

## Foreign Direct Investments as a Growth Factor for Stimulation of Economic Development and Albanian Position towards Balkan Region's FDI

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### Abstract

Foreign direct investments in Albania are perceived as an important factor of economic development and this is because of several benefits of FDI and its importance vis-à-vis other forms of capital flows. The paper aims to analyze the trend of development of FDI stock and inflow in Albania as well as its position in Balkan region in reference to foreign direct investments. In doing so the author try to answer to the research questions related to the FDI's share to national GDP, how significant are foreign direct investments in Albania related to other external inflows, what is their role to the performance of the national economy? Does Albania has a "favorite" position in the region regarding the foreign investments coming to the Balkan countries? UNCTAD, EUROSTAT, Bank of Albania and INSTAT(statistical office of Albania) published data are collected and analyzed to estimate the impact of FDI stock in national economy and Albanian position towards Balkan region' s FDI. The results show that, the foreign direct investments have extended largely during the last decades in Albania, as well as in Balkan region, showing a continuous increase, despite global financial crisis. Nevertheless the FDI inflows to the Western Balkan Countries have had a different trends. The largest share of the total FDI stock in the Balkan region, is covered by Serbia, but in reference to the FDI per capita, Montenegro is ranked in the first place in the region followed by Albania. Despite of those factors, Albania has a relatively low trans-nationalization index (FDI/GDP ratio) compare to other countries in the region.

**KEYWORDS:** FDI, economic growth, other capital inflow, foreign investors, Balkan region, economic sector, trans-nationalization index.

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### INTRODUCTION

According to OECD (2008), direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise owns at least 10% of the voting power of the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. FDI has become an important source of private external finance for developing countries and it's perceived as superior to other types of capital inflows such as external debt or portfolio investments. This is due to a long term commitment of foreign investments, high potential rate of economic profitability and in overall increase the economic growth of the host country. (CUTS,2002)

As Mossa (2012) described, the positive effects of FDI's can be summarized as follow:

- capital provision is more stable and there is a long term commitment because of the access the home country firms have in international capital markets;
- advanced and modernized technology (know-how) transferred from home country to host country, which helps transform scientific knowledge into commercial one;
- access to raw materials is easier because FDI firms control the whole process from production to the final delivery of the product and therefore have a large network with many suppliers.
- high managerial and operational skills, which are transferred in the host country;
- employment increase: FDI's contribute directly to employment opportunities either through new plant facilities or distribution;

Meanwhile, FDI's may cause also negative effects the host country economy and some of them are as follow:

- environmental damage- host country governments, in an effort to attract FDI's, compromise with host country firms that are not environmentally friendly. This is especially true in developing countries where standards and rules in environment issues are not strong;
- wage inequality - FDI's enterprises offer more attractive wages and this affects local firms through using their skilled labor;
- due to intensive competition foreign companies, may kick out of the market or depress local firms.

### **FDI's and other capital inflows in Albania and their impact in national economy**

**Foreign direct investments** inflow in Albania, at the end of 2014 recorded about Euro 870 million, or about 9% less compared to the previous year and representing about 8% of nominal GDP. About 58% of the FDI's inflow originated from Canada, while Greece and the Netherlands were the second and the third largest FDI exporters to Albania with respectively 14% and 9% of the total inflows. Broken down by industries, FDI inflows in 2014 were comprised of the extracting industry (58%), transport and telecommunication (13%) and the energy sector for about 9%. In long term perspective, Direct Investments (DI's) represent an important foreign exchange inflow in financing trade and current account deficits (about 61.5% in 2014, Balance of Payment data).The latter was evident especially post 2009, when the importance of other foreign exchange flows such as remittances, begun to contract progressively. Attracting DI's in the country has always been a priority of Albanian governments over time. Despite succeeding in some strategic projects, further effort should be considered to promote FDI's in the country, especially those in manufacturing sectors of the economy which might lead to a better export performance. Over the period, 2004-2014 foreign exchange inflows under direct investments represented about 14% of total inflows or about Euro 6.6 billion out of about Euro 48 billion total inflows during this period. All types of foreign exchange inflows to Albania during 2004 – 2011 have exhibited a steady pattern with a gradual upward trend. This trend was reversed in the period 2012-2014, during which, foreign exchange inflows, and especially, exports of goods and current transfers to Albania have decreased. FDI to Albania have reached their peak in year 2010, with about Euro 800 million, or 40 % higher than the historical long term average of direct investment inflow. The higher level of FDI's during this

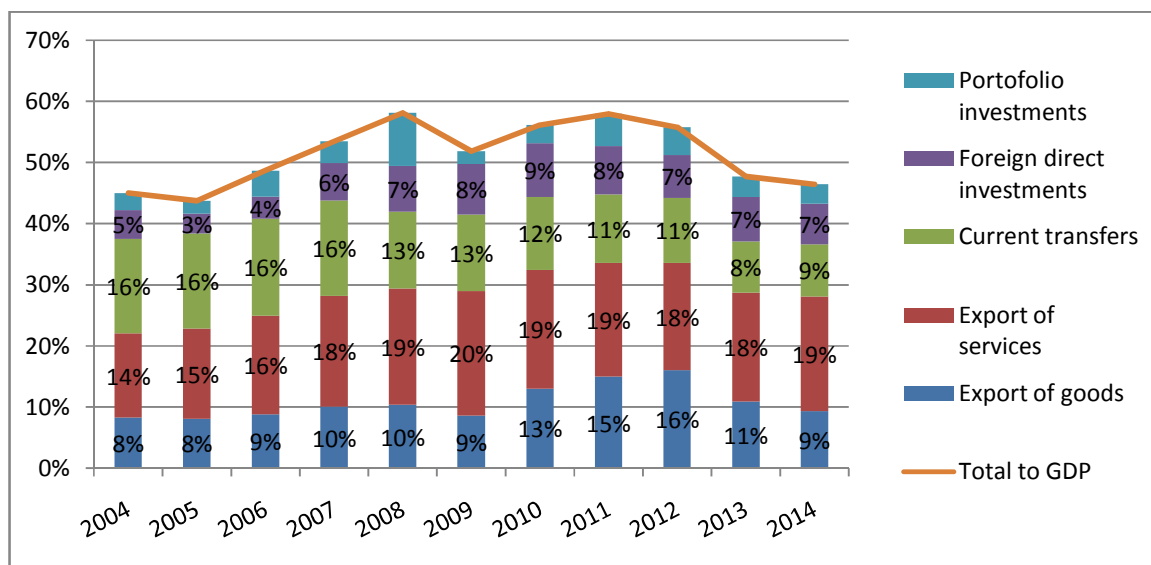
period is attributed to investments carry out under concessionary contracts in the oil drilling and extraction and hydropower production sector.

**Table.1** Foreign exchange inflows in Albania, for the period 2004-2014 *million of euro*

<i>Year</i>	Export of goods	Export of services	Current transfers	Foreign direct investments	Portfolio investments
2004	486	808	912	278	163
2005	530	967	1022	213	137
2006	631	1157	1136	259	305
2007	786	1421	1220	481	276
2008	917	1688	1117	665	768
2009	751	1771	1096	717	183
2010	1172	1751	1077	793	269
2011	1406	1747	1050	742	499
2012	1525	1673	1012	666	435
2013	1052	1715	811	700	326
2014	931	1880	852	669	315

Source: Bank of Albania

From the contribution level to overall economic development, altogether the foreign exchange inflows represent in the long-term average about 55 % of the total GDP during the decade 2004-2014. Within this period the lowest level of contribution is recorded in year 2005, for about 44% and the highest level of their contribution to the total GDP, is recorded in year 2011, for about 58%. If the impact of the main types of foreign exchange inflows in the economy is analysed, as measured by the inflow/GDP ratio, it is observed that FDI inflows rank as the second from the bottom, and are smaller than portfolio investment inflows. Revenues from the export of services and inflows in the form of private current transfers represent the top two categories of inflows, in terms of size. Exports of services as a share of GDP have maintained a steady level with a 10-year average of about 19%. FDI inflows on the other hand have recorded a long-term average of about 8% of GDP, peaking at 9% in 2010. From this year onwards, the share of FDI inflows to GDP has been almost unchanged at 7%. It's interesting to highlight the significant decrease of annual remittances in proportion to GDP. While in 2004-2010, on average and in annual terms, remittances amounted to about 17% of GDP, the following years have seen remittances drop to about 9% of GDP. Meanwhile, foreign direct investment stock at the end of 2014 marked about Euro 4,5 billion, or up by 11% when compared to the year 2013. FDI's stock nominal value registered during this year represents also the highest historical level registered during the period between (2004-2014).



Source: Bank of Albania & author calculations

**Chart 1** Foreign exchange inflows and its impact to GDP, in Albania during 2004-2014

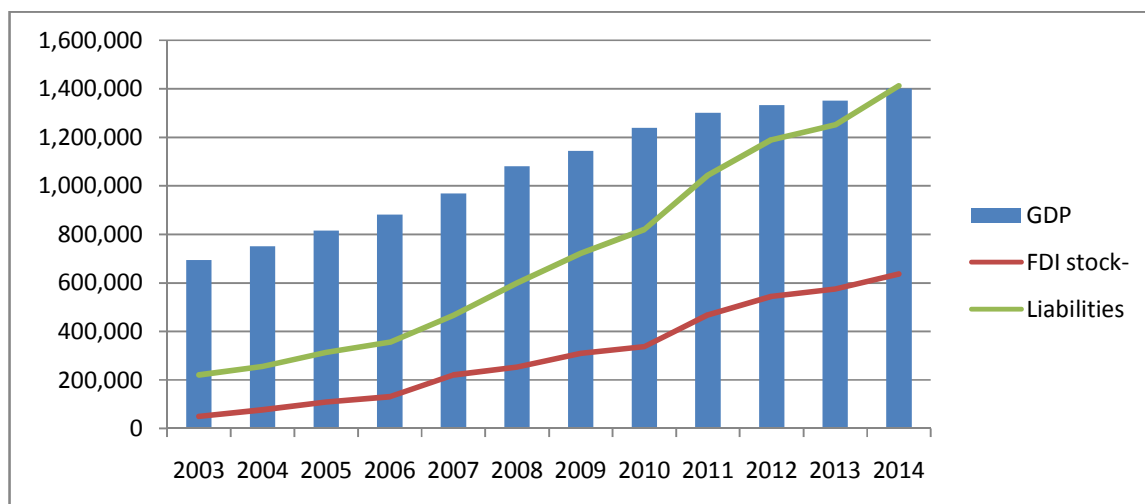
Increased stock of foreign direct investments in the country is mainly due to increased of transaction flows. The main economic activities in which is currently concentrated the stock of FDI are: transportation and communication for about 27 % of the total, financial services to around 17 % and the extractive industry for about 15 % .

**Table 2.** Index of annual changes of stock and flow of FDI's

Chain index of changes	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
FDI's_ stock	41%	22%	73%	13%	10%	8%	40%	15%	6%	11%
FDI's_ flow	-23%	22%	86%	38%	8%	11%	-6%	-10%	5%	-4%

Source: Bank of Albania & author calculations

The largest annual increase of the FDI's stock (about 73 %) is observed in 2007, the year in which also FDI's inflows experienced the highest increase level as well for about 86%, followed by an annual increase of 40% in 2011. While, a lower increase level was marked in 2013, with only about 6% in annual terms, which was accompanied by a lower increase in FDI inflows for about 5 percent. During the period between 2004-2014, the stock of FDI's has increased steadily in average of 24%, meanwhile, the average growth rate of inflows for the same period has recorded an average annual growth of about 12%. However, the historical analysis of this indicator demonstrates an upward and consolidated trend of the stock of FDI and clearly highlights the determining role direct foreign investment inflows in the creation of the stock. High growth rates of FDI's stock have resulted at the end of the 10 years, at a level which is almost 7 times higher compared to its level in 2004. Currently, the stock of FDI represents about 45 % of annual GDP in 2014.



Source: Bank of Albania & INSTAT

**Chart 2** Annual trend overall liabilities, GDP and FDI's stock

Foreign direct investments outflows and inflows are composed by two components: (a) own capital/equity and (b) debt instruments. The “own capital/equity” component, independently on from the direction of the investment (inflow or outflow) represented the determining part of the overall stock of investments. In the case of foreign direct investments, the own capital or equity represents about 70% of the stock during the 2012-2014 period. The rest is composed by debt instruments. It is important to note that the ratio between these components over time has changed in favor of “debt instruments”, thereby changing the structure of direct investments from the ratio of (74:26) in 2012 to (64:36) at the end of 2014. While the data associated with the indicator of the international investment position, show that net direct investment position at the end of 2014, measured as the difference between the stock of direct investments of non-residents in Albania and the stock of direct investments of residents abroad, amounted to Euro 3.3 billion or 24 percent higher compared with the position at the end of 2013.

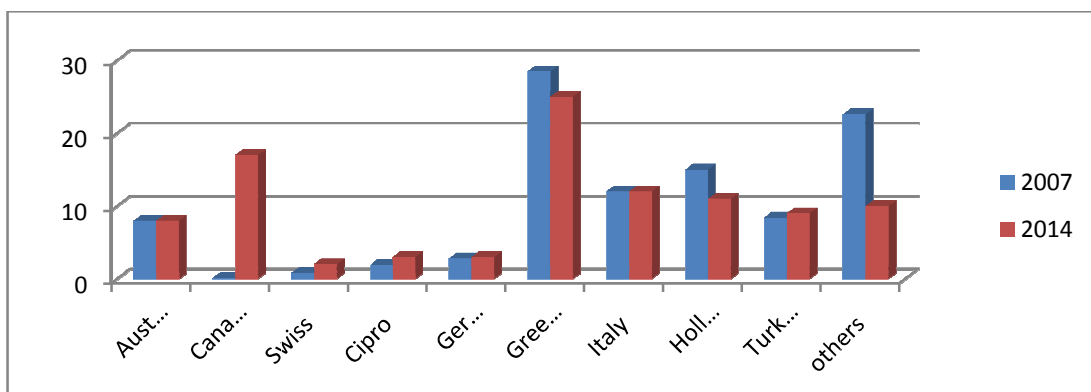
**Table 3.** IIP in Albania for the period 2012-2014, in euro million

International Investment position	2012	2013	2014
<b>Assets</b>	4,467	5,513	5,630
<i>From which: direct investments outflow</i>	779	1,437	1,230
<b>Liabilities</b>	8,498	8,938	10,086
<i>From which: direct investments inflow</i>	3,893	4,113	4,553
<b>Net position</b>	-4,031	-3,425	-4,456
<i>From which: direct investments</i>	-3,114	-2,676	-3,324

Source: Bank of Albania

The deepening of the country's net position as a borrower in 2014, is a result of the increase in the liabilities in the form of FDIs in Albania by Eur 440 million more than

during 2013. In 2013, the stock of assets invested abroad (direct investment of residents abroad) recorded an unusual increase of 85%. The trend was reversed in 2014, which recorded a decrease of the direct investments stock abroad by about 14%. An argument that can be used to explain the growth in the direct investments abroad, is linked to the general elections held in June 2013. General elections tend to be accompanied by an increased uncertainty regarding growth, stability and future prospects. As a result, resident companies are inclined to transfer part of their assets/capital abroad. In the same period, direct investments in Albania continued to increase, but the growth rate was significantly lower than in the previous years, standing at 6% in 2013 and 11% in 2014. The countries with the highest inflows in Albania were Greece with 26% of the total stock, followed by Canada and Italy with respectively 17% and 12% of the total FDI stock. EU countries together, owned about 66% of the total FDI stock in 2013, and 59% of the stock at the end of 2014. The countries with the highest FDI inflows to Albania within EU are Italy and Greece, which are also the main partners in merchandise trade. At the end of 2007, the FDI stock from Italy and Greece represented respectively 43% and 18% of the total stock originating from EU countries. At the end of 2014, the shares of the FDI stock from Italy and Greece as a percentage of the stock originating from EU countries were respectively 44% and 20%. Direct investments from Italy and Greece are concentrated in the processing industry and the real estate sector. After 2007 Albania has attracted considerable foreign investments in the sectors of construction and energy, as a result of which countries like Austria, Turkey and the Netherlands have gained prominence as direct investing countries in Albania. Investments from Canada have recorded a marked increase culminating in 2014, at the end of which the stock of FDIs from Canada was 7 times higher compared to the end of 2009.



Source: Bank of Albania

### Chart 3. FDI stock by countries for years 2007, 2014

The presence of FDIs flows from Balkan countries in Albania, is limited. The stock of DIs investment from these countries, including Slovenia comprised only 1.6% of the total FDI stock at the end of 2014. FDIs from countries in the region are of such comparatively small values, that an analysis of the size of these investments would be of little interest. However, it is worthwhile to note the difference in the trends of investments from different countries. For example, investments from Kosova, FYROM and Slovenia have exhibited an upward trend, whereas investment from Serbia has been decreasing.

**Table 4.** Foreign direct investments in the region

FDI in Balkan region	2012	2013	2014
Croatia	13	14	14
Kosovo	13	13	15
Montenegro	0	1	1
Slovenia	13	12	18
Serbia	7	4	4
FYR Macedonia	17	20	22
Total	63	64	74
<i>In % versus total stock of FDI's</i>	<i>1.6%</i>	<i>1.6%</i>	<i>1.6%</i>

Source: UNCTAD and author calculations

**What's the position of Albania towards Balkan countries in FDI?**

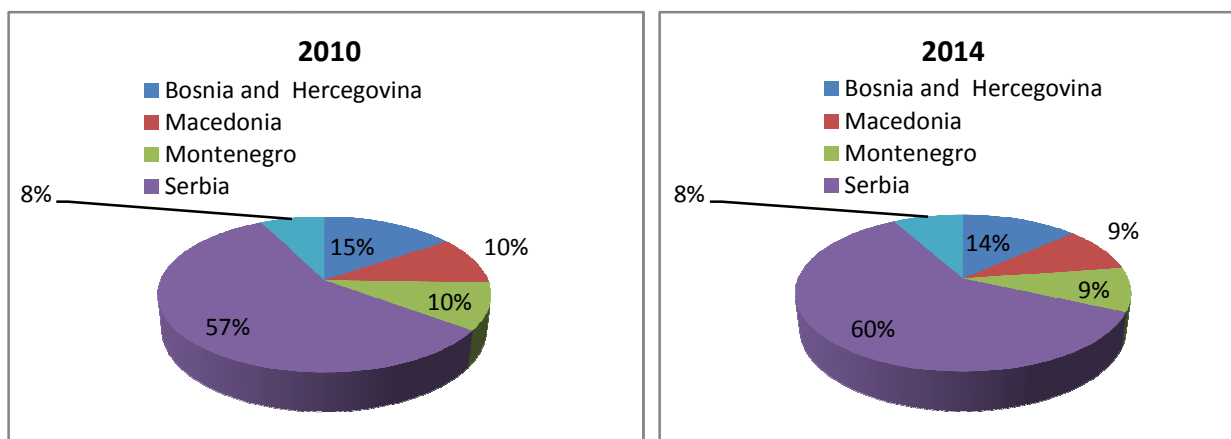
World experience on the behavior of foreign direct investment to economic growth, supports the existence of a positive relationship between them. Foreign direct investments remain an important component of economic growth while domestic demand growth is one of the main indicators that attracts foreign investment. Although countries in the region since 2008 experience negative economic growth rates, the net stock of foreign investment experienced positive growth rates. Thus, Albania is the country experiencing the highest average growth rate with about 21%, meanwhile the lowest average growth rate was registered in Macedonia with about 10% for the decade, 2004-2014.

**Table 5** Stock of FDI-s (net position in USD million)

FDI stock	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
BH	2,286	2,302	3,203	5,397	6,103	6,936	6,709	7,099	7,440	7,787	7,383
FYR Macedonia	2,193	2,087	2,764	3,747	4,132	4,525	4,351	4,678	4,863	5,489	5,140
Montenegro	-	-	-	-	-	-	4,231	4,209	4,707	5,143	4,983
Serbia	-	-	-	-	21,130	23,149	24,919	27,684	29,344	35,375	33,142
Albania	837	1,020	1,392	2,693	2,869	3,258	3,255	4,399	4,304	3,936	4,466

Source: UNCTAD

For countries such as Montenegro and Serbia, due to geopolitical changes in these countries, the average growth rate of the stock is calculated in reference of the shorter periods, so their long term average growth rate is estimated to be respectively about 4% and 8%. Likewise, if we analyze the structure of the stock of FDI-s in the region, broken down by countries, we can notice that Serbia accounts for about 60% of total stock at a regional level followed by BH with about 14%. The other Balkan countries like Macedonia, Montenegro and Albania show almost a constant weight over the period 2010-2014, accounting respectively for about 10%, 9% and 8%.



Source: UNCTAD

**Chart 4.** Net stock FDI by Balkan countries

In the process of comparative analysis of FDI, within countries in the region, another very useful indicator is the index of FDI intensity calculated as a ratio of foreign investments to GDP. Expressed as a percentage, this index avoids performance differences in size of the various economies and also enables the comparison of the role of FDI in the economies of different countries.

**Table 6** Net FDI-s stock (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
B H	23	21	26	35	33	40	40	39	44	44	41
Macedonia	39	33	40	45	42	48	46	45	50	51	45
Montenegro	-	-	-	-	-	-	103	94	116	116	111
Serbia	-	-	-	-	38	48	55	52	62	68	65
Albania	12	13	16	25	22	27	27	34	35	31	34

Source: UNCTAD & Bank of Albania

During the period 2010-2014, Montenegro at the end of 2012 recorded the largest increase in the stock of FDI to GDP by about 116 %, while the lowest level, was registered in Albania at the end of 2010 for about 27 %. In year 2014, all Balkan countries except Albania have registered a decline in this indicator compare with year 2013. The highest decline was recorded in Macedonia with about 6%, followed by Montenegro with about 5%. The other Balkan countries such as Serbia and Bosnia and Herzegovina, despite their largest share in the stock of FDI, were characterized by a contraction of the FDI stock for about 3%. Only Albania registered an increase in the stock of FDI's to GDP ratio with about 3 % compared to 2013. With regard to FDI flows in the region, the decade of (2010-2014) was characterized by volatile growth/decline rates, for all Balkan countries. Among them, should be noticed the Montenegro with the highest long term average negative growth rate estimated for about (-4%).

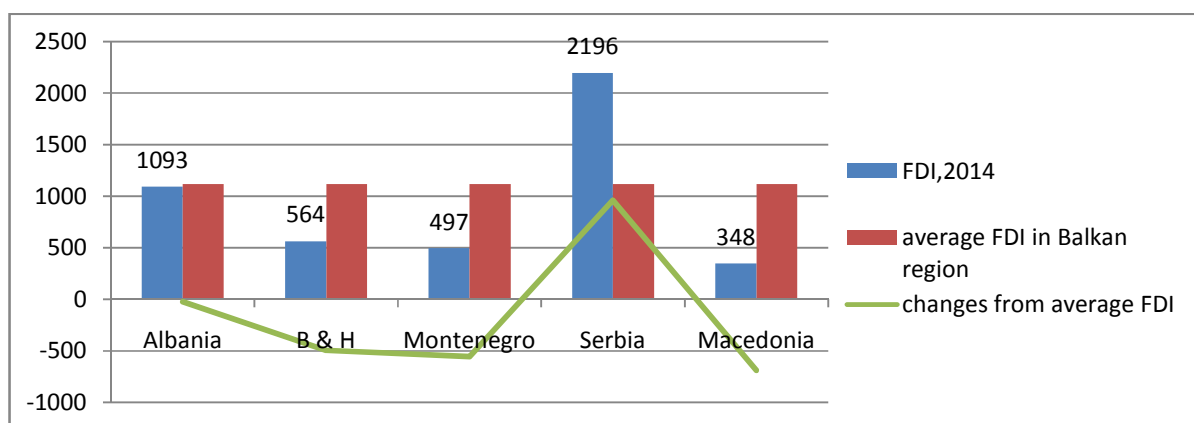


**Table 7** Structure of FDI's flows, in % for Balkan region.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
BH	43	49	42	57	12	4	9	6	10	6	12
Macedonia	27	13	33	22	7	3	5	6	4	7	7
Montenegro					12	24	17	7	17	9	11
Serbia					56	53	47	69	45	51	47
Albania	29	37	25	21	12	16	23	11	24	27	23
Balkan Region	100	100	100	100	100	100	100	100	100	100	100

Source: UNCTAD & Bank of Albania and author calculations

The highest long term positive growth of FDI flows was registered in Macedonia with 46%, followed by Bosnia and Herzegovina with about 27%. For the year 2014, countries like Bosnia and Herzegovina, Macedonia and Montenegro experienced positive growth rates of FDI's flows, with 99%, 4% and 11% respectively. Meanwhile, Albania and Serbia have undergone a contraction of FDI's, respectively (-14%) and (-9 %). Also during 2014, Albania is ranked in the second position in the region (after Serbia), recording a value of FDI flows in million of US\$ for about 1093. For the period 2008-2014, in the Balkan region the total FDI inflow is estimated for about USD 40 billion, with a yearly average inflow for about USD 1.2 billion. The analysis of the structure of foreign investment flows by countries in the region, for the same period emphasizes again that Serbia is the country where is concentrated on average about 54% of the total average inflows of foreign direct investments, followed by Albania with about 18%. The comparative analysis between countries in the Balkan region, related to FDI inflows for 2014 versus the long term average of FDI inflow for the period (2008-2014), points out that Serbia is the only country with yearly FDI inflows higher than the average annual inflow of the region, estimated for about 96%. Meanwhile the rest of countries in the region have experienced negative changes, so to say, lower yearly FDI inflow compared to the long term average FDI inflow of the region.



Source: UNCTAD and Bank of Albania

**Chart 5.** The annual DI inflow and the change with long-term average DI inflow, by countries

Among the Balkan countries experiencing negative changes, Albania recorded the lowest rate followed by BiH, respectively (-2)percent and (-50) percent, always compared with the long term average inflow of DIs of the Balkan region. Another indicator to be used for comparative analysis of FDI inflows in the Balkan countries is FDI per capita which enables us to look beyond structural differences arising from the size of territory and population. According to our estimates, the long term average FDI per capita in the Balkan region amounts to USD 310.

**Table 8** FDI's per capita, over 2008-2014

	2008	2009	2010	2011	2012	2013	2014
Albania	328	340	362	304	297	439	378
BH	261	65	106	130	92	74	148
Montenegro	1,550	2,460	1,223	896	993	716	795
Serbia	495	363	240	607	177	269	247
Macedonia	285	98	103	232	69	162	168
Balkan Region	432	338	249	428	194	258	257

Source: UNCTAD and Bank of Albania & author calculations

The country with the highest amount of FDI per capita is Montenegro, which has received an annual average of about USD 1,300, an amount about three times higher than the region average. Albania is situated in the second place with a USD 350 annual average, which is 14% higher than the region average. Bosnia and Herzegovina is the country with the lowest amount of FDI per capita in the region. It has received an average of USD 125, or 60% less than the long term average of the region.

## CONCLUSIONS

The foreign direct investments have extended largely during the last decades in Albania, as well as in Balkan region, showing a continuous increase, despite global financial crisis. The focus of our paper is to describe the performance of FDI in Albania, its role to the economic growth and the position of Albania into the Balkan region in reference to the FDI. Privatization has been the main contributor to maintain the upward trend of FDI but recently the concessionaires' contracts in hydropower sector has been the major factor of the increase of FDI in Albania. In terms of sector composition of FDI stock, the majority of it is concentrated in services sector (mainly telecommunication and financial services) and a low level of FDI in production sector, so no significance role in the economic model towards production sector. Despite succeeding in some strategic projects, further efforts should be considered to promote FDIs in the country, especially those in manufacturing sectors of the economy which might lead to a better export performance.

FDI inflows to the Western Balkan Countries have had a different trend than that of Albania due to political conflicts. Albania shares about 18 percent of the total FDI stock of the Balkan region, while the largest share of the total FDI stock in the Balkan region, is covered by Serbia, but in reference to the FDI per capita, Montenegro is ranked in the first place in the region with about 1,300 USD stock FDI per capita followed by Albania

with 350 USD per capita. Despite of those factors, Albania has a relatively low transnationalization index (FDI/GDP ratio) compare to other countries in the region.

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