Attractiveness of foreign investments in Albania:
a focused analysis of factors, constrains and policy assessment

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Abstract

Foreign direct investments are very important for the implementation of strategic reforms, transfer of advanced technologies and managerial methods, thereby stimulating economic growth in developing countries and in particular, transition economies such as Albania is.

During the last years, Albania experienced an increase in foreign investors' interest in a wide range of sectors, with energy generation, telecommunication, cement production, mining, oil and industrial parks heading the list. However, the major obstacle factors for FDI inflows seem to remain the same: pervasive corruption, weak law enforcement, poor rule of law, lack of developed infrastructure, lack of a reliable energy supply and insufficiently defined property rights.

Determining the factors that attract FDI, and furthermore identify the main characteristics of the host country's economy, are essential to understand the reason of FDI inflows to a country or region. In the empirical perspective, various studies give different results. More specifically, this paper has focused on determining the factors for and against FDI in Albania.

Keywords: FDI, EU integration, Government incentives, Investments Promotion Agency

Introduction

Albania is a country with great potential to attract Foreign Direct Investments, which can considerably increase its opportunities for further development. FDI-s constitute a very important element on providing a direct impact on the economic growth, which is very important for Albania.

After the fall of the communist bloc, Albania is trying to establish a democratic system and to realise the painful and difficult transformation from a centralized economy to a market one.

Year 1991 marked the beginning of a positive change in this regard to the privatization of agriculture, the introduction of financial autonomy of state enterprises, liberalization of prices and the signing of bilateral treaties on investment aid, creating a favourable climate for foreign investments.

Despite the efforts made and measures taken by the Albanian government since 1990, Albania still remains a country which attracts a low level of foreign direct investments compared to the other countries in the region, while it has counsiderable natural and human resources.

After year 2000, the volume of foreign direct investments in Albania has increased but still remains low compared with most Western Balkan countries. This paper analyses the performance of FDI-s in Albania trying to identify the main positive and negative factors influencing foreign investments.

1. FDI attraction literature

The investment attraction literature can be divided into two parts, the first one is the *Investment Climate* literature propelled by the World Bank's 'Investment Climate Surveys' and crystallized in the recent 2005 World Development Report entitled 'A Better Investment Climate for Everyone'. The second can be called the *Investment Promotion* literature, which is primarily addressed in Multilateral Investment Guarantee Agency (MIGA) and United National Conference on Trade and Development (UNCTAD)-led forums.

1.1. Investment climate literature

According to the 2005 World Development Report, a good investment climate will provide opportunities and incentives for private firms – from farmers and small entrepreneurs to local manufacturing companies and multinational enterprises – to invest productively, generate jobs and expand. For most purposes, the investment climate refers to the level of costs, risks, and barriers that may affect an investor's perception of returns to be gained from an investment[1].

Factors that would affect the level of perceived costs, risks, and barriers may be categorized into three components. The first would be *inputs* – which entail infrastructure and services (both physical and financial) as well as labor – that are vital to a firm's productivity. Cross-country analysis appears to corroborate that the attractiveness of a country towards FDI correlates with the availability of physical infrastructure[2], and that human capital formation and skills development can also attract FDI[3].

[1] IBRD, 2005

[2] Kumar, 2001

[3] Miyamoto, 2003

The second component of the investment climate is the *regulatory* environment – which includes regulation of entry and exit, the labor market, financing and taxation, as well as public interests such as the environment, health and safety. Javorcik, Beata Smarzynska and Mariana Spatareanu (2003) for example discuss the effects of labor market regulation; Morrisset and Pirnia (2000) examine the effect that regulatory fiscal instruments such as taxes may have on FDI with a cross-country analysis.

The third component is the set of *macro* or country-level issues concerning economic and political stability and what Globerman and Shapiro (2002) refer to as 'governance infrastructure'. 'Positive' governance infrastructure includes an effective, impartial and transparent legal system that protects property and individual rights; public institutions that are stable, credible and honest; and government policies that favor free and open markets[4].

1.2. The Investment Promotion Literature

The second body of work relevant to FDI attraction policies takes the approach that the 'enabling framework'[5] of an improved investment climate is not enough to attract FDI in today's competitive world. The amount of world FDI flow is increasing[6] due to pressure for companies to seek opportunities overseas in order to increase profits; and so is recipient countries' competition for their share of this growing pie. In both the developed and the developing world, this competition for FDI manifests in the form of investment promotion activities. 'Governments of developing countries need to go beyond offering a "passive open door" regime for FDI'[7]. Competition for a piece of the pie has driven governments to more proactive strategies, that is, marketing their area through investment promotion agencies, or 'IPAs'.

In 1964, at the first United Nations Conference on Trade and Development, the issue of promotion of foreign direct investment was addressed. The Conference recommended that developing countries 'set up investment bureau and investment advisory services and... determine and publicize areas of investment, manner of investment and investment policy.' The Conference also recommended countries 'to establish information centers... to supply all the necessary information about investment conditions, regulations and opportunities.' It was not until the 1980s, when more attention was being paid to the role of FDI in economic development, however, that most countries had set up IPA[8].

[4] Kaufmann, Kraay, and Zoido-Lobaton, 1999; Keefer and Knack, 1995

[5] Kumar, 2003

[6] UNCTAD, 2004

[7] Kumar, 2003

[8] Fredriksson, 2003

2. FDI-s in Albania

2.1. Statistical datas on FDI-s in Albania

The flow of Foreign Direct Investments (FDI) in Albania has increased significantly during the last years, reflecting an increased preference of foreign investors in Albania production factors and risk reduction. During the past five years FDI-s have increased sharply from 250 million € in 2006 to 827 million € in 2010, while FDI-s have grown with 17% compared to a year ago. FDI-s during 2010 have been green-field investments, in total absence of privatizations. These investments went mostly in the energy sector, exploration and drilling oil / gas and energy sector concessions. Also the service sector is one of the main sectors, attracting foreign investments and particularly in the telecommunications sector and banking. As well as other sectors such as manufacturing, construction, trading have attracted FDI inflows during 2010. Much of the FDI-s in Albania are in the form of capital, which constitutes 70% of the total FDI-s. Re-investment of profits constitutes a smaller but growing part of FDI-s.

During the period 2003-2009, greenfield projects in Albania consisted on:

- 9 projects in financial services
- 7 projects in the food industry, tobacco, liquor, coal, gas and oil, construction and building materials.

During the period 2004-2008, 24% of total FDI-s has come as a result of privatizations, in 2009, 26% of FDI-s came from privatisations. 44.5% of FDI-s belong to the economic sectors such as mining, industry and construction, 55.5% of FDI-s belong to services, transportation, telecommunications, financial services, commerce and business services. The origin of foreign investments is headed by the European Union, Italy and Greece are our main trading partners, which continue to dominate foreign investments. From a geographical standpoint, the capital invested in Albania comes mainly from the European Union countries, where Greece is still the most important foreign investor.

The table below shows some of the main foreign companies actually operating in Albania:

Company	Country of origin	Sector of economy
American-Albanian Fond	USA	Services
Conad	Italy	Trading
Kurum	Turkey	Industry
Rompetrol	Romania/Netherland	Oil trading
Titan Cement Group - Antea	Greece	Industry
Lockheed Martin	USA	Telecomunication
Calik	Turkey	Telecomunication
AMC	Greece	Telecomunication
Vodafon	Greece	Telecomunication
Raiffeisen Bank	Austria	Banking
Airport Partners	Germany	Infrastructure
EVN	Austria	Energy
Petroleum Bankers	Canada	Oil and gas production
BerOner	Turkey	Mining
Sigal (Uniqa Group)	Austria	Insurance

Tab.1 Main Foreign companies in Albania

Referring to INSTAT data, the number of foreign enterprises and joint-ventures until the end of 2010 increased nearly 21% compared to 2009, representing 2.9% of the total number of active enterprises in the country.

By country of origin, the largest number of enterprises comprise those originating from EU countries, and within them, the majority originate from Italy, Greece and Turkey, followed by Kosovo, Macedonia, Germany, etc...

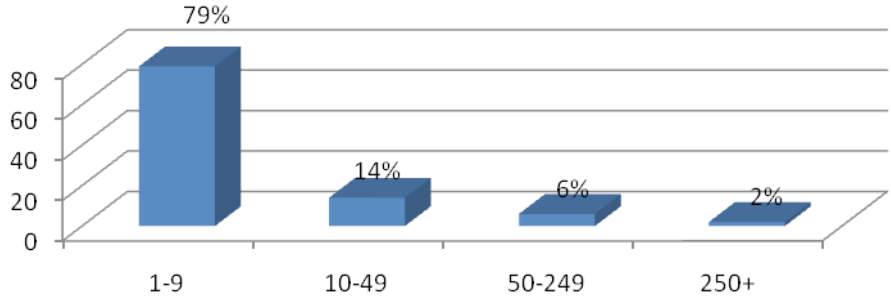
The table below presents the foreign enterprises and joint-ventures by the year of creation. From year 2006 to 2010, foreign enterprises in Albania have increased on average by 33%. These numbers show an increase of FDI-s during the last years as a result of some attractive factors in Albania.

Years	2006	2007	2008	2009	2010
Number of foreign enterprises and joint-ventures	974	1354	2107	2336	2924

Tab.2 Number foreign companies by the year of creation[9]

Total foreign enterprises and joint-ventures are devided in the production of goods that constitute 36% of total enterprises and in the services sector representing 64% of the total. More detailed listing of foreign enterprises and joint-ventures by sectors of the economy is shown in the below figure: to trade 31%, industry 25%, other services 24%, construction 10%, 6% transportation and communications, hotels, bars and restaurants, 3%, agriculture and fishing.

Referring to the structure of foreign enterprises and joint-ventures according to the size or number of employees for 2010: micro enterprises with 1 to 9 employees constitute 79% of the total number of enterprises, small enterprises with 10 to 49 employees constitute 14% of the total, followed by medium enterprises with 50 to 249 employees constituting 6% of the total. Large enterprises with over 250 employees constitute only 2% of the total number of foreign enterprises and joint-ventures actually operating in Albania.



Graph 1. Foreign enterprises and joint-ventures according to the number of employees[10]

Geographical distribution shows that the largest number of foreign enterprises and joint ventures is concentrated in Tirana and Durres, followed by the district of Vlora, Korca, Elbasan, Fier, etc.. The activity of foreign enterprises and joint ventures is oriented in the western, central Albania and the southern border with Greece, which is explained by the fact that in these areas are mainly concentrated manifacturing enterprises with export orientation to Italy and Greece.

[9] Source: INSTAT 2010

[10] Source: INSTAT 2010

2.2. Benefits of Albania from FDI-s

FDI inflows stimulate economic development and have helped developing countries such as Albania when faced with economic hardship previously[11].

FDI in the tourism industry, energy sector, road construction and the service sector are going to generate increased employment.

FDI into Albania permits the transfer of technologies and assists in competition between producers within the local market.

Gains in the economy include the development of skills, and human capital resources by Albanian employees of Energy, Construction and Engineering firms receiving training on the operations of a business. The creation of new jobs, and increases the salaries of workers leads to lifestyle enhancement. Previously, Albanian professionals would immigrate to other nations. “Brain drain” is used to describe the phenomenon of emigration of highly qualified professionals from Albania to other EU nations. FDI in Albania contributes to positive economic growth, and professionals are a source of capital for developing countries such as Albania. Reversing the brain drain has had positive effects on education, income distribution and economic welfare[12].

3. Positive factors to FDI-s in Albania

3.1. Albania’s EU integration

The impact of EU integration on FDI flows has been researched in many empirical studies. After the creation of the EU, a notable increase of intra- and inter-regional FDI flows was observed among the member countries.

A successful story of EU integration is the accession of Spain to the EU in 1986. The way of this country, from a backward, closed economy to one of the furthest developed market economies in Europe, is often called the “Spanish Economic Miracle”.

The high FDI inflows resulting from the EU integration process have been responsible for the strong economic performance of the country. FDI inflows were especially intensive between 1988 and 1992, when they reached an average of 2 % of the BIP[13]. Also Ireland experienced a real FDI boom after its EU accession in the year 1973. Many US multinationals chose Ireland as their starting point to expand in Europe. After Austria, Finland and Sweden had joined the EU in 1995, they became more attractive to foreign investors and are still the main destination for FDI in the EU[14].

[11] Economy Watch 2009

[12] Centre for Social and Economic Studies, 2006

[13] Barrios et al, 2002

[14] Galego et al, 2002

The EU integration process positively affected also the FDI flows into CEE candidate countries during last years. FDI inflows into these countries increased considerably since 1994, after the public commitment of the EU to eastern enlargement made by member-states at the Essen European Council (1994). Bevan and Estrin (2000) studied the impact of these issues on FDI flows into the CEEC-s and found out that the Essen Council announcement was associated with a significant increase of FDI flows to the possible candidates for EU accession.

The decision of the EU to open the negotiations with five CEE applicants (1997) led to an increase in the growth rate of FDI to the most successful applicant countries (Bevan et al, 2001). Kaminski (2001) underlines that the "EU factor" explains the high level of FDI inflows into CEEC-s compared with FDI received by the former Soviet republics. But the EU integration factor played a significant role only in countries that early started the radical economic reforms.

Foreign direct investments (FDI) interest in Albania is increased during the last years. Albania's transition into a NATO country and the prospective European Union (EU) membership are considered as two important factors contributing to the increased FDI inflows even during the financial crisis period.

Albania joined NATO (North Atlantic Treaty Organization) on April 1, 2009. This important membership of Albania has improved its image to foreign investors, considering the fact that Albania is still seen as a high political risky country as a result of the ethnic conflicts and wars that involved the region of Balkan after the nineties.

The Western Balkans process of integration has two important aspects: on one side the intra-regional economic cooperation within this region after the long period of disintegration before the nineties and a lot of ethnic conflicts after the nineties will improve the economic relations and create a common market in this region, on the other side all the countries of this region aspire to access to the EU. The region does not present itself homogeneously regarding European integration.

The process of accession of Albania to the EU started in January 2003. *The **Stabilization and Association Agreements (SAAs)*** are the main form of contractual relationship between the EU and each Western Balkan country. Albania has signed the SAA with EU on 12.6.2006. Albania formally applied for EU membership 28 April 2009. On November 16, 2009, the foreign ministers of the EU approved the starting process of Albania to get the candidate status for EU. Albania's admission to the EU depends on the countries future economic and political stability.

Albania's integration in the multilateral trading system has been steadily increasing. The entry into force of a free trade agreement with Turkey in 2008 and with the Stabilization and Association Agreement with EU in 2009, are very important steps in this aspect.

3.2. The role of Albania Government incentives on attracting FDI

FDI incentives have been defined as "any measurable advantages accorded to specific enterprises or categories of enterprises by (or at the direction of) a Government, in order to encourage them to behave in a certain manner" and include "measures… designed either to increase the rate of return of a particular FDI undertaking, or to reduce (or redistribute) its costs or risks". They are seen as distinct from "broader nondiscriminatory policies" such as "the general…fiscal regime for business operations"[15].

The term "FDI incentives" covers fiscal and financial benefits. Fiscal incentives include full or partial holidays from tax; reductions in the standard rate of tax; tax reductions conditional on reinvestment of profits; investment allowances and investment tax credits; accelerated depreciation of assets; preferential treatment of profit on exports; tax deductions based on specific types of expenditure (e.g. R&D); and exemptions from import duties on capital goods or other inputs (list adapted Financial incentives include: cash grants related to the value of assets invested or numbers employed or training costs; provision of subsidized facilities such as factories or sites; provision of infrastructure related to new facilities, such as roads and links to utilities; and direct subsidies[16].

- ***Fiscal and financial policy incentives***

There is a growing body of work that examines the effectiveness of tax and incentive policies in attracting FDI[17].

The development of the tax system is very important for attracting FDI inflows in transition economies. When transition began, taxes on companies represented a higher share of government revenue and of GDP than in the high income OECD countries[18], linked to a tradition of heavy taxation of enterprises. In the early years of transition, countries faced erosion of tax revenues and needed to create institutions for raising revenue in a market economy. Incentives could arguably insulate potential investors both from the initial high tax rates and from the uncertainties associated with tax reform.

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:

[15] UNCTAD, 2000

[16] UNCTAD, 2000

[17] Cass, 2007

[18] Mitra and Stern, 2002

- Reduction of the fiscal burden of social security contributions payable by employers from 20 percent to 15 percent (on May 2009).
- Introduction of a flat tax of 10% on personal income tax.
- Tax exemption of dividends designated for investments.
- Reduction of corporate tax from 20 to 10 percent (on January 2008).
- Importers of machinery and equipment are exempt from VAT if the machinery and equipment are used solely as part of their taxable economic activity.

- ***Investment Promotion Agencies***

Albinvest is the Albanian Promotion Agency for foreign investors. The Albanian Government has assigned Albinvest three strategic goals:

- Assisting and accelerating the inflow of foreign investment into the Albanian economy
- Improving the competitiveness of Albanian exporters
- Providing professional services to assist the growth of Albanian SMEs.

According to "Investment Reform Index" 2010, Albania needs to focus on improving services to investors in both pre and post establishment phase. Albania should explore the possibility of Albinvest having authority to approve some permits and licenses. Also a more sophisticated approach to client relationship management (CRM) is needed.

Many activities in Albania required cumbersome licensing procedures and permits. According to The US State Department's 2009 Investment Climate Statement, the GOA approved the Action Plan for Regulatory Reform, in 2007, which provided for a full review of Albania's entire legal licensing system to harmonize the licensing legislation to EU standards and reduce administrative barriers for businesses operating in Albania. As a result, many licenses were removed while a broad simplification of licensing procedures has been completed in many sectors including, mining, hydrocarbons, public works, health, agriculture and the environment. Part of GOA's incentive for foreign investors is "One stop shop for granting licenses". The Albanian Government's has established on May 2009 the **"One Stop Shop"** for issuing licenses and permits, National Licensing Center (NLC). This will lead to the simplification of licensing procedures. From now on the time and effort required to obtain a license is significantly lower. The procedures for getting a license are the same for national and foreign companies.

Summary

FDI inflows stimulate economic development and have helped developing countries such as Albania when faced with economic hardship previously. FDI in Albania are considered as one of the main contributors on the economic growth of the country. Our GDP and export growth rates were the fastest growing in South East Europe from 1997 to 2008.

Albania economy benefited from the FDI inflows in these potential sectors either in providing different services but at the same time offering to consumer cost efficient services through competition.

FDI-s in Albania have increased significantly during the last years, reflecting an increased preference of foreign investors in Albania production factors and risk reduction. During the past five years FDI-s have increased sharply from 250 million € in 2006 to 827 million € in 2010, while FDI-s have grown with 17% compared to a year ago.

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.

Much of the FDI-s in Albania are in the form of capital, which constitutes 70% of the total FDI-s. Re-investment of profits constitutes a smaller but growing part of FDI-s.

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.

Signing of integration agreements and the implementation of local and central incentive policies by the Albanian Government are positively correlated with FDI inflows. This means that the signing of SAA, membership to NATO and the implementation of central and local incentive policies, have strongly positively effected FDI-s into Albania.

Albinvest is the Albanian Promotion Agency for foreign investors. The Albanian Government has assigned Albinvest some strategic goals in increasing the level of FDI inflows in Albania but the Albanian Government should explore the possibility of Albinvest having authority to approve some permits and licenses.

The Government of Albania has played an important role on improving the business climate in Albania by developing a set of fiscal and legislative policies.

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