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INFLUENCE OF MONETARY AND FISCAL POLICIES ON FOREIGN DIRECT INVESTMENTS IN ALBANIA DURING 1990-2009

Attracting FDI is top priority to Albania not only to finance its budgets, but moreover to improve economic development and standards of living. High inflow of FDI can increase efficiency of production and introduce new products at the markets. Some of these benefits are: a) increase in competitive potential between domestic production enterprises; b) entrance of advanced technology; c) progress in knowledge of various fields of production resulting from contacts with foreign customers; d) possibilities for optimal utilization of human resources and help to increase their professional skills etc. In this paper we analyze FDI introducing 3 models: the first model is going to analyse monetary policies, then fiscal policies and in the end we are going to take into consideration all the figures on a national scale taking into account the corruption as well. We confirm the important role of monetary and fiscal policies to attract foreign investments in Albania aiming to serve the economic growth.

Keywords: foreign direct investments; fiscal policies; monetary policies; GDP.

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ВПЛИВ МОНЕТАРНОЇ І ФІСКАЛЬНОЇ ПОЛІТИКИ НА ПРЯМІ ІНОЗЕМНІ ІНВЕСТИЦІЇ В АЛБАНІЇ В 1990-2009

У статті вказано, що залучення ПІІ є пріоритетом для Албанії. Нові інвестиції допоможуть у фінансуванні бюджетів, поліпшенні економічної ситуації в країні, підвищенні рівня життя, вплинуть на рівень продуктивності фірм і допоможуть вивести нові продукти на ринок. Основні переваги ПІЇ: 1) підвищення конкурентоспроможності місцевих компаній; 2) впровадження нових технологій; 3) здобуття нових знань і контрактів з-за кордону; 4) можливості оптимального використання людського потенціалу країни і підвищення професійних якостей. Проаналізовано ПІІ із застосуванням 3 моделей: для аналізу монетарної політики, фіскальної політики і загальних показників по країні, включаючи рівень корупції. Підкреслено важливу роль монетарної і фіскальної політики в залученні прямих іноземних інвестицій в Албанії.

Ключові слова: прямі іноземні інвестиції; фіскальна політика; монетарна політика; ВВП.

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ВЛИЯНИЕ МОНЕТАРНОЙ И ФИСКАЛЬНОЙ ПОЛИТИКИ НА ПРЯМЫЕ ИНОСТРАННЫЕ ИНВЕСТИЦИИ В АЛБАНИИ В 1990-2009

В статье указано, что привлечение ПИИ является приоритетом для Албании. Новые инвестиции помогут в финансировании бюджетов, улучшении экономической ситуации в стране, повышении уровня жизни, повлияют на уровень производительности фирм и помогут вывести новые продукты на рынок. Основные преимущества ПИИ: 1) повышение конкурентоспособности местных компаний; 2) внедрение новых технологий; 3) получение новых знаний и контрактов из-за рубежа; 4) возможности оптимального

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использования человеческого потенциала страны и повышение профессиональных качеств. Проанализированы ПИИ с применением 3 моделей: для анализа монетарной политики, фискальной политики и общих показателей по стране, включая уровень коррупции. Подчеркнута важная роль монетарной и фискальной политики в привлечении прямых иностранных инвестиций в Албании.

Ключевые слова: прямые иностранные инвестиции; фискальная политика; монетарная политика; ВВП.

1.1 Introduction. The ability to attract foreign direct investments (FDI) has become in the last decade a focal point of economic policies in many developing countries. This strategy is based on the view that FDI flows increase the production potential of a country and of course productivity level. Furthermore, it is assumed that foreign capital can play an important role in simulating local investment activity, both upstream and of a production chain and also at the acquisition level, in the development of technology. In line with these considerations, there has been a steady increase in the weight of developing countries on global FDI flows, interrupted only during the period 1997-2000, following the spread of the Asian crisis. In this context Mediterranean area is highlighted for its weak performance, both on worldwide and also within developing countries. In fact, while in the last decade, the rate growth of FDI in the world has been steady and very strong, and in particular those directed to developing countries, the Mediterranean countries appear to have remained at the edge of such processes. Albanian FDI level remains a major problem since the advent of Albanian democracy; their flow in recent years has just surpassed the 30 mln dollars annually, ranking the country among the last places in Europe by attracting FDI. A few years ago the Democratic Prime-Minister Berisha during a cabinet meeting appeared to find the solution. He presented "Albania-1euro" initiative to make the country more attractive to foreign investors. Despite this, Albania doesn't look like an attractive country for foreign investments for a number of reasons:
- strong institutional weaknesses (inefficiency and bureaucracy);
- corruption;
- uncertainty of the transaction rules for foreigners (e.g., property rights);
- infrastructure and networks problems;
- delay in the process of privatization of many economic sectors etc.

1.2 Empirical analysis. In this study, we draw the official information from these institutional sources:
- Ministry of Finance,
- General Directorate of Taxes,
- Central Bank of Albania,
- Ministry of Economy,
- INSTAT Albania.

Simultaneously, we are going to make use of the studies performed by the International Monetary Fund, European Bank for Reconstruction and Development as well as other international institutions.

For our empirical analysis we are going to use two data groups; data taken from INSTAT and information drawn from the General Directorate of Taxes. At the same time, we are going to develop the same econometric model using information from

the above mentioned international institutions. Furthermore, we are going to analyse the fiscal incomes of 1990-2009, the flow of foreign investments for the same period and the economic indicators.

Greater importance will be shown to:

- annual fiscal incomes, paying more attention to those years of fiscal reforms with new taxes.

- fluctuation along with the flow of foreign investments in Albania (FDI) (or precisely the increase of fluctuation after the fiscal reforms have been made at the same time), as well as the foreign investments regionally based for the same period of time.

- the rate of economic growth (GDP) in Albania after the change of political system from the collective system being exercised during the communist period, where everything belonged to people.

- the newly democratic system accompanied by mass privatizations and introduction of private property.

- simultaneously, we are going to take into consideration the standard fluctuations such as: import, export, the increase of GDP, the immigrants' savings, the norm of interest for investments and the norm of interest for savings.

- the monetary aggregates M1, M2, M3 to understand how short-term and long-term monetary policies influence the flow of foreign investments, being also based on the figures of inflation and the corruption level.

The data drawn from INSTAT and the governmental institutions of the Albanian state have continuously had a series of wrong values. This pattern has been followed by all the Albanian governments aiming to improve their performance during the electoral elections as well as to grow the credibility in the face of international institutions regarding the obligations they take towards reforms. To eliminate the inaccuracy in elaborating the following information, we will correct no data of INSTAT or The General Directorate of Taxes but we will compare them with those data of the international institutions.

The greater part of them is taken from the international institutions such as: World Bank, International Monetary Fund, and International Transparency Agency. In order to realize the empirical analysis at the following models, we also base on the data elaborated by the authors. Unfortunately, information on regional unemployment is accurate only for 2002 and 2003 (published by INSTAT), and for 2007 and 2008 (published by the Ministry of Work, Social Affairs and Equal Opportunities). Regarding other years, we are going to consider the average number of unemployment for all the regional municipalities.

The fiscal system of the Republic of Albania underwent an entire reform during the period 1990-2009. Worth mentioning are the most crucial reforms of 1992, 1996, 1999, 2005 and 2008. Their results are felt in a year after the implementation. Worth mentioning is also the increase of FDI flow excluding the reform of 1996 which was slightly felt because of 1997 when we experienced the Albanian financial decline because of the financial pyramids invented by Carlo Ponzi.

The financial reform of 2008 aimed at tempting foreign investors to transform Albania into an attractive country for foreign investments. This reform came to fruition and we can observe this at the chart 1.1. It shows the level of foreign direct

investments in Albania from 1990 to 2009. Basing on the data analysis, we notice that the tendency of FDI goes up in a swing with the culminating point in 2008-2009 (we should underline that this tendency is due to mass privatizations by the government of Berisha and not to the willingness of foreign investors to invest in the country).

Chart 1.1. **Flow of foreign investments in Albania during 1990-2009 (mln. euro) Source: IMF, WB and ITA.**
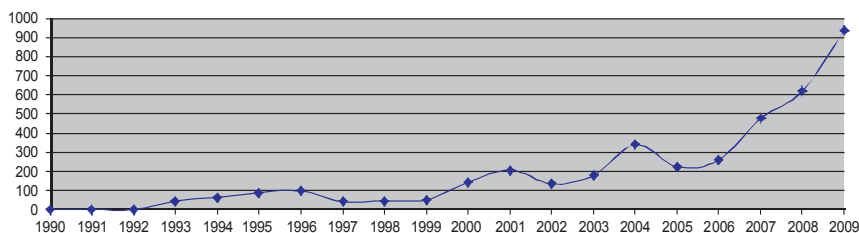
Source: IMF, WB and ITA.

General administrative data. Albania consists of 12 regions. Each region is composed of 3 categorized municipalities, one of them belongs to the regional centre. Information drawn at the region is not so reliable because we have available data taken from Albanian institutions and not from international institutions. The information related to regional FDI is elaborated data, not 100% accurate. Viewing these data, it is noticed a higher concentration of FDI in Tirana, the capital city of Albania with the population of more than 800 thousand inhabitants. Meanwhile, we notice a concentration of FDI along the coastal and border towns like Durresi and Vlora. In the following econometric models we will try to make use of all the available data. The first problem being faced is the lack of information in 1997 because of the reasons stated above. We hold the opinion that it is more efficient to present 2 model groups. In the first group we are going to make use of information on the national scale, available for the majority of international institutions. While in the second group we are going to use mainly regional information, available in the greater part only from Albanian institutions.

1.3 The factors determining the flow of foreign investments in Albania. To estimate the effect of FDI on the regional scale, we will consider: the flow of FDI, the population, the unemployment and the flow of FDI per person. In order to make use of all the data altogether, we are going to launch our study on the correlations between these varieties.

Table1.1

The coefficient of correlation, using observer 1:001 - 2:120, Critical value 5% (per twice) = 0, 1267 per n = 240				
FDI_per_Region	N_Unempl_Region	FDI_P_Per_Region	Pop_per_Region	
1,0000	0,0225	0,8598	0,1488	FDI_per_Region
0,0225	1,0000	0,1446	-0,2594	N_Unempl Region
0,8598	0,1446	1,0000	-0,1036	FDI P per_Region
0,1488	-0,2594	-0,1036	1,0000	Pop_per_Region

The matrix of correlation points out a good figure of correlation between the parameters of unemployment and FDI on the regional scale, precisely a negative correlation between unemployment and FDI on the regional scale. It is therefore the

negative correlation which allows us to follow such parameters on the same regression model.

The first model.

$$FDI_{per_{region}} = \alpha + \beta_1 Pop_{per_{region}} + \beta_2 N_{unempl_{Region}}$$

$$+ \beta_3 FDI_{P_{per_{Region}}} + \beta_4 Exp + \beta_5 GDP_{per_{pers}} + \varepsilon \tag{1}$$

Let's mark with *a* distance from the main cities being a statistic variable which does not change in relation with time, ε is the term of mistake, *β1, β2, β3, β4, β5* are the coefficients of the model.

Table 1.2

Model 1: Occasional effects (OLS), based on 240 observations. Including 12 cross-section units The length of historical series = 20				
	Coefficient	Standard mistake	Report t	p-value
Constant	-11,873	12,2983	-0,9658	0,3352
Pop_per_Region	3,36756e-05	1,64485e-05	2,047	0,0418 **
N_Unempl_Region	-0,203455	0,172886	- 1,177	0,2405
FDI_P_Per_Region	117639	4194,41	28,05	3,56e-076 ***
Dis_Dr	-0,0371027	0,0870231	-0,4264	0,6702
Dis_Tr	0,0768883	0,0870073	0,8837	0,3778
Dis_Vl	-0,0176679	0,0568452	-0,3108	0,7562
Dis_Gj	0,0219237	0,0408072	0,5373	0,5916
GDP_Per_Pers	-360,283	81,3661	-4,428	1,47e-05 ***
Export	0,000329108	5,40153e-05	6,093	4,63e-09 ***

Generally viewed, the first model shows an important result. The depending parameters of FDI on the regional scale are clearly illustrated by the GDP variable per person (p-value: 1,47e-05). Other important figures are the export (p- value: 4,63e-09) and the population parameters on the regional scale (p-value: 0,0418).

GDP per person and the export parameters are an easy example to interpret. FDI per region gives a considerable contribution to the increase of GDP and the export diagram. It means that a considerable part of FDI in Albania are addressed to only transfer the process of production (thus, to exploit the cheap labour of the working class) and afterwards they export the readymade product to the original country where they have first set up and initiated their business and operation. At the same time, we could emphasise that the product being produced in Albania is not destined for Albanian market.

The unexpected result of the first model gives us the impression that the geographic position where FDI is addressed is not an important factor. This result can be explained on the basis of the model we used. It was an OLS model with occasional effects bearing in mind that the distance is constant when it is perfectly surveyed by this model. If we try to have the same model OLS, not with occasional effects but with continuous ones, we notice that we get higher figures which are excused (as we already mentioned about export); it can also be explained by the reason that the Albanian state has its main commercial partners (Italy and Greece), therefore those border countries transfer to Albania only parts of their production processes (clothing industry).

Divergent determining possibilities of regional FDI in Albania in 1990-2009.

We observe heterogeneity in distributing FDI to many regions. There has been a noticeable concentration of FDI in Tirana. It is because of its population which is more than 800.000 inhabitants, which means a better and wider market for public consumption. As being mentioned above, the geographical position plays a strategic and important role. Albanian borders, especially the coastal ones, play a decisive role in the economic growth. We have a dense concentration along the borders and coast. As we mentioned above, FDI is addressed to Albania mainly to exploit the low cost of the working class and the Albanian fiscal system which is profitable especially for the first 3 years of activity. We also observe a correlation (despite the negative sign) between the norm of unemployment and FDI on the regional scale. It is because of the fact that a part of FDI have not been greenfield ones but investments on purchasing and developing the existing businesses. It goes without saying that employment has not always been on the increase, despite the high level of FDI.

Model 2 is the same with the first one with the only exception that in this case the estimation is made by OLS *Pooled taken* as a depending variable of national FDI.

$$FDI = \alpha + \beta_1 N_{Exchange_{interes}} + \beta_2 N_{Int_{fin}} + \beta_3 E_{rate} \frac{L}{\$} + \tag{2}$$

$$\beta_4 E_{rate} \frac{L}{euro} + \beta_5 Immigrant_{incomes} + \beta_6 Agr_{M3} + \varepsilon$$

*Table 1.3 .***The results and the number of observations of model 2**

Model 2: Pooled OLS, based on 240 observations.
Including 12 cross-section units
The length of historical series = 20
Depending variable : FDI

	coefficient	standard mistake	report t	p-value	
constant	-49,4083	41,4774	-1,191	0,8830	
Pop_per_Region	-8,08019e-06	5,48500e-05	-0,1473	0,0418	**
N_Unempl_Region	-3,65747	0,895623	-4,084	6,11e-05	***
FDI_P_Per_Region	46884,3	22778,7	2,058	0,0407	**
Dis_Dr	-0,0726466	0,308103	-0,2358	0,8138	
Dis_Tr	0,123060	0,297941	0,4130	0,6800	
Dis_Vl	0,0206406	0,194432	0,1062	0,9155	
Dis_Gj	0,111945	0,140999	0,7939	0,4280	
GDP_Per_Pers	-360,283	81,3661	-4,428	1,47e-05	***
Export	0,00606005	0,000198254	30,57	3,88e-083	

R-current	0,827874	R-current frame	0,821912
Test F	F(8, 231)	P-value(F)	8,48e-84

Stimulating *OLS pooled*, following the same parameters except the change of the depending variable which is moved from regional FDI to national FDI. The results are practically the same with the first model. Even though we encourage a *panel* with

sustainable effects, the same results are given regarding the geographical position, but knowing that this model might not be 100% efficient and econometrically accurate because all the variables are dynamic in time and meanwhile we are given prevailing data drawn from Albanian institutions.

We would not like to comment the results of this model, we would simply observe if it were any difference when we moved from regional to national FDI. The results drawn from the first two models mentioned above, provide confirmation of all the hypothesis made by international institutions as well as by many articles published by the Albanian Agency of Investments. In conclusion, we could point out that investors come to Albania with the mere goal to reduce production costs, despite its being a small country with a limited market.

The decisive factors of FDI in Albania. To analyse FDI on the national scale and to verify the results of different international reports, such as *Doing Business* of *World Bank* or *Albanian New Investments Strategy* and International *Monetary Fund*, we are going to introduce 3 models.

The first model is going to analyse the monetary policies, then fiscal policies and in the end we are going to take into consideration all the figures on a national scale taking into account the corruption, as well. In the first model, we will use as depending variable FDI and as other variables we will consider monetary policy: GDP, free international market (the report of export and import depending on GDP), immigration incomes, and the norm of inflation, the norm of interest, the exchange rate, and the monetary aggregate and last but not the least corruption.

1.3.1 FDI and monetary policy. Based on international reports and the policies of the Bank of Albania, we could say that Albania is not exactly a matured country regarding the commitment of monetary policies.

We will be guided by a simple model as follows:

$$FDI = \alpha + \beta_1 N_{Exchange_{interes}} + \beta_2 N_{Int_{fin}} + \beta_3 E_{rate} \frac{L}{\$} +$$

$$\beta_4 E_{rate} \frac{L}{euro} + \beta_5 Immigrant_{incomes} + \beta_6 Agr_{M3} + \varepsilon$$

(3)

We have obtained an important coefficient regarding the immigrants' cash (p-value: 0,0030). It is almost the same according to our expectancy that a good share of the immigrants' incomes goes to different investments at the Albanian territory. In addition, we are experiencing pleasing assessments regarding the savings norm, the financial norm along with that of the monetary aggregate M3. All the above mentioned norms are approved by The Central Bank of Albania. Therefore, we could point out the importance of the monetary policy of Albania. The more reliable and mature the policies are, the more appealing it becomes to investments. Urged by this motive, we could say that the primary objective of The Central Bank of Albania is to stabilize prices, to get the norm of interest under control and at lower figures. We observe that the exchange rate of lek/euro has a coefficient of positive index but not so important. However, we could not exclude the contribution of this parameter in explaning the FDI.

Table 1.4

Model 3: OLS, based on observations. 1990-2009 (T = 20)			
Depending variable FDI			
	coefficient	*Standard mistake*	Report t	p-value
N_Exchange Int	16,0676	6,59381	2,437	0,0313 **
N_fin Int	-9,77856	5,26593	-1,857	0,0880 *
Exchange Rate L/USD	-0,181833	0,585306	-0,3107	0,7614
Exchange Rate L/EU	0,468544	0,590488	0,7935	0,4429
Immigr. incomes	-0,468963	0,126320	-3,713	0,0030 ***
Agr_M3	0,00185294	0,000814842	2,274	0,0421 **

R-current	0,963975	R-current frame	0,942960
Test F	40,13746	P-value(F)	1,67e-07

1.3.2 FDI and the fiscal policie.

$$FDI = \alpha + \beta_1 P_{Tax} + \beta_2 \Delta_{FiscIncom} + \beta_3 Corrupt. + \beta_4 P_{Power} + \beta_5 Technical_{Govern} + \varepsilon$$

Table 1.5

Model 4: OLS, based on observations. 1990-2009 (T = 20)			
Depending variable: FDI			
	Coefficient	Standard mistake	Report t	p-value
Const	-6,78967	68,1833	-0,09958	0,9229
Profit tax	0,0125781	0,00273034	4,607	0,0013 ***
Δ_Fisc Incomes	0,00203349	0,000710152	2,863	0,0187 **
Corruption	-0,645295	10,3508	-0,06234	0,9517
Party_Power	20,2159	33,0716	0,6113	0,5561
Technical governm	36,1908	65,3412	0,5539	0,5932

R-current	0,868572	R-current frame	0,795557
F (5, 9)	11,89576	P-value(F)	0,000944

In the above mentioned model, we are mainly trying to find the reason why The Ministry of Finance in Albania is seeking with all possible means to bring Albania close to "the fiscal paradise" with very low taxes with the aim of increasing the number of foreign investors in Albania.

This philosophy is proved at model 4, where we are given a better index concerning profit tax, a low tax if we compare it with our neighbouring countries. It is also one of the most important taxes for FDI. Besides, there are encouraging figures concerning the differences at fiscal incomes compared with the previous year. It results from the fact that increasing state incomes means providing more opportunities to encourage foreign investments. Worth mentioning about this model is corruption, which according to international institutions negatively influences FDI.

In the above model we notice that corruption is not an important index although the coefficient is negative.

In this model we decided to have two variables (dummies): the party in power and, the second, the technical government of 1997. We referred to the last one because we lack the data of 1997. We did not find a reliable conclusion. We notice in the above model that R2 has got a relatively high value which shows that this model is very reliable.

1.4 Foreign investments in Albania. The last model we are going to take into consideration is a model with sustainable effects counting the most important economic figures.

$$FDI = \alpha + \beta_1 \Delta_{M_3} + \beta_2 Corruption + \beta_3 P_{Power} + \beta_4 Inc_{GDP} + +\beta_5 N_{Exch_{Interest}} + \varepsilon \quad (6)$$

Table 1.6

Model 5: OLS, based on observations. 1993-2009 (T = 17) Depending variable: FDI Perfect correlation Dis_Vl Dis_GJ				
	Coefficient	Standard mistake	Report t	p-value
Const	832,560	778,961	1,069	0,3971
N_Exch_Interest	18,0759	5,07832	3,559	0,0707 *
Agr _M3	0,00227894	0,000594502	3,833	0,0618 *
Inc_GDP	1228,90	405,013	3,034	0,0936 *
Party_Power	20,2159	33,0716	0,6113	0,1561
Corruption	1,30483	15,3490	0,08501	0,9400

F (5, 9)	11,89576	P-value(F)	0,000944
R-current	0,998619	R-current frame	0,988949

The only novelty of this model is that we have a very small value (p-value) of the variable "party in power". During the last years, the Democratic Party which came in power in 2005 has always aimed to increase the flow of FDI in Albania. It is easily understood if we analyse the fiscal reforms after 2005. Besides, we have progress even with the variable AM3 which gives the difference value of monetary aggregate of M3 in relation to the last year. It shows the credibility of The Central Bank of Albania

We are given R2 with a close value to 1 at this model. On one hand, it proves the reliability of this model but on the other we could say that this model has got 17 observations which is less than other observations.

Conclusions. At this study, the analysis confirms the important role of the monetary and fiscal policies in attracting foreign investments in Albania aiming to serve the economic growth.

Based on economic results, we easily observe the dependency of foreign investments on profit tax, immigrants' shares, interest norm and on the monetary aggregate M3.

We observe the concentration of FDI close to borders, even though when we use the data on the regional scale it is not felt.

The most unexpected result is that no important index exists between FDI and corruption. This result is against the reports of international institutions even though the missions of European Union and the International Monetary Fund never speak their minds about the corruption which prevails in the Albanian political class, but they state that the government could fight against corruption better.

In summarising this work, we could highlight that monetary and fiscal policies

are important instruments to attract foreign investments.

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