



The Dynamics of Foreign Direct Investment in Albania. Comparison with the Western Balkan Region

Lorena Çakërri

Department of Finance, University "Ismael Qemali" Vlorë, Albania

Filloreta Madani

Department of Finance, University "Ismael Qemali" Vlorë, Albania

DOI: 10.26417/ejme.v1i2.p35-44

Abstract

Foreign direct investment is an international financial flow that has grown in the last 25-30 years. These financial flows are desirable both from developing countries and developed countries. Although developed countries are those that absorb the largest share of foreign investment, during the last years has increased the share of foreign direct investment directed towards developing countries and countries in transition. Albania has also intensified its efforts to be more competitive in this "struggle" in attracting these international financial flows. Foreign investment can bring significant benefits to the recipient countries as the effect on economic growth of these countries. These efforts have been efficient in view of the growing trend of foreign direct investment inflows. However, it is necessary to see a broader picture to see if this trend has occurred in the countries of the Western Balkans region as well. The purpose of this paper is to analyze if foreign direct investment impacts the economic growth in Albania. Also, this paper analyze whether Albania and the countries of the Western Balkans region have followed the global trend of the FDI flows or not, and to determine the decisive factors in these developments. The methodology of the paper is based on the descriptive analysis of the secondary data collected by the financial institutions in Albania, the region and the world.

Keywords: Foreign direct investment, financial international flows, attractive policies, economic growth.

Introduction

Over the last decades, Albania has undergone fundamental changes that have had a significant impact on the country's economy. Prior to 1990, the Albanian economy acted as a completely centralized economic system. After the collapse of communism in the early 1990s, Albania entered a phase of transition that was accompanied by a large number of social and economic changes. In 1993, Albania implemented a successful macroeconomic stabilization program (by controlling the budget deficit, currency growth and inflation rate), liberalizing prices and foreign trade, and privatizing agricultural land. These reforms focused on increasing attractiveness for foreign investors which were seen as indispensable for securing financial capital.

The other reforms undertaken were aimed at creating all the premise for moving quickly to a market economy. In the focus was the privatization of state-owned enterprises. (IMF 2004). Reforms also focused on adopting the legal framework for Albania, which was trying to move towards a market economy.

Soon the results of the effort were noticeable. Albania generally managed to stabilize the macroeconomic situation. The economic growth after 1997 shows a positive rate fluctuating at an average of 5% in the last decade and the 2009-2010 period shows the effects of the global crisis on the economic growth of our country, reducing it to 3.5%. The 2012 the economic growth rate was much lower than that of 2011. The global crisis affected Albania also through the recession experienced by its main trading partners, Italy and Greece(Curran 2009). Thus 2013 continued with a 1.1% decrease in economic growth. In 2014, Albania began to experience GDP growth. The growth of real GDP reached 2%, reflecting a significant increase from the previous year. This improvement of the economic situation could be the effect of improving the economic situation of the European Union as the European Union is the main trading partner of Albania.

In 2015, economic growth in real terms climbed to 2.8%. This growth was caused by the increase in domestic demand, as a result of increased investment. It was the construction sector that had a significant impact on economic growth. It grew by 14%, recovering from the situation this sector experienced in the second half of 2014. In 2016, Albania experienced a better economic situation. Real economic growth amounted to 3.2%. This was caused by the formation of gross capital from the Trans Adriatic Pipeline project and by the increase of exports of goods and services.

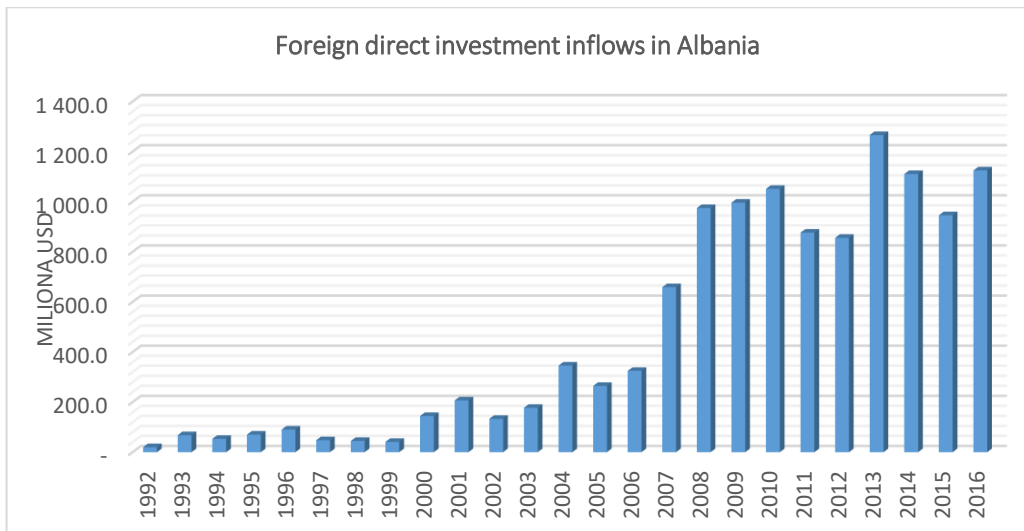
Dynamics of Foreign Direct Investment Development in Albania

Foreign Direct Investments in Albania began to emerge mainly after the 90s of the last century. At the beginning of these years, the number of FDIs was relatively small, but over time they began to grow significantly. Albania adopted a law on foreign investment in 1994. This law aimed to release the entry of foreign investors by increasing the legal protection for them.

A Law on Concessions was approved in 1995, which created some investment facilities in the fields of physical infrastructure, mining, tourism etc. This is because Albania is a country that offers great opportunities for foreign investors.

The graph below shows the performance of Fdi flows for the years 1990-1999.

Graph 1. Foreign direct investment, inflow, 1992-2016



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

From Graph 1 we see that over the years, FDI inflows have come to a generally upward trend until 1996. An important part of these flows at this time can be attributed to the ever increasing activity of the schemes pyramid.

The collapse of financial schemes in 1997 brought about a drop of around 50% of direct investment inflows compared to their best performance over 1995-1996. The Kosovo crisis in 1999, although a regional factor, had its impact in Albania as part of the Balkans. Thus, investments continued to decrease.

Synthesized in the years 1990-1999, the inflow of foreign direct investment inflows has been varied over the years. These developments are mainly attributed to political and macroeconomic stability.¹

Foreign direct investments are considered as one of the decisive elements for Albania's economic growth. The generally growing FDI trend in Albania has helped transform the country's economy into a market economy, boosting the country's level of opening up and helping Albania's economic integration. Also, the positions of the Albanian state for integration have reflected the growing of FDI. If we look at the

¹ In fact, political and macroeconomic stability are crucial factors for FDI inflows (Global Investment Competitiveness Report 2017/2018)

performance of foreign direct investments in this period, we note that they have come to an upward trend. Among the developments of direct investment flows and GDP growth in Albania, we see a similar performance. In the years Albania experienced a rise in inflows of foreign direct investment, it has experienced growth of economic growth.

In 2000, FDI captured \$ 206 million. The privatization of the National Commercial Bank had a significant impact during this year. In the period 2001-2002 there was a decrease of FDI level compared to 2000, reaching a value of 133.1 million euros. In 2003, FDI surged to 177 million euros. The 2004 year saw another increase, FDI inflows totaled 345.7 million euros. In fact, the growth of foreign direct investment flows in 1999-2004 can be attributed mainly to successful privatization initiatives by the Albanian government, such as the sale of Amc to Cosmote, increased investment from Vodafone, privatization of the Savings Bank, privatization Alb Telecom and Armo.

In 2005, foreign investments experienced a reduction of \$ 264 million. Starting from 2006 until 2008, a significant increase in FDI was observed. This increase in investment flows in this period was mainly provided through concessional contracts in strategic sectors such as industry and energy. An undertaking and a set of other measures for the creation of industrial zones and parks and improvements in the field of legislation were undertaken.

What is also evident from the presentation in Chart 5, the performance of foreign direct investment, although fluctuating, has had a significant upward trend in 2000-2008. The total of FYIs in this period was 3.22 billion euros. From 2006 to 2008, FDI inflows increased by 300%, reflecting the growth of foreign business confidence in Albania's political and economic stability. Based on all macroeconomic indicators, during the course of the year, the Albanian economy during these years marked a positive performance.

In 2009-2010, foreign investment inflows continued to maintain the upward trend of previous years, not showing the effects of the global financial crisis. Again, an important role played privatization in the total inflow of investment inflows.¹ The sale of 76% of the shares of the power distributor (OSSh) to the Czech company CEZ contributed to maintaining the upward trend of FDIs.

In 2010, Albania ranked the second largest FDI in the region after Serbia when its FDI increased to more than \$ 1 billion for the first time. A feature of foreign direct investment by 2010 is the fact that they appear mainly in Merges and Acquisition form. Greenfield's investment is limited in this period. In 2011, foreign investments were oriented towards the energy sector, with the construction of small hydropower

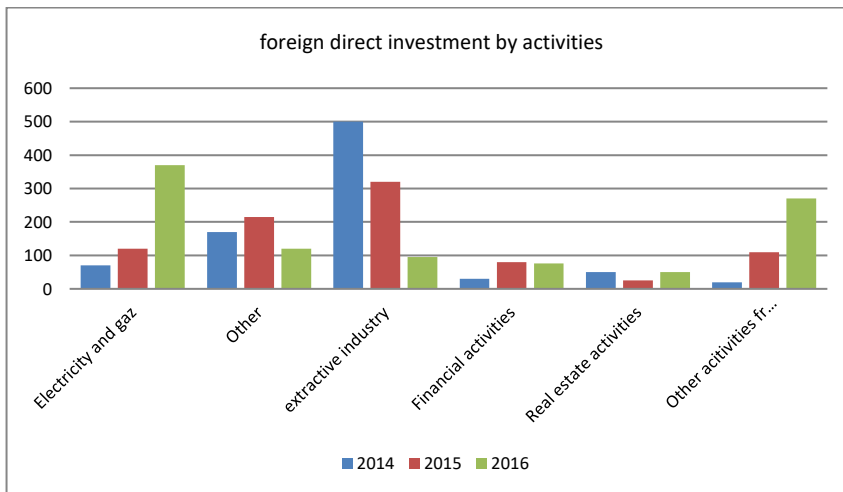
¹ In a study by Boubakri et al. (2011), it has been suggested that privatization could create an opportunity to improve the investment climate.

plants, which constituted an important part of the total FDI. FDIs during 2010 were green investments, with total privatization shortage. These investments went mainly to the energy sector. In 2011, FDI inflows dropped slightly to EUR 742 million. Even in 2012, FDI dropped slightly.

So, if during 2008-2011, many countries were experiencing the effects of the economic-financial crisis, foreign direct investment in Albania continued to grow.¹ But it should be said that the growth rate slowed down compared to the 2006-2008 period.

In 2016, foreign investments again marked a significant increase. Part of the Significant in this value are investments for Gas Pipeline (about 40%). This investment in the extractive industry made it in 2016 this sector with the largest share of FDIs.

Chart 1 Foreign direct investment by activities in Albania over years 2014-2016.



Source: Bank of Albania, processed by the author

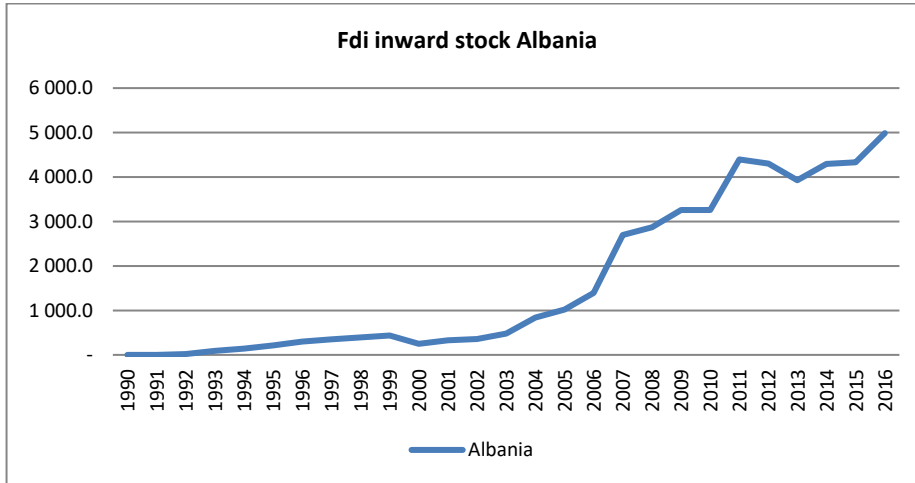
Generally, over the past ten years foreign investment inflows have increased considerably. In the years 2008-2017, inflows inflated to an average value of \$ 1 billion a year. FDI inflows amounted to more than \$ 1 billion in 2017, compared to \$ 1.12 billion in 2016 and \$ 9.45 billion in 2015.

So, what can be said about the inflow of foreign investment inflows into Albania during the period 1990-2017 is that there has been an upward trend in general, although it has been associated with fluctuations of values over the years. What is

¹ The impact of the international financial and economic crisis in Albania was also mitigated by the limited importance of the export channel to convey the crisis in the country and Albania's relatively modest support to international financial markets. Monetary policy framework, prudent banking supervision and flexible exchange rate also had stabilizing effects

important, however, is the fact that the foreign direct investment stock in Albania has been growing steadily.

Graph 2. Foreign direct investment inward stock in Albania



Source: Unctad, edited author

In fact, the growth of foreign direct investment stocks over the years is an element that explains the positive impact of foreign investment on economic development. Johnson (2006) states that FDI stock is the one that conveys the long-term effects of foreign direct investments in the host countries. This indicator for Albania is significantly increasing throughout the period.

2. An Overview of the Economic Situation in the Region

The Western Balkans region has all the opportunities to achieve a positive and lasting economic growth both short-term and long-term. And in 2016, the region experienced a growth of economic growth compared to the previous year. Not all countries in the region equally affected this growth. They experienced growth of the economic growth rate of Albania and Serbia, thus affecting the economic growth of the region. These optimistic forecasts for the region are devoted to increasing the role of investments in the region and net exports. Employment also marked positive performance almost throughout the region.

Table 1. Real GDP (Annual change in percentage)

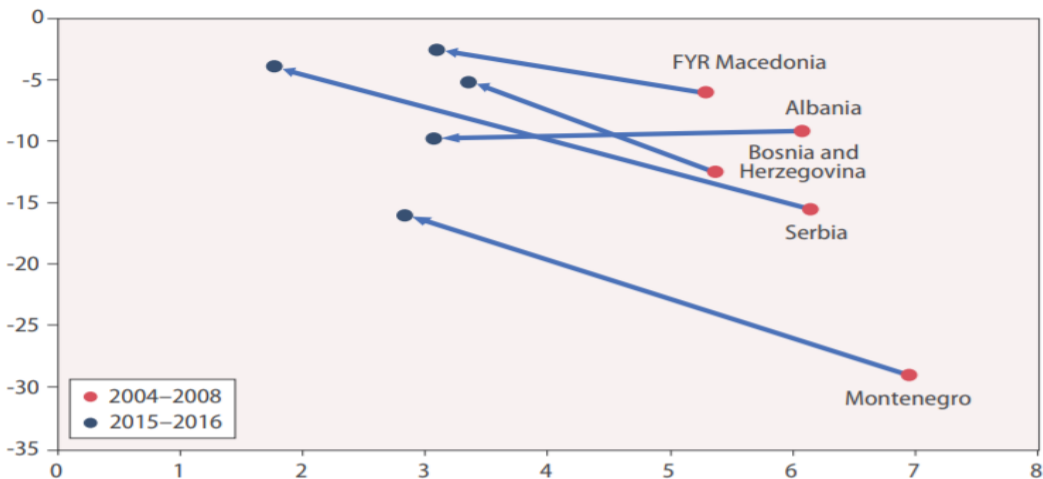
	Average									Forecasting		
	2000–09	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Albania	5.9	3.7	2.5	1.4	1.0	1.8	2.2	3.4	5.9	4.3	3.7	3.2

Bosnia dhe Herzegovina	4.2	0.8	0.9	-0.7	2.4	1.1	3.1	3.2	2.7	3.2	3.5	4
Kosovo		3.3	4.4	2.8	3.4	1.2	4.1	4.1	4.1	4	4	4
Macedonia	3.1	3.4	2.3	-0.5	2.9	3.6	3.9	2.9	0	2.8	3	3.5
Montenegro		2.7	3.2	-2.7	3.5	1.8	3.4	2.9	4.2	3.1	2.4	3
Serbia	5.1	0.6	1.4	-1	2.6	-1.8	0.8	2.8	1.8	3.5	3.5	4

Source: IMF, *World Economic Outlook April 2018, Cyclical Upswing, Structural Change*

Infrastructure improvements are seen as an important element in achieving a sustained performance of economic growth, especially in Montenegro and Albania. But these large infrastructure projects have boosted imports, thus exacerbating external deficits. Also, these infrastructure projects financed by China¹ loans have exacerbated public debt, despite all fiscal consolidation efforts in the region. Also, current account deficits mean that these countries need foreign capital for financing. However, the pattern of growth in recent years in the region appears to be more balanced.

Chart 4. GDP growth and current account deficits in South East Europe



Source: IMF *International Financial Statistics and UN/DESA, World Economic Situation and Prospect 2018: Chapter 3; Regional Development and Outlook*

Thus, this situation made Foreign Direct Investment (FDI) an important way of securing capital in the Western Balkans region. But the Balkans region needs to create a growth pattern that is not so much dependent on foreign financial flows. In fact, the

¹ World Economic Situation and Prospect 2018: Chapter 3; Regional Development and Outlook

possibility of joining the European Union of Western Balkan countries will also condition the economic performance of these countries.

Table 2. Current Account Balance (Percent of GdP)

									forecasting		
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Albania	-11.3	-13.2	-10.1	-9.3	-10.8	-8.6	-7.6	-7.2	-6.7	-6.7	-6.1
Bosnie Herzegovina	-6	-9.5	-8.7	-5.3	-7.4	-5.7	-5.1	-5.2	-5.9	-6.5	-4.8
Kroacia	-1.1	-0.7	-0.1	0.9	2	4.5	2.5	3.7	3	2.1	0.3
Kosovo	-11.6	-12.7	-5.8	-3.6	-7	-8.7	-8.9	-8.7	-8.9	-8.6	-7.7
Macedonia	-2	-2.5	-18.5	-14.5	-15.2	-13.2	-18.1	-18.9	-19	-17.8	-10.2
Montenegro	-22.7	-17.6	-3.7	-1.3	-2.1	-0.6	-0.3	0	-0.9	-1.2	-2.1
Serbia	-6.4	-8.6	-11.5	-6.1	-6	-4.7	-3.1	-4.6	-4.5	-4.1	-3.8

Source: IMF, *World Economic Outlook April 2018, Cyclical Upswing, Structural Change*

Foreign Investment in the Western Balkans

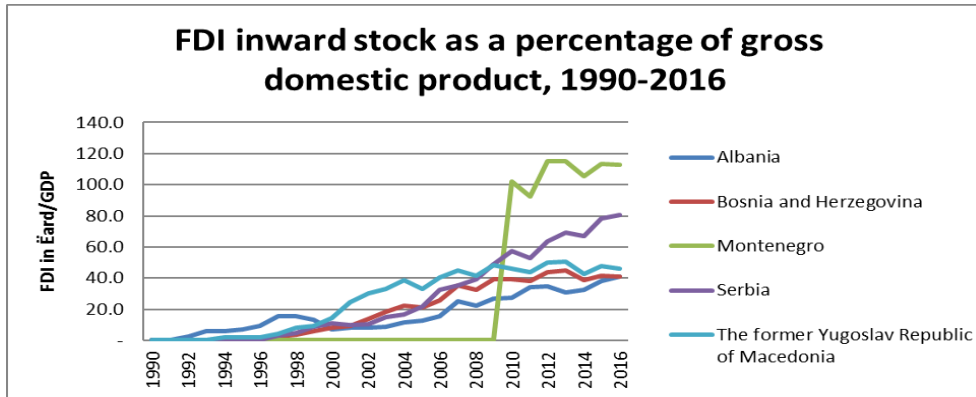
Western Balkan countries are characterized by growing current account deficits. These countries see inflows of foreign investment important, but at the same time this fact makes them more dependent on these flows.

The region is increasing its competitiveness by improving the investment environment. Significant improvements are being made in all directions. Even improving infrastructure, as an important element in the absorption of FDI, the Western Balkans is paying much attention.

All Western Balkan countries have institutionalized aspirations for attracting more foreign investment by creating agencies for fostering foreign investment. Even these countries are making efforts to create regional investment agreements, no longer agreements by special countries. For all these countries, the possibility of being part of the European Union is a fact that has influenced the positive performance of the inflows of the ihds. Many of the improvements made to the investment environment of these countries are the result of reforms needed for their membership in the EU.

For most Western Balkan countries except Montenegro, foreign investment has flourished in the period 2000-2010, including 2008, the year of the global financial crisis. In fact, the impact of the global financial crisis on these countries was felt in 2011 because these countries were not integrated into global networks. Consequently, this served as a protection for them.

Graph 5: FDI inward stock as a percentage of gross domestic product, 1990-2016

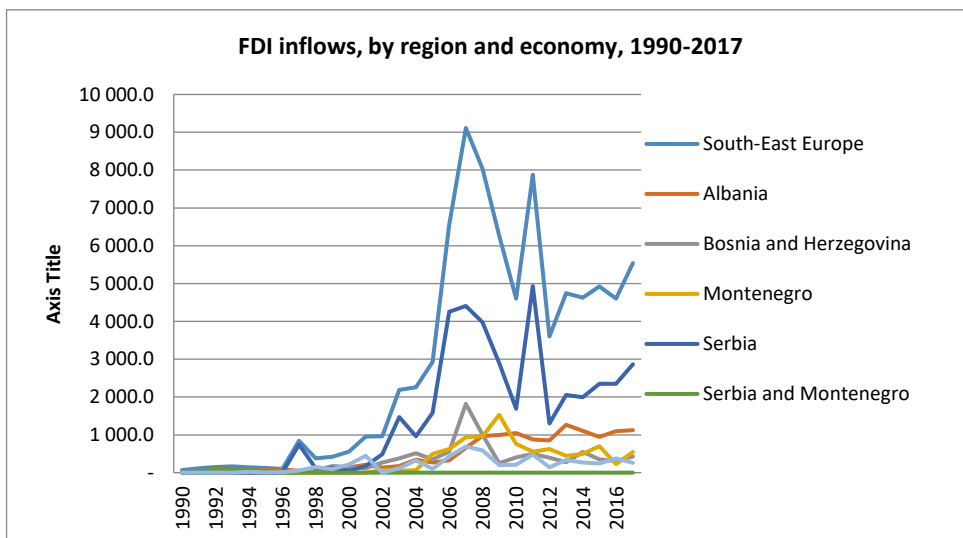


Source: Unctad, edited author

Graph 5 shows clearly the trend of FDI stock growth. It is slowing down after 2011 compared to the rapid growth we see in the period 2000-2010.

If we look at the inflow of foreign direct investment inflows into the Western Balkans, we see that Serbia has the largest share of inflows. Albania is the second country in the region to assess the size of inflows. However, Albania has a positive feature compared to other countries. It is the only country that has a steady growth trend of inflows for the entire period, starting in 1990.

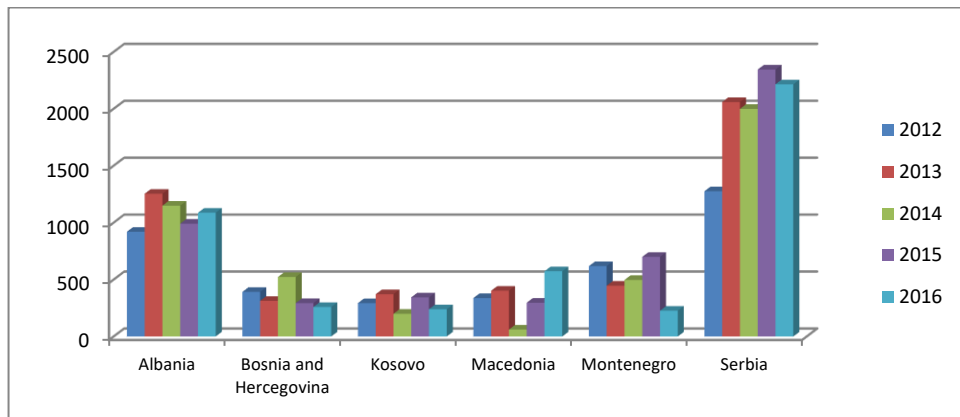
Graph 6: FDI inflows, by region and economy, 1990-2017



Source: Unctad

The distribution of net FDI flows between the Western Balkan countries appears unevenly distributed (see Chart 2). Serbia has been able to absorb the largest amount of FDI net inflows over the past years, 2012-2016. Serbia has the advantage of being the largest market in the region, including the number of its population. Also, Serbia has a distinctive feature compared to other countries in the region as there are some economic zones devoted to foreign investment, focusing on industry development. The likelihood of EU membership also contributes to increased inflows.

Chart 2. Net FDI flows, for the period 2012-2016.



Source: World Bank

Also, Serbia has the largest share of foreign direct investments in the Greenfield form compared to the countries of the region. These investments in this form are known for their positive effects in the host country.

Table 3. Value of FDI projects declared greenfield, by destination, 2004-2016 (Million dollars)

Country	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Albania	135	660	445	4 458	3 324	116	58	450	326	56	53	132	39
Bosnia Hercegovina	455	2 282	640	601	1 981	1 316	311	1 235	1 338	888	981	3 145	925
Montenegro	-	-	131	695	715	120	372	388	340	755	1 177	43	608
Serbia	985	1 178	3 292	3 061	7 734	3 262	3 775	3 964	4 731	4 205	2 545	4 580	2 186
Macedonia	175	266	1 676	533	2 661	776	454	830	1 120	578	839	435	328

Source: ©UNCTAD, Financial Times Ltd, FDI Markets

Albania ranks after Serbia in the region, attracting relatively constant amounts of FDI net flows over the years (averaging about \$ 1 billion). This amount is partly due to investments in projects in the energy sector that have occurred in recent years, especially the TAP project. Significant structural reforms have been undertaken, especially in the energy sector and in the financial sector. Albania is making efforts to strengthen the judicial system and the functioning of a rule of law. Foreign direct investments are mainly drawn from various privatization initiatives in sectors such as banks, telecommunications, production and energy. In 2017, Albania's IAs suffered a decline.

Macedonia has seen a steady growth of FDI inflows. Compared to 2012, the volume of FDI in 2016 has increased by approximately 70 percent. The year 2017 marked a significant decline compared to 2016. Macedonia has a wide network of special economic zones. Also, Macedonia has paid attention to the effect of various incentives for foreign investors, extending the range of these incentives, involving tax and financial incentives.

While for Montenegro, foreign investments have declined in 2016. Macedonia has been aiming for legislative improvements over the years in order to stimulate the privatization process. In Montenegro in 2017, foreign investments marked a positive performance. The sector that contributed most was tourism. However, this economy needs to diversify the economic structure because it relies on very few sectors.

Kosovo has a small share of the total foreign direct investment in the region. These low FDI values can be explained through the country's troubled political situation. In 2016, FDIs in Kosovo declined. There was an increase in 2017, mainly in the sectors of financial intermediation, construction and real estate. What damages Kosovo is the political image.

Bosnia and Herzegovina's performance is not one of the best in the region in absorbing the flows of FDI. Since 2014, there has been a decline in FDI. Bosnia and Herzegovina has not made much progress with the country's economic and structural reform. This has led investors to perceive many negative elements of the investment climate, such as high corruption.

Conclusions

Foreign direct investment inflows in Albania showed a generally upward trend throughout the period from 1990 to 2017. Positive performance owing to continued improvements in the legal and regulatory framework devoted to the investment climate liberalization. Generally, over the past ten years foreign investment inflows have increased considerably. In the years 2008-2017, inflows inflated to an average value of \$ 1 billion a year. FDI inflows amounted to more than \$ 1 billion in 2017, compared to \$ 1.12 billion in 2016 and \$ 9.45 billion in 2015.

So, what can be said about the inflow of foreign investment inflows into Albania during the period 1990-2017 is that there has been an upward trend in general, although it has been associated with fluctuations of values over the years. What is important, however, is the fact that the foreign direct investment stock in Albania has been growing steadily. The negative impact on foreign direct investment inflows has been turbulent political situations. Foreign direct investments in Albania did not show significant decreases as a result of the financial crisis that included the main investment countries in Albania.

For almost all of the Western Balkan countries, foreign direct investment recognized growth in the period 2000-2010. The impact of the global financial crisis on these countries was felt in 2011 because these countries were not integrated into global trade networks. Serbia is the country that has the largest share of the total direct foreign investment of the region. Also, Serbia has the largest share of Greenfield projects in the region. Albania is the second country in the region for foreign direct investment flows. Albania has a positive feature compared to other countries. It is the only country that has a steady growth trend of inflows for the whole period, starting in 1990. In Western Balkan countries, foreign direct investment has contributed to the financing of current account deficits. All of these Western Balkan countries have a problem with the judicial system and the credibility of the rule of law, thus damaging their image in the eyes of foreign direct investors.

References

- [1] Boubakri, N., Cosset, J.-C., Guedhami, O. & Saffar, W. (2011). The political economy of residual state ownership in privatized firms: Evidence from emerging markets *Journal of Corporate Finance*, vol.17: pp.244-258. Available
- [2] Curran, L. 2009 "The Impact of the Crisis on EU Competitiveness in International Trade", *Intereconomics*, September/October 2009 Available online at <https://archive.intereconomics.eu/downloads/getfile.php?id=702>
- [3] Global Competitiveness Report . 2017-2018. Available at <http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf>
- [4] IMF International Financial Statistics and UN/DESA, World Economic Situation and Prospect 2018: Chapter 3; Regional Development and Outlook Available online at https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/WESP2018_Full_Web-1.pdf
- [5] IMF, World Economic Outlook April 2018, Cyclical Upswing, Structural Change, Available online at <https://www.imf.org/~media/Files/Publications/WEO/2018/April/text.aspx>

- [6] INVESTMENT CLIMATE IN MONTENEGRO 2017, Available online at www.srp.gov.me/ResourceManager/FileDownload.aspx?rId...2
- [7] Investment policy review , Bosnia and Hercegovina , *United nations conference on trade and development, 2015*. Available online at http://unctad.org/en/PublicationsLibrary/diaepcb2015d1_en.pdf
- [8] Kikerkova,I 2017, "Success or failure of the implemented strategy on attracting foreign capital in the form of FDI in the Republic of Macedonia" *EKON. MISAO I PRAKSA DBK. GOD XXVI. (2017.) BR. 2. (939-954)*, Available online at <https://hrcak.srce.hr/file/282103>
- [9] Osmani ,R. 2016." Improved Business Climate and FDI in the Western Balkans", *Journal of Economic and Social Studies*, Available at <http://eprints.ibu.edu.ba/2971/1/5%20Jecoss%206.1%20%28Osmani%29.pdf>
- [10] Prifti, E 2014, "BOT Contract through the optics of Albanian legal provisions. Issues of the implementation and transfer framework" *Academicus - International Scientific Journal* Available online at <http://www.academicus.edu.al/nr14/Academicus-MMXVI-14-094-106.pdf>
- [11] Pula,E Loxha,A Elshani D 2017," How 'friendly' is Kosovo for Foreign Direct Investments: A Policy Review of Gaps from a Regional Market Perspective", *A POLICY REPORT BY GROUP FOR LEGAL AND POLITICAL STUDIES NO. 01 – FEBRUARY 2017*,Available on line at <http://www.legalpoliticalstudies.org/wp-content/uploads/2017/03/How-friendly-is-Kosovo-for-Foreign-Direct-Investments-Policy-Report-GLPS.pdf>
- [12] Radenković,I 2016. Foreign Direct Investments in Serbia, Research Paper Series of Rosa Luxemburg Stiftung Southeast Europe,Available online at http://www.rosalux.rs/sites/default/files/publications/6_Radenkovic_engl_web.pdf
- [13] Sanfey P, Milatovic J 2018, The Western Balkans in transition:diagnosing the constraints on the path to a sustainable market economy Availabe online at <https://www.ebrd.com/.../western-balkans-summit-2018-diagnostic-p...>
- [14] United Nations, World Economic Prospects, 2018.Available online at https://www.un.org/development/desa/dpad/ép-content/uploads/sites/45/publication/WESP2018_Full_Web-1.pdf
- [15] Western Balkans : Regional Economic Integration Issues Notes June 2017.
- [16] Zoto, O.2012, Investimet e huaja direkte nw Shqipwri ,analizw e efekteve ,politikave dhe lidhja me rritjen ekonomike, <http://www.doktoratura.unitir.edu.al/wp-content/uploads/2012/09/Oltjana-Zoto-Fakulteti-i-Ekonomise.pdf>