

FOREIGN DIRECT INVESTMENTS AND BUSINESS CLIMATE IN ALBANIA

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Abstract: Albania has opportunities to attract foreign direct investments in several sectors of economies: agriculture, manufacture economy, tourism etc. Albania has a great potential, but the domestic capital is very low and it is not enable to utilize these opportunities. The aim of our paper is to point out some of the obstacles and the opportunities that Albania offers to the foreign investors. We have tried to show the position that Albania has in term of foreign direct investments and the ease of doing business in relation to the other countries in the region.

JEL classification: F14, F21

Key words: foreign investment, privatization, doing business, barriers, opportunities.

1. Introduction

The foreign direct investments provide a lot of benefits to a country. They increase employment, increase the productive capacities of a country, give access to the new technologies and better work practice, help in the integration into the EU economies etc. The crucial role of foreign direct investments on the economy, induced us to examine the evolution and the role of foreign direct investments in Albania. The paper is divided in seven sections. After having explained the methodology and data set, the second section describes the foreign direct investment since the starting of the transition period, explaining their falling or their growth during these years. Next, we have attempted to point out some of the opportunities that Albania offer to the foreign investors and some of the obstacles that the foreign investors have to face in Albania. The business climate in Albania is discussed in the section five, based on the indicators of “Doing business” reports of the World Bank. An analysis of foreign direct investments and business climate in Albania in comparison to the region’s country is performed in the section six. The last section covers the paper’s conclusions.

2. Methodology and data set

The data used in this paper derives from many sources. The data regarding the foreign direct investments in Albania have been collected from reports of local institutions (Instat, Bank of Albania etc). The data regarding the indicators of doing business in Albania and the region have been taken from the World Bank reports of the last years.

The foreign direct investments in Albania are compared to the foreign direct investments in the region’s country, by computing the foreign direct investments per

capita.

The region includes the following countries: Bosnia & Herzegovina, Croatia, FYR Macedonia, Kosovo, Montenegro and Serbia.

3. Evolution of foreign direct investments in Albania

The foreign direct investments in Albania have been first appeared in 1993. The first foreign companies investing in Albania were Italian companies, because they have more access to supervise the Albanian market and they have the possibilities to explore the areas more likely for investments. Even though very slowly, there are observed modest growth rates until 1997. The events of 1997 were ruinous for the fragile market economy of Albania. The demolition of pyramid's schemes and the politic instability set back the new foreign investors and removed the most part of the existing investors from Albania. The most part of them have got very difficult to restart again their business in Albania; therefore they didn't come back any more. The image-building of Albania as an insecure country, the recession of the economy, the lack of attractive incentives and the postponement of the privatization procedures negatively affected the foreign direct investments in Albania. In 1997 the foreign direct investments were reduced by 47 percent in comparison to the previous year. During the following two years, the amount of foreign direct investments has been constant, until 2000. It is explained by the relation of foreign direct investments with politic stability of a country. During 1999, some Italian investors have shown interest on the purchase and concession of the mine industry, owned by the state; but these enterprises were not finalized. Only after 2000, the foreign direct investments have been significantly grown up, especially in production activities on purpose of exports.

In 2001, the foreign direct investment amounted in USD 207 mlln, as result of privatization process (in particular the privatization of the mobile phone operator AMC) and Albkrom consession contracted by Italian company "DARFO".

The delays in the privatization process of Telechom, the Saving bank and INSIG resulted in the decrease of FDI in 2002 (USD 135 mlln).

According to the statistics, in 2003 the foreign direct investments have been increased more than 16 percent in comparison to the previous year.

Due to the privatization of the Saving Bank in 2004, the amount of foreign direct investments was about USD 341 mlln: more than one third of that amount belongs to the privatization of the Saving Bank. The most large foreign direct investments performed in 2004 are: airport partners together with Hochtief (USD 80,9 mlln), Edil Centro (USD 10 mlln), Kurum Group Company (USD 2,5 mlln) etc.

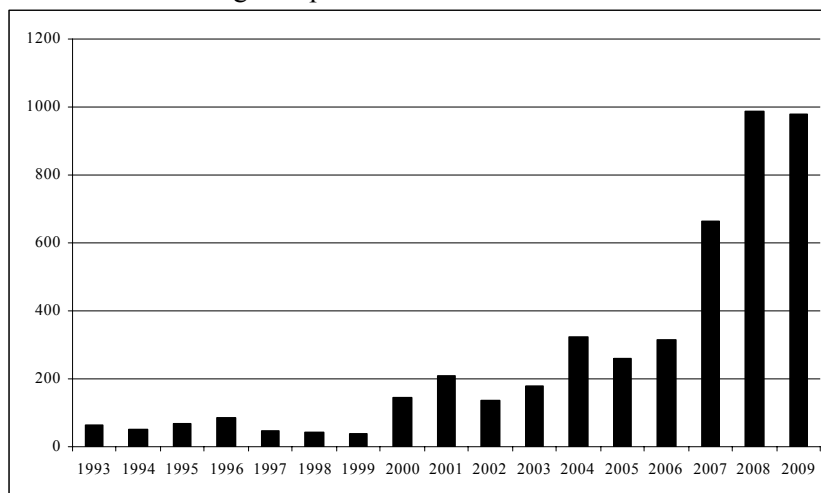
As result of lack of privatization, in 2005 and 2006 we observe a reduction of foreign direct investments. But in the following years the foreign direct investments have been rapidly grown up.

In 2007, foreign direct investment in Albania amounted to more than USD 622 mlln. They have been increased by more than 90 percent in comparison to 2006.

In 2008 the foreign direct investments peaked to respectively USD 988 mlln as result of privatization of "ARMO", 75 percent of the shares of OSSH, and 61 percent of the shares of INSIG (the only state-owned insurance company), etc.

The foreign direct investments in 2009 are 3.8 times higher than in 2005. There are some reason explaining this increase: a sustainable growth of the economy (excluding the impact of the global crises, in the two last years), the membership in

NATO, which means more security for investments and less instability, low tax rates and the labor force still being cheap.



Source: Bank of Albania statistics

Figure no. 1 FDI in Albania (in million USD)

Actually there are more than 1000 foreign investors operating in Albania. Regarding the participation of foreign investment capital, the companies which have invested in Albania are of totally foreign capital or partially foreign capital (joint venture). In more than 85 percent of the joint ventures, the foreign investors have more than 50 percent of the shares.

The sectors which have attracted the most the foreign investors in respect to the number of the enterprises, are commerce sector and manufacture industry; recently the construction industry and energy. Regarding the labor force distribution, the manufacture industry and banking industry have the largest number of employers.

More than 80 percent of the foreign direct investments have been located in the areas with highest income and infrastructure, i.e. Tirana (the capital city) and Durres.

The BE countries are the principal foreign investors in Albania. Among them Italy and Greece hold the first places, due to geographic position and because the major part of the exports are destined to these countries.

4. Barriers and opportunities to foreign direct investments in Albania

In spite of the increasing of foreign direct investments, they are still very low in comparison to the countries in the region. During the transition period, the foreign investors have faced several barriers, some of which we have explained below.

During the communism period, Albanian economy was the closest economy among all the Central and Eastern countries in Europe - therefore the people have inherited a negative business climate;

The perceived politic and economic risk of Albania has been high. Especially as result of the events of 1997, Albania has been classified as a country with a high level of the political risk. The political risk is the risk of loss when investing in a given country, caused by changing of country's political structure or policies.

The poor infrastructure in transport, electricity, watersupply system and telecommunications at least until a couple of years before has been a serious barrier;

The corruption in Albania is one of the obstacles that foreign investors face too (as the Prime Minister Berisha pointed out “Corruption was almost an industry”). The corruption index is still high, but there is a decrease of it, as well. The Corruption Perception Index 2010⁴⁵ for Albania is 3.3, ranking Albania in the 87th place, leaving behind B&H and Kosovo, from the region. The same index for 2009 was 3.2, ranking at the 95th place. It can easily be observed that there is a progress of 8 levels. We have to consider that even though this index is high, it’s in the same range (3.1-4) with some of the countries of the region as Serbia and Montenegro. So, the government has a lot to do about the corruption in the future. It is one of the conditions that Albania has to meet, as one of the conditions for integration into the EU;

The weak regulatory system as a result of the lack of certain laws (including weak anti-money laundry laws or poor anti-tax evasion laws) and the bad implementation of the procedure and the corruption of the juridical system have stopped foreign investors from investing in Albania.

The capital market remains underdeveloped. It consists of the formal market (Tirana Stock Exchange), dealers licensed to trade securities and informal market of joint-stock companies shares transactions. There are encouraging steps taken by the government to put in place the legal and regulatory framework, in order to build a functioning stock exchange. This makes convergence with EU easier and provides financial and banking opportunities through a foreign investment framework to operate (Market Access 2008)

But, however during the last years the increase of foreign direct investments has been one of the priorities of the government. The Albanian government has induced an affirmative attitude towards foreign investment; its strategy to strengthen the business environment was incorporated by the removal of administrative barriers to investment.

The law of foreign direct investments in Albania ensures a favorable investment climate in Albania. There is no restriction regarding foreign investments entry, and the foreign investors are treated equally as the domestic investors. Foreign investors are entitled only to lease land (not to purchase) in state-owned areas but there is no restriction on acquisition or leasing of private owned land;

Foreign investors are equally treated with domestic investors for taxation and legal purpose;

Albania has an attractive geographic position, situated on the eastern Adriatic coast. It has the possibilities to develop mountain tourism, coast tourism and cultural tourism as well.

Almost one-third of the country's population works outside the country. The remittances they provide help alleviate poverty and drive a boom in housing construction as well as infrastructure (Euromonitor International, 2009).

The privatization process is going on. Recently (on February 2011) Albanian government has decided to privatize all the rest part of the state-owned objects encouraging the foreign direct investments.

“Albania one euro” initiative is launched from Albanian government in 2006. It

⁴⁵ The Corruption Perceptions Index (CPI) measures the perceived level of public-sector corruption in 187 countries and territories around the world. The CPI is a "survey of surveys", based on 13 different expert and business surveys.

is aimed to attract the foreign investors by offering them the entry in Albania for one Euro, the land for one Euro and technological assistance for one Euro.

5. As assesment of business climate in Albania

This section examines the business climate in Albania based on the “Doing Business” World Bank’s reports from 2007 to 2011. Doing business presents quantity indicators on business regulation and protection of investor rights. For example, the report of 2011 provides rankings of 183 economies in respect to the easy of doing business in nine categories with a rank “1” being the best. The higher the ranking, the worse is the economy respecting the terms of easy of doing business. As shown in the Table no.1, we observe that the ranking of Albania during the last five years has been really improved by 38 ranks. In general, with exception of the indicators “Dealing with construction permits” and “Paying taxes”, the other indicators have been improved, as result of the recent macroeconomic reforms undertaken by the government.

Table no. 1 “Doing business” indicators for Albania

Indicators	Rank according to the world bank report of				
	2007	2008	2009	2010	2011
Easy of doing business	120	136	86	82	82
Starting business	121	123	67	46	45
Dealing with con. permits	161	168	170	173	170
Registering property	76	82	62	70	72
Getting credit	48	48	12	15	15
Protecting investors	162	165	14	15	15
Paying taxes	125	118	143	138	149
Trading across borders	101	70	77	66	75
Enforcing contracts	99	74	89	91	89
Closing business	89	168	181	183	183

Source: “Doing Business” World Bank reports

More specifically, we easily observe that:

“Starting business” indicator is improved by 63 percent. Therefore Albania is ranked from 121st in 2007 to 45th in 2011. This is result of electronic business registration, reduction of necessary initial capital and canceling of the requirement for business registration in the Chamber of Commerce.

“Dealing with construction permits” indicator is slightly made worse, which means that according to this indicator, Albania is ranked from 161st in 2007 up to 170th in 2011. In Albania, a business needs 331 days to have a permit and it have to pay a price about four times more the average income per capita.

“Registering property” indicator has not been change too much. In 2011 Albania is ranked the 72nd according to this item. The “property” issue in Albania is very delicate. Transferring of the property from one owner to another requires a number of six procedures and about 45 days. The cost of document transferring is about 4.2 percent of the property’s value. The most part of the properties are registered in a “Temporary register” opened in 1994, but the documents issued based on it are no more

valid. In 2004 a “Permanent register” is created, but the property transferring is manually executed and only according to the requirement of the concerned person.

“Getting credit” indicator is improved by 69 percent. The rank of Albania is improved from 48th in 2007 to 15th in 2011. The Albania was one of the economies who have reformed the most. It created a new public credit registry with full information on loans of all sizes, for individuals and for firms.

“Protecting Investors” indicator has been fallen down by more than 90 percent, improving the rank of Albania from 167th in 2007 to 15th in 2011. This indicator has been improved the most. It is due to the reforms performed in 2008 regarding the increased disclosure requirements, regulated approval of related party transactions and a new company law.

“Paying taxes” indicator has been slightly improved from 149th to 138th. Albania made it easier and less costly for companies to pay taxes by amending several laws, reducing social security contributions and introducing electronic filing and payment. But despite the reforms undertaken by the Albanian government, it still is ranked the last in the region.

“Trading across borders” indicator rank has fallen down from 101 in 2007 to 75 in 2011. The undergoing reform in Albania has in focus simplification and harmonization of procedures including documentations, introduction of risk based management system for inspections and automation of trade clearance procedures.

“Enforcing contracts” indicator has fallen down from 99 in 2007 to 89 in 2011. Juridical system in Albania faces serious problems. The number of procedures needed to enforce a contract is 39, while the time necessary to complete the procedures is 390 days. The cost required to complete the procedures is about 39 percent of the claim value. The procedures would be facilitated, for example through the establishment of the Administration Court. But due to the recent political disputes in Albanian parliament, the approval of the law on Administration Court has been postponed.

“Closing business” indicator ranks Albania the last out of 183 economies. The new law on bankruptcy has been approved in 2008, but there is no practice taken in consideration in the world report’s bank.

6. FDI and Business Climate in Albania versus region’s countries

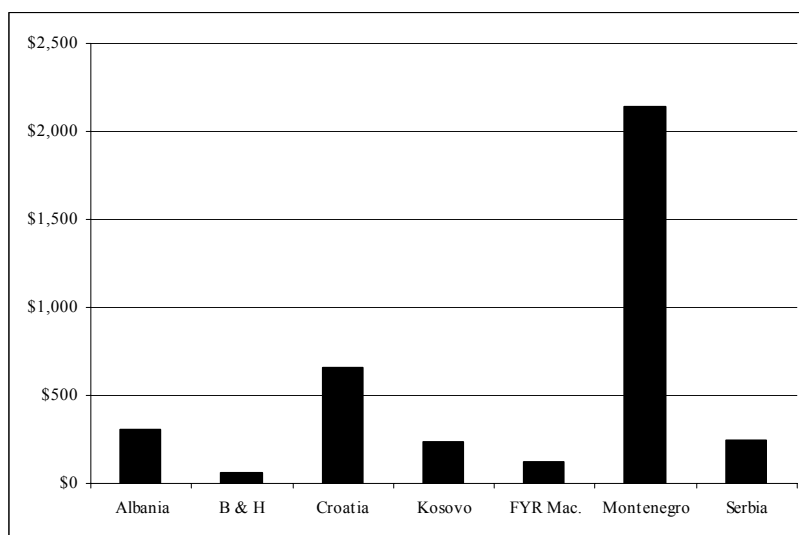
The countries in the region have been less effective in attracting foreign direct investments, than the other countries of Eastern Europe because of political instability the small sized markets, informal economies, poor infrastructures, underdeveloped financial systems etc.

The foreign direct investments in the region amounted to USD 8,052 mlln: about 36 percent of that amount belong to the foreign direct investment in Croatia, 24 percent belongs to Serbia and 17 percent belongs to Montenegro. But if we calculate the foreign direct investmet per capita (as Figure no.2 shows), Montenegro holds the firs place in the region with USD 2144 per capita, followed by Croatia with USD 656 per capita.

Montenegro was the only country in the region, continuing to enjoy a boom in investments, thanks to its liberal taxation, policy and promotion of public-private partnerships especially in tourism.

Croatia holds the second place in the region regarding the foreign direct investments per capita. The privatization of strategic state-owned assets has been a major source of foreign direct investments in Croatia. Also Croatia has a significant

comparative advantage in tourism sector.



Source: Author's calculation

Figure no. 2 FDI in USD per capita in the region

Albania is ranked the third with USD 310 per capita.

Regarding the business climate in the region's countries, the Table no. 2 shows the ranks of each country in the region. FYR Macedonia holds the first place, ranked at 36th, followed by Montenegro ranked at 66th and Albania ranked at 82nd.

Table no. 2 "Doing business" indicators in the region

Indicators Doing Business World Report 2011	Albania	Bosnia & Herz.	Croatia	Kosovo	Macedonia, FYR	Montenegro	Serbia
Easy of doing business	82	110	84	119	38	66	89
Starting business	45	160	56	163	5	51	83
Dealing with con. permits	170	139	132	173	136	161	176
Registering property	72	103	110	65	69	116	100
Getting credit	15	65	65	32	46	32	15
Protecting investors	15	93	132	173	20	28	74
Paying taxes	149	127	42	41	33	139	138
Trading across borders	75	71	98	130	66	34	74
Enforcing contracts	89	124	47	155	65	135	94
Closing business	183	73	89	31	116	47	86

Source: "Doing Business in 2011" World Bank report

„Starting business” - Business registration reforms in FYR Macedonia made it one of the easiest places to start a business today. In 2006 the business registration is changed from a juridical one to an administrative one. The publication requirement in an official newspaper was replaced with the automatic registration in website register.

The number of new companies is increased. Therefore, the necessary time to start a business in Macedonia is three days, while in Albania it is 5 days. Both these countries are included in the ten countries with the fastest procedures. But in 2010 Croatia and Montenegro are improved the most. Kosovo made more difficult by replacing the tax number previously required with a fiscal number which take longer to issue and requires the tax administration to first inspect the business permits.

„Dealing with construction permits” - Croatia has improved the most in dealing with construction permits, approving a new building code. It replaced the location permit and project design confirmation with a single certificate simplifying and speeding up the construction permitting process. Although the Eastern Europe was the region with the most reforms regarding the construction permits in the last years, all the countries in the region are still ranked at the end, regarding the required procedures, time and the minimum capital as well. The dealing with construction permits is more difficult in Serbia, which rank is 176. Kosovo and FYR Macedonia hold the first places regarding to the „Dealing with construction permits” indicator.

„Registering property” - FYR Macedonia cut the time to register property by 40 days: as result twice as many properties were sold in 2009 as in 2007, despite the financial crises.

„Getting credit” - Good practices supporting access to credit have been followed by Serbia (allowing out of court enforcement), Bosnia & Herzegovina and Montenegro (maintaining an unified register), and Albania (distributing data on loans below 1 percent of income per capita). These countries have improved their secured transactions system during last years. Serbia’s volume transactions increased by 4346 in 2005, to 24,059 in 2009, while Albanian’s rose from 4105 in 2005 to 9860 in 2007.

„Protecting investors” - Albania has adopted new legislation. It is ranked among the first countries regarding the extent of director liability index. (It is nine from the maximum of ten.) Most economies that strengthened investor protection did so as part of wider corporate governance programs, as Albania and FYR Macedonia. A Deutsche Bank Study of the Standard and Poor’s 500 shows that the companies with strong and improved corporate governance system exceeds those with poor ones by 19 percent within a time period of two years. Regarding the extent of disclosure index, Croatia is one the of the countries with the lowest index (The Croatia’s disclosure index is one from a range 0-10).

„Paying taxes” - The most part of the region has simplified tax payment during the last years: FYR Macedonia in 2008, Albania and Montenegro in 2009. FYR Macedonia has the lowest tax rate in the region 10,6 percent. It has reduced the corporate profit tax for undistributed profits from ten to zero percent. It has simplified tax compliance process. It is ranked the fifth in the lowest tax rate list of the world. Bosnia & Herzegovina and Montenegro have merged the taxes other than profit tax. FYR Macedonia and Montenegro have simplified the tax compliance process, while Albania has established the electronic tax system.

„Trading across borders” - Among the countries which have improved the most in trading across borders, Montenegro is ranked the forth. But it holds the first place among the region’s countries. It has reduced the number of the required trade documents. Montenegro’s custom administration simplified trade by eliminating the requirement to present a terminal handing receipt for exporting and importing of goods.

„Enforcing contracts” - Kosovo is ranked the last regarding the reforms made in the judiciary system. It is one of the countries which require most procedures (The

number of required procedures is 53).

„Closing business” - Serbia is ranked the second among the countries which have improved the most regarding the closing business. Serbia has passed a new law on bankruptcy, which among others, has reduced the length of insolvency procedures and it has introduced unified reorganization procedures. Also, in 2008 Albania has passed a new law on bankruptcy, but it has no impact yet.

7. Conclusions

In this paper, we have tried to answer to these questions:

- Why foreign investors have invested in Albania?
- Why foreign investors still hesitate investing in Albania?

Regarding the first questions, there are many factors which have attract foreign direct investments to Albania, as geographic location, low labor cost, privatization process, natural sources, qualified labor force, the engagement of the government to improve the climate business in Albania (lowering the taxes, treating foreign investors equally to the domestic ones etc).

Regarding to the second question there are many barriers to foreign direct investments in Albania too: high level of corruption, weak juridical system, informal economy, undeveloped financial system, poor infrastructure, instability in the region etc.

However, comparing to the other countries in the region, Albania is doing well. But the Albanian government still do not have a well defined strategy to attract foreign direct investments in long-run, although the foreign direct investments have been announced as one of the priorities of the actual government („One Euro” initiative).

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