How the Foreign Direct Investment Impact Economic Growth. Case of the Albanian Economy

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Abstract
Albania is a developing economy country with about 30 years of market economy experience. In recent years, Albania has experienced economic growth coupled with lower inflation, lower unemployment, an increase in Foreign Direct Investment, and an increase in GDP per capita. This paper aims to present a complete picture of the macroeconomic indicators, comparing our country with the countries of the region. This analysis will be supported by secondary data obtained from the World Bank, the International Monetary Fund, and the central banks of each country. The analysis will include the years after the financial crisis to see how the economy as a whole has recovered.

According to the analysis, we conclude that FDIs and Remittances have a significant effect on economic growth in Albania. We will then look at what is the relationship between the economic growths (represented by GDP per capita) of these countries and the level of Foreign Direct Investment, Remittances, and Inflation rate. These data will be processed with SPSS statistical software.

Keywords: Foreign Direct Investment, Inflation, Gross Domestic Product, Economic Growth, Country in Transition, etc

JEL: E3, E4, O1

Introduction
The level of Foreign Direct Investment in the economy is a global issue because it affects the economy of each country. FDI has many definitions, but the concept underlying this paper will be a more international one, as follows:

“Foreign Direct Investment, according to the OECD (2007), reflects the intention of securing a resident interest of one resident in one economy (direct investor) in a resident unit of another economy. The concept of "sustainable interest" implies the existence of a long-term relationship between the direct investor and the enterprise, as well as a significant influence of the investor on the management of the decision-making process in the enterprise. The FDI index is important in developing as well as developed countries”.

Foreign direct investment is the flow of capital by an investor who buys a property/asset in another country to manage it (Denisia, 2010). Foreign Direct Investment plays an important role in the Albanian industry and ensures the competitiveness of Albanian products in the world market. The main role of FDIs is to help bridge the gap between Albanian industrial capacity and ongoing facilities. According to Moosa & Cardak (2002), Foreign Direct Investment plays an important role as a source of financing for the development of the country. FDI also influences domestic investment growth, creates new job opportunities, increases the level of market competition, and all of these have a positive impact on economic growth (Quazi, Vemuri, & Soliman, 2014).

The manner of operation of Foreign Direct Investments is also supported by the Albanian legislation. According to the "Law on Foreign Investment" no. 7764, dated 02.11.1993, states: "Foreigners have the right to engage in economic activities without the need for any authorization or possible permission. These investors are treated no less favorably than Albanian citizens, except in cases of involvement in the possession of the land, a case which is dealt with by a separate law. Albanian legislation provides that at any time or in any case, the foreign investment shall be treated equally and fairly and shall enjoy full protection and security. Investors who suffer
losses as a result of wars, armed conflicts, national emergencies, or other similar events will be treated with specific articles just like Albanian investors. Foreign direct investment relates to many other economic variables because FDI represents a very important variable for the Albanian economy, especially after the 1990s. According to Eustat (2000), the value of FDI accounts for about ¼ of international transfers across the globe. According to Jones (1996), the competitive advantage of some developing countries has made it possible to change the direction of FDI flows, for example in the case of lower wages in the labor force in some of these countries it has been possible that many foreign investments to focus on Albania.

**Literature review**

Like any other phenomenon, Foreign Direct Investment has its positive and negative sides. Theoretical views on this issue vary from the ideas that FDI loses the identity of a country, to the idea that they are an aspect of the economy without which the latter cannot exist and for therefore they should be viewed positively. Often theoretically they are seen as a channel of opportunity, especially for developing countries. According to Lipsey (1999), FDI is the most important and dynamic source of investment in a developing country. Nevertheless, FDI flows should not be viewed solely in terms of a single flow, but of many subsequent flows of initial capital flows. Specifically, in addition to the initial investment, FDI is followed by international capital movements, from the host country to the country of origin, by the movement of managerial, technological, and so on. FDI plays a very important role in transforming countries, especially post-communist ones (Moose 2000). The biggest challenge of any economy is to open it internationally and to orient it to competitive advantages and international cooperation. One of the main advantages of FDI is that they affect the economic development of their host country and as such are in most cases emerging economies. After the 1990s, these investments were the main source of large funding, especially in countries with prospective economic growth. One of the other functions of FDI besides financing is the transfer of new technologies and capital inputs.

Countries that have received FDI from another country can develop their human resources, employing young people in the business of a particular business. FDI helps create new jobs, increase workers' wages, and simplify lifestyles, and more. Foreign direct investment usually contributes to the development of the productive sector of the host country of investment. FDI plays a crucial role in disputing the productivity of host countries. Companies in these countries have the opportunity to explore new, foreign markets and thereby generate more revenue and profits. FDIs are a source of deficit financing in the Balance of Payments by improving lending to host countries. FDI plays an important role in creating the right economic conditions for EU membership, one of Albania's biggest challenges in recent years. But in addition to the advantages, the disadvantages of foreign direct investment are also the other side of the coin. They mainly occur in the case of issues related to the operation and distribution of foreign investment earnings. One of the indirect disadvantages of FDI is that the less developed economic sectors of the host country are always inadequate when the level of FDI adversely affects them. Similar situations in countries such as Ireland, Chile, Singapore, and China confirm such an opinion. It is quite normal for the host country to have a responsibility to limit the extent of the impact of FDI. According to Zoto (2012), these countries need to be sure that the entities that realize FDI in their country must abide by the environment, governance, social rules that are defined and function in that country. FDIs themselves contain high costs of communication, travel, etc. The linguistic and cultural differences that exist between the investing country and the host country can also present problems in the case of FDI.

One disadvantage of FDI, however, is that there is always the possibility of failing to own a company that has companies abroad. This has often led many companies to approach FDI with high caution. It has been noted several times that there is considerable volatility in a particular geographical region which causes much concern for the foreign investor, political risk. Market size as well as host country conditions may be other important factors for FDI. In cases where the host country is not strongly linked to the more advanced neighboring countries, this is a challenge for investors. It has been noted several times that host country governments have had problems with FDI as the host country government has less control over the operation of companies which
are wholly owned subsidiaries of a company abroad. But all of these international classifications of foreign direct investment have their impacts on the economy, both positive and negative. The effects of FDI are divided into economic, political, and social effects. According to the principles of neoclassical economics, FDI increases the well-being of the host country, under certain optimal conditions (Lall and Streeten, 1977), such as maximizing the profitability of the international company and having a competitive advantage in the country being invested, in terms of inputs and their prices.

Foreign Direct Investment brings to the economy of the host country's impact on microeconomic and macroeconomic indicators. This means that these investments affect both the firm's output and the balance of payments and market structure with its components. Experience in many countries has shown that the arrival of foreign companies can bring about improved competition in the country, but on the other hand, these new companies through non-competitive forms can bring about distortions of fair competition. In this study, the focus is on the impact that Foreign Direct Investment has on the overall product, for example on the economic growth of the host country. The main theories of growth are focused on the influence of such variables as: population growth, technological advancement, capital accumulation, new natural resources, increasing real per capita income.

According to endogenous growth theory, exports are a very important indicator of economic growth because they transfer technological innovations, especially from FDI countries (Lucas, 88; Romer 86, 89; Grossman and Helpman, 91; Edwards, 92). According to Adewumi (2006), Foreign Direct Investment serves as a promoter for the long-term economic development of underdeveloped countries. FDI can help the host country in particular in technology transfer, and its use in domestic investment, transfer of know-how and managerial or professional skills. In his study Krkoska (2001), also stresses the importance of spillover in the economy of the host country, and the replacement of the depreciated capital of that country with the new foreign direct investment capital, which also leads to increased productivity of the host country.

According to Markusen (1998) and the extensive literature, FDI inflows also affect international trade. According to him, this is seen from the intensification of international trade flows from the host country to the rest of the world, as well as from the use of competitive advantages of different countries. The main benefits of international trade are quality improvement, cost reduction, and product pricing. Experience has shown that the production of particular products is more efficiently managed by foreign companies because this would increase the effectiveness and reduce the extent of government intervention, especially in developing countries.

FDIs also has a significant impact on microeconomic indicators such as the number of employees and the increase in the level of wages in the economy. According to Moose (2001), foreign investment directly increases employment by deploying new aids, or indirectly by stimulating employment across different distributions. The increase in the number of employees can occur not only from one company to another but also from one city to another, thus increasing the total number of employees. Foreign direct investment affects the reduction of employment through disinvestment and restrictions on production facilities. But much other practical evidence shows that the impact of FDI on employment is low. According to Vaitos (1976), the occasional early training of a country's local employees is crucial to the success of the company, but they are nonetheless cost-effective. One of the other impacts of Foreign Investments is their impact on productivity, as these investments increase productivity and reduce unit costs. This is achieved by promoting exports by targeting the global market, and by creating opportunities for economies of scale.

According to Jones (1996) in addition to these positive impacts mentioned here, negative impacts such as the movement of capital and its return to the country of origin, even the negative effects on the environment, or the increase of power in a country and the influence of policies and government are recognized. Increasingly, Albania has taken steps towards measures to increase foreign direct investment, and this is most evident after the 1990s. These policies have been successful given the size of capital inflows last year.
FDI flows in Albania remain relatively low and grew slowly before 2006. Since then, FDI has grown substantially, maintaining a positive rate during 2009 as well, with serious setbacks in most European countries. The highest level of FDI in Albania was in 2010, reaching more than $1 billion, making it the second-largest FDI recipient country in SEE after Serbia (UNCTAD, 2011). Albania's FDI inflows have developed independently of global and regional trends during the global financial crisis, showing a steady increase in 2009 and 2010. Comparing Albania's sectoral composition, financial intermediation is the only sector in which the FDI share of Albania exceeds that of other SEE countries. Whereas in other sectors of the economy such as the production and energy industry, Albania has the lowest percentage of FDI.

Important to note, according to Moose (2000), is the identification of other non-economic factors. If we have ever seen the reasons, the effects of FDI it is important to explain that there are often non-economic reasons that determine the direction of foreign direct investment, such as a country's political risk, tax policies, property problem, mentality, culture, problems of one country with other countries, etc.

**FDI Policy in Albania**

The Albanian government has developed policies similar to those of the European Union to attract as much foreign investment as possible and to provide a safe and encouraging environment for foreign investors. Some of these easing measures are listed below:

- Exchange rate stable especially with the two base currencies the euro and the US dollar.
- Facilitation of obtaining the legal status of foreign residents.
- Creating an effective legal framework for the way Foreign Investments operate in Albania. Law 7764 "On Foreign Investment", dated November 2, 1993, was created to create a favorable investment climate for foreign investors in the country.

The political factor has at times been a driver of foreign investment growth and other obstacles, but in most cases, governments have served as an important bridge to opening up the Albanian economy. According to Luci and Frasheri (2015), the role and objective of government have always been to attract FDI flows by pursuing certain policies:

- The opening of privatization of state-owned assets to strategic investors;
- Providing a competitive corporate tax regime - including a 10 percent flat corporate income tax; taking measures to improve the business climate by simplifying business procedures through e-government reforms;
- The creation of an institution responsible for attracting FDI, with a clear mandate.

In addition to the above-mentioned measures, they have contributed to increased investor interest over the past two years, Albania's NATO membership, and progress towards EU integration. Policies to favor the growth of foreign direct investment have been designed since the early 1990s, as soon as Albania transitioned from communist rule to pluralism. According to Luci and Frasheri (2015), the three main elements that attract the attention of foreign investors are the overall return on individual projects; the ease with which affiliates can integrate with global strategies, and the overall quality of the enabling environment that impacts the risks and rewards expected for the firm considering FDI. According to OECD (2002) and Blonigen (2005), the following measures should be taken to increase the level of foreign direct investment and investor confidence:

- Reducing economic and political instability in the country.
- Taking measures to mitigate corruption.
The presence of transparent and efficient legal institutions to improve the business climate in the country.

 Favorable fiscal packages for foreign investors.

 Flexible labor market institutions.

 High-quality educational institutions.

 Markets for a good functioning of capital and intermediation.

 Facilities for opening and closing a business.

 Competition policy and sectorial regulatory and supervisory bodies for domestic and foreign investors;

 Foreign direct investment in Albania has also been favored by our country's geographical position. The largest proportion of foreign direct investment capital originates from neighboring and European Union countries. As mentioned above, the main impact of these investments is the employment growth and economic growth in recent years. One of the major consequences of the financial crisis in Albania is the decline in FDI, as the countries from which these investments came were heavily affected by the financial crisis. Albania has great potential for its economic development. Here we can mention the food industry; the wood processing and mineral extraction industry and the tourism sector. These domestic potentials and tax incentives have driven foreign investors. The literature on FDI is very extensive by both domestic and foreign scholars. According to Velmampy, Achchuthan, & Kajanathan (2014), developing countries should mainly focus on FDI foreign direct investment as a source of external finance. According to Flavianus (2012), Foreign Direct Investment flows are divided into 3 categories.

 1. The initial capital invested by the foreign enterprise in the host country.

 2. Profits from foreign companies in the host country.

 3. Intermediate or long-term loans according to the liquidity needs of the foreign company.

 Experience has shown that developing countries are increasingly aware of the role of foreign direct investment as an engine of growth in their economies. According to Ball, McCulloch, Frantz, Geringer & Minor (2002), portfolio management, ownership, and control are the key elements that distinguish FDI from portfolio investments. According to Borici & Osmani (2015) as well as Wu, Li & Selover (2012), foreign investments fall into two categories: direct investment and portfolio investment. Indirect investment, investors invest equity in a firm for a return on investment and are entitled to participate in the management of the firm. In contrast, in portfolio investments, investors buy securities (such as stocks and bonds) for a return on their investment. Many theoretical and empirical efforts have identified factors that can improve economic growth and performance to make suggestions to policymakers to bridge the gap between developed and developing countries and to create sustainable development (De Jager, 2004). Managers need to be sensitive to the external environment which is so dynamic, and which have a huge impact on decision making (Kraja Borici, & Osmani, 2015).

 The chart below shows the value of Foreign Direct Investment and remittances as a percentage of GDP (data obtained from the Bank of Albania Annual Report, 2018). Remittances are counter-current inflows and outflows at home or abroad. According to Diaz (2009), the repercussions of inward remittances are different in each country and depend on monetary policy. The econometric estimates also indicate that, when an upsurge in remittances occurs, its contribution to economic growth is smaller in countries where remittances tend to produce an overvalued exchange rate, reinforcing macroeconomic stability in the context of an open economy. The remittance inflows are remittances to their relatives in Albania. While remittance flows are money that foreign nationals who have worked in Albania transfer to their home countries. The main countries of origin of
remittances from Albania are Greece, Italy, the United States of America, Macedonia, Germany, and Canada. These six countries have the largest share of remittances with Albania, accounting for 98% of the total. Other countries comprise a very low percentage, about 2% of the total. The graph also shows that the flow of remittances and FDI declined after the financial crisis of 2008 because the countries of origin of these flows were severely affected by this crisis. FDI reached its highest value during 2011-2013 where they accounted for approximately 9% of GDP. The increase in FDI during this period came as a result of the crisis of many countries that have invested in Albania. After 2013 we see a slight contraction in the value of Foreign Direct Investment. Remittances have flourished during the period 2005-2009 where the highest percentages of GDP have been recorded. With the onset of the financial crisis, their value declined sharply as a result of the fact that the majority of remittances came from migrants working in countries most affected by the crisis.

*Graph 1. FDI and Remittances as % of GDP*

![Graph showing FDI and Remittances as % of GDP](image)

*Source: Bank of Albania, 2018*

**Methodology**

This research is quantitative and in terms of its application, it is an empirical study on the factors influencing economic growth in Albania. Above is the research framework.

*Figure 1. Research framework*

According to the literature cited above, evidence indicates that Foreign Direct Investment has a positive impact on economic growth (the variable that measures the economic growth supported by the literature is GDP per capita). Also, other variables that are assumed to be positively correlated with economic growth are remittances
rate, Gross Domestic Product growth rate, and inflation rate. The data are obtained from the World Bank data for Albania for the period 2005-2018, annual data. Data were processed with SPSS statistical software in simple linear regression.

Equation is:
\[ GDP_t = C_t + B_0 FDI_t + B_1 \ln + B_2 \text{Remittances} + u_t \]

The hypothesis being tested for this equation are as follows:

\( H_0 = \text{There is no significant relationship between Net Foreign Direct Investment and economic growth in Albania.} \)

\( H_a = \text{There is a significant relationship between Net Foreign Direct Investment and economic growth in Albania.} \)

\( H_0 = \text{There is no significant relationship between Inflation and economic growth in Albania.} \)

\( H_a = \text{There is a significant relationship between Inflation and economic growth in Albania.} \)

\( H_0 = \text{There is no significant relationship between Remittances and economic growth in Albania.} \)

\( H_a = \text{There is a significant relationship between Remittances and economic growth in Albania.} \)

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<th>Variables Removed</th>
<th>Method</th>
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<td>Enter</td>
</tr>
</tbody>
</table>

a. Dependent Variable: GDP per capita
b. All requested variables entered.

Model Summary

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<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
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<td>.926(^a)</td>
<td>.858</td>
<td>.794</td>
<td>.03568</td>
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</table>

a. Predictors: (Constant), GDP growth rate, INFLATION, Net FDI, Remittances

ANOVA

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<th>Df</th>
<th>Mean Square</th>
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<th>Sig.</th>
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<td>Residual</td>
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<td>0.001</td>
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<tr>
<td>Total</td>
<td>0.080</td>
<td>13</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
a. Dependent Variable: GDP per capita

b. Predictors: (Constant), GDP growth rate, Inflation, Net FDI as % of GDP, Remittances as % of GDP

The provided regression in Table 1 shows overall coefficients generated from the leaner regression analysis. The results of the table will be further explained in the research findings and summary below.

<table>
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<th>Model</th>
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<td>B</td>
<td>Std. Error</td>
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<tr>
<td>(Constant)</td>
<td>3.954</td>
<td>0.330</td>
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<tr>
<td>Remittances</td>
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<td>Net FDI</td>
<td>0.325</td>
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<tr>
<td>Inflation</td>
<td>0.160</td>
<td>0.092</td>
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<tr>
<td>GDP growth rate</td>
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<td>0.050</td>
</tr>
</tbody>
</table>

a. Dependent Variable: GDP per capita

H0 = There is no significant relationship between government terms and regulations and inflow of foreign direct investment in Tanzania.

Based on the hypothesis test in Table 7 since p-value (0.140) is greater than 10% (p = 0.10), proving that null hypothesis was accepted indicating there is no significant relationship between government terms and regulations and foreign investment inflow in Tanzania.

H0 = There is no significant relationship between government terms and regulations and inflow of foreign direct investment in Tanzania.

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H0 = There is no significant relationship between government terms and regulations and inflow of foreign direct investment in Tanzania.

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H0 = There is no significant relationship between government terms and regulations and inflow of foreign direct investment in Tanzania.

Based on the hypothesis test in Table 7 since p-value (0.140) is greater than 10% (p = 0.10), proving that null hypothesis was accepted indicating there is no significant relationship between government terms and regulations and foreign investment inflow in Tanzania.

Results

- Based on the hypothesis tested in Table 1 since the p-value for GDP growth rate (0.408) is greater than 10% (p = 0.10), providing that null hypothesis was accepted indicating there is no significant relationship between GDP growth rate and economic growth in Albania.

- Based on the hypothesis tested in Table 1 since the p-value for inflation (0.116) is greater than 10% (p = 0.10), providing that null hypothesis was accepted indicating there is no significant relationship between inflation and economic growth in Albania.

- Based on the hypothesis testing in Table 1, since the p-value for net foreign direct investment (0.015) is less than the critical value (p = 0.10), proving that the null hypothesis is rejected indicating that there is a significant relationship between net foreign direct investment and economic growth in Albania.
Based on the hypothesis testing in Table 1, since the p-value for remittances (0.037) is less than the critical value (p = 0.10), proving that the null hypothesis is rejected indicating that there is a significant relationship between remittances and economic growth in Albania.

Table 1 is the finding of the model and will interpret the results obtained from the ANOVA and the coefficients of regression. The variables were tested with a 95% confidence level. A value of R equal to 0.92 indicates that our model is significant and the independent variables explain the dependent variable at the 85% level. This means that the closer to 100% the R square value is, the stronger the relationship between variables. Looking at the values of R and R² (R square) we can say that we have built a statistically significant model. According to the regression, Remittances and Net Foreign Direct Investments have proved statistically significant to explain the dependent variable (Bird and Choi, 2019). Analyzing the coefficients before the statistically significant variables, we can see that FDI is positively correlated with the Gross Domestic Product per capita, while remittances, as we said, are significant but have a negative correlation with the dependent variable (Bird and Choi, 2019) and Diaz (2009). Increasing Foreign Direct Investment by 1% results in an increase in GDP per capita of 0.58%. Foreign Direct Investment leads to employment growth, increased use of technology, and capital movements, the growth of which positively impacts economic growth. While an increase of 1% in remittances results in an economic decrease of 0.59%.

Conclusions

Albanian economy is still in transition so developing countries should focus on foreign direct investment (FDI) as a source of external finance. Investors may have full control in the short run by simply selling their investment. However, they do not have control over the long-run. Inflows of FDI in Albania over the years have changed especially after the financial crisis.

FDI flows have increased significantly since the 1990s. The main reasons for the level of foreign investment are political and economic instability, the perceived risk; lack of accountability and institutional capacity, poor implementation of the law, inefficiency and low-cost infrastructure, delays in developing a comprehensive strategy of economic and social development, etc.

Central and local government play no proper role concerning the function to be carried out, also because of poor connections with investors. Environmental Governance explains why there are still many countries that attract little foreign investment thereby limiting their productivity and prosperity even though foreign investments are an engine of economic growth worldwide. There is low support from other state institutions. The low interest of foreign investors is due to the perception of a high risk associated with political changes in Albania and the lack of stability in the Balkans.

Speaking of the potentials and opportunities that Albania has for attracting FDI, they are numerous. Potential sectors are tourism; agriculture; services etc. But to attract more and more FDI, successful platforms need to be developed that improve the infrastructure of these sectors. In addition to these platforms designed by the government, publicity on the potentials offered by Albania needs to be increased. In this way, foreign investors will be safer to invest in our country and foreign direct investment will increase. Priority for the Albanian government should be the development of rich and conducive policies to attract foreign investment in priority sectors.

References


