

An Assessment Of Foreign Direct Investments Effects In Albania

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Abstract

In a country like Albania, Foreign Direct Investments (FDIs) are the main priority for economic growth and especially where they focus. Many developing countries (including our country) view these investments as unique opportunities to develop faster and increase the competition and the level of exports. We try to find in this work a link between FDIs and economic growth in Albania. We estimate in this framework some quantitative models, with some economic indicators as independent variables and with the level of foreign direct investment in Albania as a dependent variable. In this context, FDIs are dependent on many factors which can be classified as quantitative variables, like economic growth, average wages, foreign trade, GDP per capita, taxes, etc., and qualitative variables, like Index of Economic Freedom, infrastructure, secure internet servers, etc.

Key words: FDIs, developing economies, FDIs flows, economic growth.

INTRODUCTION

Foreign Direct Investments, in their classical form, are defined as a physical investment that a foreign entrepreneur does in a country other than his country of origin, by engaging his financial funds with the purpose of having returns over this investment. FDIs are investments that affect the growth of economical and political stability between the country of origin and the hosting country. Foreign investors benefit from certain facilities that are offered to them by the hosting country (that are not offered by the country of origin) and in return, they bring long-term investments to the hosting country. FDIs have become very quickly a very important element of growth, development and global economical integration during the 90's, (UNCTAD, 2003).

FDIs bring in the hosting country companies with a different culture and capacity, compared with existing companies in that market, by bringing change, even radical sometimes, in the way goods and services are perceived and offered and of standards in the entire sector. All of this, effects the economical growth in general, but in countries like Albania, they increase first of all the employment. The employment growth in the production industry has been one of the most obvious benefits from FDIs for Eastern European countries during 1995 – 2010 (UNCTAD, Trade and Development Report 2012, pg. 86-93). Seen in this context, (as per reasons mentioned above) both country of origin and hosting country have economical development and growth.

Countries that respect authorship and patent rights, invest in research and development and use innovative technology and software's, have a focus in building and increasing capacities of their working force, become very soon major attractions for foreign investors. It's related to many advantages in the country's market and also according to competitiveness in global markets.

THE EFFECT OF FDIs IN DEVELOPING ECONOMIES

The effects of FDIs in the economy are multidimensional; FDIs in Albania are in the form of shared equity, in almost 80%¹ of cases, and in the form of initial capital and additional contributions. The first full legal basis in Albania concerning FDIs are founded under the Law No.7764, 2.11.1993, "On Foreign Investments" with a status derived from Law No.7594, 4.8.1992, "On Foreign Investments". Legislation in Albania make sure that foreign investors and local investors have equal rights. We can find in the table below some main practical advantages and disadvantages of FDIs in Albania.

Tab.1: Impact of FDIs in developing economies (the case of Albania):

The Effect of FDIs in developing economies	
Advantage	Disadvantage
<p>FDIs are pure funding sources, even for the development of projects of large scale.</p> <p>They offer new opportunities of development (in preparation of agreements with foreign clients, due to entering in the international market).</p> <p>FDIs are long-term and strategic investments (the focus of the company is the long-term activity with development perspectives).</p> <p>High performance (FDIs are investments that influence the use of new technology, new capacities and more efficiency).</p> <p>Increase of employment and quality of management in the hosting country.</p> <p>Reduction of the cost of capital (foreign investors can increase the amount of capital in international markets by reducing the level of capital cost).</p> <p>They increase significantly the quality aspect, both for goods and services, making it comparable to the standards of developed countries.</p>	<p>Repatriation of profits by foreign owners, given that FDIs in Albania have 80% of their stock in shared capital, a large proportion of profit (if net profit is expected to be positive) will go out of country as a dividend, meaning that we will have a movement of capital from our country to the countries of origin.</p> <p>Negative impact in current account (repatriation of profits; outflows can also be funds of financial nature for various non-resident creditors in Albania, e.g., in 2008 'Albanian Mobile Communication' gave a loan to the parent company in Greece).</p> <p>The deficit of domestic capital or foreign capital (this is not even potentially problematic for Albania). If foreign capital exceeds certain limits or parameters of an economy in equilibrium, it can create an economic dependency on foreign investors.</p>

According to official statistics, the average annual of stock of foreign investments in Albania for the years 2001 – 2011 is spread in these countries of origin:

Tab. 2: The average annual stock of FDIs in Albania, 2001 – 2011.

Country of origin	Total in millions Euro	Percentage over the total
Greece	558.4	23.6%
Italy	326.6	13.8%
Austria	280.2	11.8%
Turkey	228.4	9.6%
Netherlands	227.8	9.6%
Canada	194.2	8.2%
Switzerland	79.0	3.3%
Germany	72.2	3.0%
Other	405.2	17.1%

¹ National Bank of Albania, "Report on Foreign Direct Investments, 2011".

Source: Bank of Albania, 2013.

The average annual stock of FDIs in Albania for the years 2001 – 2011 is concentrated mostly in the sectors of 'Financial Intermediation', 'Transport, warehousing and communications' and 'Refining Industry'. We can see table 3 for a more detailed classification.

Tab. 3: Dispersion of FDIs for each sector, 2001 – 2011.

Economy sector	Total in million Euro	Percentage over the Total
Financial Intermediation	627.4	26.5%
Transport, warehousing and communications	424.4	17.9%
Refining Industry	392.4	16.5%
Productions Industry	228.4	9.6%
Trade (big and small quantities)	212.6	9.0%
Constructions	186.0	7.8%
Production and delivery of electricity	88.2	3.7%
Hotels and restaurants	82.6	3.5%
Other	130	5.5%

Source: Bank of Albania, 2013.

EMPIRICAL RESULTS

In this section, we analyze several economic indicators, which are related to the development and growth of FDIs flows. We consider time series data with an annual period, from 2001 to 2011.

Tab. 4: Annual empirical data for Albania, 2001 – 2011.

Year	FDIs net inflows /GDP	Economic Growth	OP/GDP (foreign trade)	Average monthly wage (in ALL)	Index of Economic Freedom	Secure Internet servers for 100 inhabitants	Gross capital formation /GDP	Fiscal Burden
2001	0.0507	0.07	0.60	14, 820	56.60	1.00	0.2755	0.1017
2002	0.0303	0.03	0.67	16, 541	56.80	1.00	0.2449	0.1084
2003	0.0315	0.06	0.67	18, 522	56.80	1.00	0.2344	0.1197
2004	0.0457	0.06	0.65	19, 039	58.50	2.00	0.2384	0.1194
2005	0.0313	0.06	0.68	19, 993	57.80	1.00	0.2360	0.1399
2006	0.0356	0.05	0.74	21, 842	60.30	5.00	0.2505	0.1494
2007	0.0609	0.06	0.84	27, 350	61.40	8.00	0.2976	0.1304
2008	0.0957	0.06	0.86	34, 277	62.40	15.00	0.3213	0.1471
2009	0.1108	0.08	0.82	36, 075	63.70	22.00	0.2891	0.1495
2010	0.0919	0.03	0.86	34, 767	66.00	27.00	0.2579	0.1480
2011	0.1056	0.04	0.90	35, 949	64.00	44.00	0.2534	0.1438

Based on empirical data and on the relation of variables in the following tables, we can create some regression models that indicate statistically significant connections between the dependent variable, FDIs net inflows/GDP, and other several independent variables.

Tab.5: Economic indicators and their explanation

Code of the variable	Economic Indicator	Description	Source of data
Y	FDIs net inflows/GDP	It is the best indicator of the level of net inflows of foreign investment in the economy.	World Bank
X1	Economic Growth	Increase in % of GDP. Grogan and Moers (2001), found a statistically important relation between economic growth and FDIs inflows in economies in transition, for the studied period (from 1990 to 1998).	World Bank
X2	OP/GDP (foreign trade)	The amount of imports and exports of goods and services (OP) in relation to GDP. According to Wheeler and Mody (1992), there is a positive relationship between OP and manufacturing sector and a weak negative correlation with the electronic sector.	World Bank
X3	Average monthly wage (in ALL)	As one of the most important voices of the business operating costs, salary expenses are an attractive factor for foreign investors when the wage standard is low. Charkrabarti (2001) concluded that there is a stable connection between average wages and FDIs.	INSTAT
X4	Index of Economic Freedom	This index takes values from 0 to 100. The index itself consists of 10 other variables that are weighted. This index measures the entrepreneurial abilities of a country. Economic freedom "is the key to creating an environment that allows a virtuous cycle of entrepreneurship, innovation, and economic growth and sustained development to flourish (The Heritage Foundation, THF, p. 2) .	WHF & WSJ
X5	Secure Internet servers for 100 inhabitants.	Improved facilities range from simple but protected pit latrines to flush toilets with a sewerage connection. To be effective, must swear facilities constructed correctly and properly maintained.	World Bank
X6	Gross capital formation/ GDP	It is a ratio of tax revenues to GDP (in \$). Favourable fiscal policies encourage both local and foreign business. According to the study of Egger and Raff (2011), taxes have a significant effect on attracting FDIs flows.	World Bank
X7	Fiscal Burden	Servers using encryption technology in Internet transactions. This indicator is considered as determining for the technological development of the use of internet. Technological development and FDIs flows have a significant positive connection, according to the study of Neuhaus (2006).	World Bank

Based on these variables we can create several regression models as shown in the table below.

Tab. 6: Variables used in the models and their explanations.

Variable	Econometric Models		
	Y(I)	Y(II)	Y(III)
X1			
X2			
X3			
X4			
X5			
X6			
X7			
$Y_1(I) = \alpha_0 + \alpha_2 x_2 + \alpha_3 \log(x_3) + \alpha_5 x_5 + \alpha_6 x_6 + \alpha_7 x_7 + \varepsilon$			
$Y_1(II) = \alpha_0 + \alpha_2 x_2 + \alpha_3 \log(x_3) + \alpha_4 \log(x_4) + \alpha_5 x_5 + \alpha_6 x_6 + \alpha_7 x_7 + \varepsilon$			
$Y_1(III) = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 \log(x_3) + \alpha_5 x_5 + \alpha_6 x_6 + \alpha_7 x_7 + \varepsilon$			

Note: ✓ included in the model, ✗ not included in the model.

We represent in table 7 the level of statistical importance for the selected variables, for each model. We observe that all the coefficients are statistically significant.

Tab. 7: Level of statistical importance of selected variables

Variable	Econometric Models		
	Y(I)	Y(II)	Y(III)
X1			-0.109* (0.049)
X2	-0.290** (0.022)	-0.292** (0.016)	-0.325** (0.023)
X3	0.267** (0.022)	0.249** (0.018)	0.285** (0.018)
X4		0.160* (0.067)	
X5	0.001** (0.000)	0.001** (0.000)	0.001** (0.000)
X6	0.405** (0.035)	0.407** (0.025)	0.445** (0.032)
X7	-0.347** (0.082)	-0.362** (0.060)	-0.327** (0.062)
Adjusted R2	0.996	0.998	0.998

Note: Numbers in parentheses are t ratios. * and ** denote significance at 10% and 5%, respectively. According to test F, the statistical importance is 5%.

CONCLUSION

For the hosting country, the existence of FDIs is associated with the introduction of new technologies and more efficient capacities, intake of additional capital in the economy, more advanced technical and managerial skills, increased economic competitiveness (in terms of vertical and horizontal expansion or both), etc. According to UNCTAD (2012), investment of international corporate companies played an irreplaceable role in the globalization process.

In this regard, this study had as main focus to show statistically significant relation of FDIs inflows / GDP, with the main indicators of the Albanian economy. In this study we took 11 years (from 2001-2011), taking into account limitations on obtaining the data. We also did not take into consideration the Albanian economic recession of 1997 – 1998, a period with major influential forces in the denaturalization of the variables.

From this study, we conclude that the dependent variable, FDIs inflows / GDP ratio, is negatively correlated with the economic growth (% GDP), the level of external trade (import and export), fiscal burden, and has a positive correlation with the use of services through internet for every 100 inhabitants, the average wage level, and a positive strong correlation with the level of GDP invested in fixed assets.

Above results emphasize the significant relationship according to theoretical background. We affirm that FDIs in Albania will create possibilities for the development of businesses (local enterprises), and improve the standard of living in the country. They will reduce the level of unemployment in Albania, and improve the infrastructure standards and conservation of the environment. They will also affect positively the growth, the organization and the connection of market parts and will contribute to the consolidation of the whole national economy.

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