investors. Some of the measures are the registration of businesses, public procurement, tax reform, trade policy, regulatory reforms to improve transparency. It is indispensable that public institutions operate in a transparent manner. If the procedures are prolonged in time, their acceleration would be accompanied by corruption. This phenomenon affects negatively on the business climate, therefore it is important to increase efficiency of public institutions. For such purpose, minimizing bureaucratic procedures of public institutions would be an important factor for the investment climate in general.

In addition, the regulatory framework has a huge impact on the activities of companies (foreign and domestic). In those sectors having a complete regulatory framework or which are characterised by a low level of implementation, the business in general suffers difficulties. This issue can affect also the security of firms, in particular of foreign firms, to invest in our country. It would also effect on the decision of investors to withdraw from our country.

The property title over land persists to be a major problem for foreign investors. It is very difficult for many properties to have a property title and get registered, due to the lack of documentation, or because several persons claim to have property title upon the same assets. Such problem affects negatively on both foreign and domestic investors are reluctant to invest their money in countries with property title issues. We hope that in a near future these issues are resolved by the close cooperation of the relevant institutions.

3. Conclusions

It is true that Albania has made a lot of progress in various fields during these years; alas it needs to make a lot of work, yet. What is perceived as a challenge for the country's economy should necessarily turn into advantage to attract foreign investors. The rule and strengthening of law, security of property titles, reduction of corruption, regulation of construction permits, enforcement of contracts, etc., are some of the problems which are perceived as key barriers by foreign investors.

If Albania will continue to move with the same paces, we hope that in the future FDIs are increased having a positive and relevant effect on economic growth.

In conclusion, we can say that the economic and political stability, market size, openness of the country, tax level, commercial policies, government policies, institutional aspect and quality of infrastructure are the main determinants that effect on the attraction of FDIs from the host countries.

References

- Campos, N. F. & Kinoshita, Y. 2002. "FDI as Technology Transferred: Some Panel Evidence from the Transition Economies", *William Davidson Working Paper*, No 438.
- Chakrabati, A. 2001. "The Determinants of Foreign Direct Investments: Sensitivity Analyses of Cross- Country Regressions", *Kyklos*, p. 89-114.
- Cho, J. 2003. "FDI: Determinants, Trends in flow and promotion policies", *Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific*, p. 99-112.
- Doing business 2014
- Easterly, W. 2001. "The Lost Decades: Developing Countries' Stagnation in Spite of Policy Reform 1980-1998", *Journal of Economic growth*, vol. 6, fq. 135-157.
- FDI Report, 2012
- Global Rating Agency, 2012

- Lim, G. 2001. "Determinants of, and the Relation Between, FDI and Growth", *International Monetary Fund (IMF)*, No. 01/175.
- Lipsey dhe Kravis. 1982. "Location of overseas production and production for exports by US multinational firms", *Journal of International Economics*, p. 201-223.
- Matev, M. 2008. "Determinants of FDI in Central and Southeastern Europe", *8th Global Conference on Business & Economics*, Florence, Italy.
- Mello, D. 1997. "FDI in Developing countries and growth: A Selectivity Survey", *Working Papers Series, UK*, p 1-46.
- Merledeve dhe Schoors. 2004. "Determinants of FDI in transition economies", *Centre for Russian International Socio-Political and Economic Studies, Ghent University*.
- Noorbakhsh, Farhad, et.al. 2001. "Human Capital and FDI Inflows to Developing Countries." *World Development* 29.
- Walsh dhe Yu. 2010. "Determinants of FDI: A Sectoral and Institutional Approach", *IMF, Working Paper*, WP/10/187.