*POSTCOMMUNIST ALBANIA: THE ROLE OF FDI IN DRIVING ECONOMIC GROWTH*

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# POST-COMMUNIST ALBANIA: THE ROLE OF FOREIGN DIRECT INVESTMENTS IN DRIVING ECONOMIC GROWTH


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## LIST OF ABBREVIATIONS

| | |
|---|---|
| FDI | Foreign Direct Investments |
| WB | World Bank |
| ACIT | Albanian Center for International Trade |
| EU | European Union |
| IMF | International Monetary Fund |
| EBRD | European Bank for Reconstruction and Development |
| IPA | Investment Promotion Agencies |
| INSTAT | Institute of Statistics Albania |
| SAA | Stabilization and Association Agreement |
| OECD | Organiztion for Economic Co-Operation and Development |
| WIR | World Investment Report |
| WTO | World Trade Organization |
| FTA | Free Trade Agreement |
| CEFTA | Central European Free Trade Agreement |
| NBC | National Business Center |
| EF | Economic Freedom |
| GDP | Gross Domestic Product |
| MF | Ministry of Finance |
| MIE | Ministry of Infrastructure and Energy |

## DECLARATION

I hereby declare that I hold complete authorship of this paper, taking responsibility under international copyright laws. The entire conception of this scientific paper is based on my studies and research regarding Foreign Direct Investments and their role in the economy of a post-communist country with a relatively long political and economic transition, such as the economy of Albania. It is based on reliable and authentic sources, which, intertwined with the knowledge gained from my studies, I have presented in this paper as a testament to its veracity under my full authorship. Throughout my work, I have cited theoretical, scientific, and institutional sources according to regulations and international standards.

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## 1. INTRODUCTION

The collapse of the communist system in the 1990s occurred simultaneously in many countries of Southeastern Europe and brought with it drastic changes in the political, economic, and social life of these countries, including Albania. Albania's transition from a centrally planned economy to a market-driven system following the fall of communism represents a significant and quite specific example of economic transition. With these shifts it must be pointed out how a lot of new economic concepts arouse. Yet, facing significant challenges, Albania began the push to connect with the global economy. In those initial years of opening its markets, the country adopted Free Trade Agreements and identified Foreign Direct Investment (FDI) as a key part of its development strategy.[1]

These efforts complemented Albania's fundamental shift in economic policy from state administration to a private-sector approach. At the same time, they were enhancing the prospects for infrastructure, new technologies, and institutional changes. Albania's overall economic growth was helped by this, but at the same time, the country had to face various huge challenges in modernizing its infrastructure, harmonizing its legal framework, and finding its way into international markets. Foreign Direct Investment contributed considerably to the growth of the Albanian economy, especially in light of the distinct difficulties faced by the economy during the post-communist transformation. Therefore, it is reasonable to expect that the FDI area has become one of the main topics of discussion for both government strategists and academic researchers.

Following the transition in 1991, these investments were viewed as crucial not just for rebuilding the economy but also for socially fostering a new culture around

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[1] Oltiana Muharremi, "Discussion: Challenges and Recent Developments of Foreign Direct Investments in Albania and Western Balkan Countries," *Central European Business Review* 9, no. 4 (September 30, 2020): 96–111, https://doi.org/10.18267/j.cebr.242.

private enterprise in Albania. Investment flows, both coming in and going out, helped various economic sectors grow. Many industries felt these effects differently, but the overall positive impact on industry became clear.

During this time, sectors that needed significant capital and advanced technology, like telecommunications, energy, and infrastructure, experienced particularly strong growth, while other fields saw more moderate benefits.[2] Academic research often highlights how Foreign Direct Investment (FDI) can drive technological innovation, create more jobs, and make it easier to access global markets. For Albania, however, integrating successfully into the world economy really means digging into all the key elements needed to make that happen.

While FDI has certainly made positive contributions, its impact has been dampened by ongoing institutional shortcomings. For instance, issues like an underdeveloped legal and regulatory framework, limited cooperation between foreign investors and domestic businesses, and the challenge of matching incoming FDI with the country's key development priorities have lessened its effectiveness.

Despite going through a lengthy transition, Albania has made significant economic strides over the last few decades. Clear signs point to the economy growing more steadily and benefiting more people. This economic progress has also helped lift average incomes per person where they climbed from just 18% of the EU average back in 1998 to reach 30% by 2012. Importantly, this growth played a key role in cutting the country's poverty rate nearly in half, bringing it down from 25.2% to 12.5% by 2008.

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[2] Meleq Hoxhaj and Ilira Pulaj, "An Overview of Foreign Direct Investment in Albania," *European Journal of Business and Management Research* 7, no. 4 (August 8, 2022): 256–60, https://doi.org/10.24018/ejbmr.2022.7.4.1542.

In reality the effectiveness of Foreign Direct Investment (FDI) in reviving Albania's economy was hampered by several other factors. These included regional and global crises, as well as challenges in ensuring that bilateral and multilateral regional trade agreements were consistently applied by all parties involved. Furthermore, the 2008 global financial crisis hit the Albanian economy hard, and together with ongoing regional economic instability, these issues disrupted the flow of incoming investments and hindered the country's ability to fully leverage the potential of FDI.[3] These shocks put a strain on macroeconomic stability, damaged investor confidence, and caused project delays, ultimately resulting in lower long-term profits and hindering sustainable economic development.

Over these decades, Albania has put in place significant structural and organizational reforms. The main goals were to foster more equitable economic growth, boost productivity and competitiveness, create more jobs, deliver better public services, and improve governance. Alongside these internal efforts, the country also focused on strengthening regional connections and gaining access to markets nearby and further afield. A key development here was the diversification of export markets, which notably helped attract more Foreign Direct Investment (FDI) and fuel economic growth domestically.

From this perspective, it's particularly important to look at the way Albania's approach has evolved during these years of economic transition. After all, the country joined the World Trade Organization (WTO) back in 2000. It then signed the Stabilization and Association Agreement with the European Union in 2006, gained EU candidate status in 2014, and officially started accession negotiations with the EU in July 2022. Exploring the role and effects of Foreign Direct Investment in this context will provide an understanding of how the country might

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[3] UNCTAD World Investment Reports.

optimize the benefits for sustainable progress. The following section presents the major research questions directing this dissertation to investigate with greater depth the dynamics involved.

### 1.1.RESEARCH QUESTIONS

MAIN QUESTION

- How has the relationship between Foreign Direct Investment (FDI) and Albania's Economic Growth evolved since the 1990s?

SUB-QUESTIONS

- How have government policies and the regulatory framework in Albania influenced the attraction and effectiveness of Foreign Direct Investment (FDI)?
- How is political stability and governance reforms evidenced in the sustainability of foreign direct investment in Albania?
- How significant is the contribution of FDI compared to other determinants of GDP growth?
- Which economic sectors have benefited most from FDI, and how effective have economic reforms been in creating a favorable environment for foreign investment?

The principal research question, "How has the relationship between Foreign Direct Investment (FDI) and Albania's Economic Growth evolved since the early 1990s?" seeks to analyze the evolving relationship between FDI and economic growth in the country. This has particular relevance given the fact that the transition is mainly from a centrally planned economy operating under the closed policies of its former system to an open economy based on market principles. In addition to it, "How have government policies and the regulatory framework in Albania influenced the attraction and effectiveness of Foreign Direct Investment (FDI)?” aims to examine the role and impact of governmental action in establishing a conducive investment environment. Moreover, measures like trade agreements, tax breaks, and sector-specific changes can play a significant role in luring in foreign investment. It is crucial to analyze these indicators' practical efficacy on the ground as well as how well they truly matched Albania's larger economic objectives. Their actual contribution to raising the amount of FDI entering the nation will be ascertained with the aid of this analysis.

Another sub-question emerges: “To what extent have political stability and governance reforms influenced the sustainability of FDI in Albania?”. This area of interest considers how the political climate and functioning of institutions relate to keeping the FDI in Albania in the long run. Generally, political instability, corruption, or ineffective governance can scare foreign investors away. Positive reforms, on the other hand, normally instill confidence for solid and long-term investments. Therefore, it's pertinent in analyzing Albania's political situation, paying attention to any related progress in governance and transparency, to be able to properly understand how these factors have influenced the stability of FDI therein.

Lastly, the question "How significant is the contribution to FDI compared to other determinants of GDP growth?" Such an inquiry invites a measurement of FDI impact alongside other major influences: domestic investment, growing exports, and labor market dynamics currently at work. This would create an overview of the "complete picture," with hopes of identifying a specific location for FDI in the whole story of economic development in Albania since the early 1990s, which later will be accompanied by which ‘sectors’ have benefited the most out of it.

## 1.2.THESIS OBJECTIVES

Given the significance of Foreign Direct Investment (FDI) and its real impact on fostering economic development in post-communist Albania, setting out clear, measurable objectives for this study is essential. The aim is to clearly delineate the specific contributions and context of FDI through this research.

Post-communist Albania offers an interesting case study where one can analyze the economic developments, with a special focus on the structural transformations and institutional reforms that have shaped the investment climate.

The primary factors working toward the attraction of Foreign Direct Investment to Albania can be discussed by taking into account variables such as the economic, political, and institutional environments, as well as geostrategic considerations.

There is a critical evaluation of the impact of foreign direct investment on Albania's economic development, particularly concerning the labor market, export-import flows, technology development, and the issuance of strategic sectors.

Policy recommendations on measures and strategies are necessary to improve Albania's investment environment to ensure they will sustain long-term economic growth from the current perspective of integration.

Achieving these study objectives involves examining specific policy indicators and developments over the years. In a country like Albania, the impact of FDI has certainly fluctuated. These fluctuations have often moved in parallel with political stability and the various stages of the integration path that Albania has navigated and continues to pursue.

## 1.3.PROBLEM STATEMENT

Albania has long since been subjected to the post-transformation, not just in the political arena but also in every aspect of the economy and society at large. Among the key indicators in such transformation would be the string pull for Foreign Direct Investment (FDI) which is every country's hallmark in growth and especially so in infrastructural modernization and entry into the world market.

While these efforts have often produced positive economic indicators, Albania still faces significant challenges in attracting and sustainably managing FDI. The identified problems frequently stem from internal political, institutional, and legal factors. These challenges highlight issues such as low levels of competitiveness, weaknesses in support structures, and legal uncertainty. This legal unpredictability often arises because the process of aligning domestic laws with European standards (part of the integration process) frequently requires additional, specific sub-legal acts to effectively implement national strategies and objectives concerning FDI.

Given this context, and to understand more clearly not just their numerical impact but also their qualitative effectiveness, specifically regarding the transformation of economic sectors, integration into international value chains, and productivity growth[4], the need arises for an in-depth analysis of the actual role Foreign Direct Investment (FDI) has played in Albania's economic development since 1990.

This study is one of the most important problems with the aim of providing valuable guidelines for the design of future development policies and improving the investment climate, not only at the academic level, but also at the practical level.

[4] Alfaro, L. et al. (2004). FDI and economic growth: the role of local financial markets.

### 1.4.RESEARCH FRAMEWORK

In accordance with the purpose of offering a coherent and simplified perspective on the role played by Foreign Direct Investment (FDI) in Albania's economic development during the post-communist period, this thesis will analyze the introductory chapter in the beginning. This introductory chapter includes the objectives, research questions, the identification of the research problem, and a very extensive review of the literature.

Subsequently, the thesis will clarify the landscape of theoretical concepts related to FDI and the determining factors that carry economic implications. To orient the study of FDI, the third chapter will focus on Albania's post-communist economic journey. It will address the emergence and development of FDI within Albania, its role and impact on economic growth, as well as the classification and distribution across the sectors with the most potential, extending to the transfer of technology into the economy via FDI.[5]

The analytical focus shall therefore consider the convening of a chapter looking into the impact and its empirical analysis of FDI on the development of the country. This will involve an extensive analysis of qualitative and quantitative data, institutional analysis, and policy indicators. Concrete results are expected through graphical and econometric analysis based on the research methodology employed for this study.[6]

In the end, the study will also bring out solid conclusions and recommendations for a conducive environment that would further enhance any competitive impacts of

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[5] FMN (2010). "Shqipëria—2010 neni IV konsultimet, konkluzione paraprake të misionit" 10 mars, Uashington, D.C. http:// www.imf.org/external/np/ms/2010/031010. htm.

[6] Amat Adarov and Robert Stehrer, "Implications of Foreign Direct Investment, Capital Formation and Its Structure for Global Value Chains," *The World Economy* 44, no. 11 (November 2021): 3246–99, https://doi.org/10.1111/twec.13160.

Foreign Direct Investment (FDI) against domestic investment aimed at stimulation of investment and sustainable economic growth in Albania. The structure of this thesis underlines much the importance of FDI when viewed from that perspective of European integration and in the transition of Albania from that very serious post-communist period.

### 1.5.LITERATURE REVIEW

Foreign Direct Investment (FDI) is widely recognized as an important driver of economic growth in both developed and developing markets. Its role extends beyond providing financial capital, encompassing crucial elements like technology transfer, knowledge spillover, and integration into global value chains, thereby influencing markets.[7]

Considering significant research regarding the importance of governance and institutional quality across different patterns of sector-specific strategy in optimizing returns from FDI, transition economies like Albania are an interesting context within which to study this type of investment. Estrin and Uvalic further emphasize that the major countries in transition have gone through serious structural and political changes in the course of the 1990s in order to create conditions suitable for foreign investments after the end of centrally planned economic systems.[8]

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[7] Konig, G. (2009) "The impact of investment and concentration among food suppliers and retailers in various OECD countries", paper presented at the VIIth global forum on international investment, OECD, 7-8 dhjetor.

[8] Alan Bevan, Saul Estrin, and Klaus Meyer, "Foreign Investment Location and Institutional Development in Transition Economies," *International Business Review* 13, no. 1 (February 2004): 43–64, https://doi.org/10.1016/j.ibusrev.2003.05.005.

Privatization, market liberalization, and tax incentives are major weapons increasingly used to foster a favorable investment climate. As Estrin and Meyer suggest, reforms of these kinds have created conditions for an increase in FDI inflows, but the quality and sustainability of such investments over the long term will depend on continued institutional development.

Integration via Foreign Direct Investment (FDI) has been a significant contribution to Albania's economic development in its integration into Global Value Chains (GVCs). This relation, however, has been characterized by many difficulties- infrastructure shortfalls, political instability, and restrictions in property rights enforcement, all of which would affect the long-term effectiveness of FDI toward sustainable economic growth.

Many studies have found that countries with effective regulatory frameworks and consistent policy implementation are usually far more successful at attracting FDI and leveraging its economic benefits.[9] In this respect, administrative effectiveness becomes critical in both attracting and retaining FDI inflows. Kaufmann says that good governance, political stability, control of corruption, and a transparent judiciary improves the investment environment. Moreover, Raza corroborates this view, pointing out that institutional quality and control of corruption create not only a friendly and stable environment for investors but also enhance entrepreneurship and growth of businesses.[10]

According to Tran and Le, governance systems are catalysts that foster FDI and entrepreneurial activities at a local level. He agrees with Dunning's eclectic

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[9] Görg, H. and Greenaway, D. (2001). "Foreign direct investment and intra-industry spillover: A review of the literature," Research Paper No. 37, University of Nottingham.

[10] Syed Ali Raza, Nida Shah, and Imtiaz Arif, "Relationship Between FDI and Economic Growth in the Presence of Good Governance System: Evidence from OECD Countries," *Global Business Review* 22, no. 6 (December 2021): 1471–89, https://doi.org/10.1177/0972150919833484.

paradigm that shows how location-specific advantages, including a strong institutional framework, attract foreign investment. Meyer further noted that, of all East European countries, perhaps the greatest priority in post-communist economies has been assigned to the institutional reforms to encourage FDI, particularly post-liberalization in the 1990s.

Poor regulatory quality and systemic defects, such as corruption, violation of property rights, and bureaucratic inefficiency, act as significant barriers to foreign investment. Ackerman points out that these conditions are even more difficult in post-conflict environments where building governance structures would be crucial in restoring institutional trust for sustainable development that will bring in impactful FDI.

Thus, the contributions of Foreign Direct Investment to the economy are complex. According to scholars like Rao, it is FDI that provides jobs and thereby contributes to industrial development. This is consistent with modernization theory, which draws inspiration from neoclassical growth models such as that of Solow[11], emphasizing that in the short term, wealth accumulation brings benefits, while technological advancement brings benefits over time.

Additionally, the work done by Romer on endogenous growth theory in explaining the role of FDI to promote innovation and productive growth via knowledge spillover and 'learning by doing'.[12] Empirically, studies have demonstrated a positive externality from FDI. For example, Borensztein has argued that the foreign direct investment into a country adds more to the economic growth of it than does

[11] Solow, R. M. (1956). *A Contribution to the Theory of Economic Growth*. The Quarterly Journal of Economics, 70(1), 65–94.
[12] Paul M. Romer, "Endogenous Technological Change," *Journal of Political Economy* 98, no. 5 (1990): S71–102.

domestic investment, especially when the host country has a minimum human capital threshold for absorbing technology transferred through FDI.[13]

Similarly, Agosin and Machado highlighted that the productive capacity of the host economy must match the types of FDI influxes to create the most possible upstream and downstream linkages[14]. They added, however, that badly targeted FDI tends to detract from local firms, thereby diminishing the overall benefits.[15]

### 1.6.STUDY METHODOLOGY

This thesis follows a mixed methods approach, which will be the best method to adequately explain the current effect of FDI as a driver of economic growth in Albania and includes quantitative methods using statistical analysis of data regarding the role of FDI within the country, together with qualitative methods - based on documentation and institutional sources related to the period under review. In this light, based on the analysis of such data, an exploratory and descriptive consideration will include some econometric elements.

Furthermore, sources of data collection included primary and secondary sources of data. Direct insights are provided by primary sources through interviews with officials of AIDA (Albanian Investment Development Agency), representatives from beneficiary sectors, and foreign investors (FDI). This has secondary data

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[13] E. Borensztein, J. De Gregorio, and J-W. Lee, “How Does Foreign Direct Investment Affect Economic Growth,” *Journal of International Economics* 45, no. 1 (June 1998): 115–35, https://doi.org/10.1016/S0022-1996(97)00033-0.

[14] Agosin, M. R., & Machado, R. (2005). *Foreign Investment in Developing Countries: Does it Crowd in Domestic Investment?* Oxford Development Studies, 33(2), 149–162.

[15] Manuel R. Agosin and Roberto Machado, “Foreign Investment in Developing Countries: Does It Crowd in Domestic Investment,” *Oxford Development Studies* 33, no. 2 (June 2005): 149–62, https://doi.org/10.1080/13600810500137749.

coming from institutions such as INSTAT, the Bank of Albania, the World Bank, UNCTAD, Eurostat, and the OECD, among others.

The data will allow statistical methods of estimation, including the relationships between indicators with FDI flows and GDP. In particular, process regression analysis is used for the impacts of FDI on economic growth in Albania in the coming years as a post-communist country for a prolonged transition period of political and economic changes.

Another element in supporting this research is the qualitative analysis which gives realistic insights in government policies and their objectives with regard to attracting FDI and utilizing such investments for economic growth.

The analysis including such components can be done through various kinds of tools like statistical software packages, and in this case, Microsoft Excel is being used for regression and correlation analysis suited for the economy of Albania. Other than that, it applies a framework of analysis of economic growth with a FDI context based on the Solow growth model.

To accommodate the analysis of relevant external data, this thesis also borrows figures published by international financial institutions and bodies that regulate various trade agreements. Various forms of joint investment agreements, broader regional projects, and initiatives aimed at rural development are included in the data, such as: the World Bank, the EBRD, and the WTO.

Albania has adopted liberal investment legislation aimed at facilitating Foreign Direct Investment (FDI) growth. This approach has included cultivating relationships with international institutions, which began with the onset of the post-communist changes. Notably, close collaboration with the European Bank for Reconstruction and Development (EBRD) and the Energy Community has played a significant role in Albania's economic growth. The EBRD has made significant contributions by investing in SMEs and modernizing the financial sector so as to further strengthen the private sector. At the same time, with the help of the Energy Community, Albania's alignment with EU energy standards catalyzed the investment in renewable energy and modernization of the country's energy infrastructure.[16] Nevertheless, some researchers posit that the positive outcomes notwithstanding, Albania's institutional and governance bottlenecks have worked against the effectiveness of such initiatives more so in the energy sector. Such shortcomings in reform implementation and governance have hindered the maximization of these projects, alluding to the fact that international assistance is likely to succeed where such obstacles have been successfully conquered.

The International Monetary Fund (IMF) membership of Albania, starting in 1992, kept the Albanian economy afloat in the lag period of its transition. The IMF assistance on account of financial and monetary policy helped the stabilization of public finance and the control of inflation on their way.[17] Yet, Vines and Gilbert criticize the IMF for laying too much emphasis on austerity measures that worsen social inequalities and prevent a quick recovery. Above all, it raises crucial questions on balancing short-term fiscal restraint and long-term development concerning transition economies like that of Albania.

Besides examining the IMF, the cooperation of the World Bank, which began in 1991, has also provided significant finance and technical assistance for energy, transport, and education projects, increasing Albania's competitiveness in the world economy. However, there were problems with the implementation of projects funded by the World Bank; again, there would be inefficiencies in fund

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[16] Çupi and Muça., 83.

[17] David Vines and Christopher L. Gilbert, eds., *The IMF and Its Critics: Reform of Global Financial Architecture*, 1st ed. (Cambridge University Press, 2004), https://doi.org/10.1017/CBO9780511493362.

management and problems in establishing sustainability of the projects. These shortcomings reveal a considerable gap between the objectives of international assistance and what actually-very often-the results. Indeed, it causes concern about the front of long-term investment outcomes in Albania's development.

At that time, though Albania's economy was instable and underdeveloped, it was seeking membership in international organizations as a part of its strategic orientation towards political change, thereby introducing market discipline and directing foreign investors towards safer opportunities. In this context, Albania's membership in 2000 in the World Trade Organization (WTO) proved to be a milestone in the country's transition toward integration in the global trade circuit.

WTO membership promised to Albania wider access to international markets and would have quite a significant impact in attracting FDI as it promised the investors that they could work within a transparent and internationally accepted regulation.[18] It also contributed tremendously to shaping economic growth through trade liberalization along with market-oriented policies of reform such as extensive reductions of tariffs. Though such a positive stance does not really consider the evils of the WTO framework, Pajo among many other critics would say that the Convention made it possible for Albania to unleash a wider spectrum of markets, but provided equal footing in relation to exposing key vulnerabilities in areas where it did not have any competitive advantage.[19] These weaknesses thus raise dilemmas regarding the real value of WTO membership for a developing country with limited industrial capacity in the long term.

[18] Sara Pajo, "Analysing The Impact Of Wto Accession On Albania's Trade Policies And Economic Development," *Journal of International Trade and Economic Development* 1 (October 18, 2024): 13.

[19]Pajo., Analysing The Impact Of Wto Accession On Albania's Trade Policies And Economic Development",15.

Meanwhile, a very significant concurrent development was the aspiration of the country to become integrated into the European Union. This political goal was complemented by a sense of geographic belonging. A turning point was represented by the signing of the Stabilization and Association Agreement (SAA) with the European Union (EU) in 2006, which was instrumental in fast-tracking modernization efforts in Albania.[20] The SAA set Albania's policy agenda parallel to that of the EU, an alignment that not only promoted trade relations but also provided a mighty boost to the inflow of FDIs.[21] The SAA was essential in anchoring the framework of the Albanian institutions and moving towards the rule of law, hence promoting democratic governance.

Contrary to general opinion regarding the SAA as a crucial forward step, it was not void of critics. According to some scholars, such as Husi, the SAA brought some positive developments to Albania, including financial assistance, but at the same time it imposed tough requirements that slowed down reforms in some sectors. The huge stipulations on compliance with EU standards could have arrested some very important and timely reforms and created this very thin line of contestation between external pressure and Albania's capacity for reform.

[20] Husi, G. (2015). Public administration in Albania and the process of European integration. *Academic Journal of Interdisciplinary Studies*, 4(2 S2), 300–310. https://doi.org/10.5901/ajis.2015.v4n2s2p300

[21] Çupi, Juxhin, and Ermelinda Muça, *The Economic Development and Trade Liberalization in the Post-Communist Albania*, 79.

## 2. THEORETICAL CONCEPTUALIZATION OF FDI AND DETERMINING FACTORS

This chapter shall serve as the origin for various definitions of Foreign Direct Investment (FDI) as a general theoretical and conceptual background for different approaches and understandings related to it. The chapter will also classify economic variables associated with FDI in Albania according to its evolution and development along with different factors such as income, costs, and employment, by cross-reference with different theories. The goal is to analyze how these theoretical drivers have influenced FDI in this specific context. The impact will also be reflected through an examination of determining factors based on specific analyses and their concrete effects. The selection of variables for study and analysis will primarily relate to the policies, strategies, and overall climate established in Albania to attract FDI.

### 2.1.THEORETICAL NOTIONS OF FDI

"According to the classic theoretical notion from the OECD (2007), Foreign Direct Investment (FDI) "reflects the objective of establishing a lasting interest by a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the direct investor (direct investment enterprise)". The concept of 'lasting interest' implies the existence of a long-term relationship between the direct investor and the enterprise and signifies a significant degree of influence on the management of the latter. FDI is important in both developing and developed countries.[22]

Given the fact that foreign direct investment (FDI) is so important worldwide, and especially in Albania, luring this capital has frequently taken on political

[22] OECD (2007)

significance. In fact, obtaining FDI during certain legislative times has often been considered a sign of effective governance. Referring to the stated law No. 7764, "On Foreign Investment," dated November 2, 1993, the core principle regarding FDI essentially states: "Foreigners have the right to engage in economic activities without the need for prior authorization or permit. Foreign investors are treated no less favorably than Albanian citizens, except regarding land ownership, which is governed by a separate law."

Consequently, FDI can be defined along the following lines: It refers to an investment made by an economic unit-an individual, corporation, or institution-which is resident abroad in host country. The purpose is the establishment of a lasting interest and effective control over the management of an enterprise located in that host country in which the investment is made. As noted by UNCTAD (2022), for an investment to quality as FDI, the foreign entity must instate a lasting control over a local enterprise, which in general requires that it owns no less than 10 percent of the equity share capital of that enterprise.

In the Albanian context, and regarding these theoretical notions, FDI constitutes a major part of economic development for transition economies. Following the fall of the communist regime and the move to a free market economy (FME), foreign direct investment was seen as a key resource for modernizing infrastructure, stimulating growth, and creating new employment opportunities for Albanians. During this period, all efforts were made to attract foreign direct investment through the liberalization of markets, privatizations, and the improvement of the domestic business climate, as an added attraction with its low labor costs, trade agreements with the EU, and good geographical position[23].

[23] Hobbs, J., et al. (2021). *Does Foreign Direct Investment and Trade Promote Economic Growth? Evidence from Albania*. Economies, 9(1), 1. https://doi.org/10.3390/economies9010001

Different forms of FDI are commonly applied, such as: FDI that can be manifested in terms of their nature and strategy in relation to the performance in the host country. For example, "open-field investment" refers to the construction of a completely new operation from scratch, which may include the construction of new infrastructure, the construction of new production lines or the opening of factories. "Horizontal FDI" is said to occur when a company invests in the same industry abroad in which it operates in its own country. In contrast, "vertical FDI" occurs when investments are made at different stages of the same production chain within the host country, such as raw materials, production or distribution. Another type, "conglomerate FDI", is said to involve investments in businesses other than the main activities of the investing company. Finally, FDI can also take the form of "Mergers and Acquisitions" (M&A), which refers to the act of buying or merging with existing companies operating in the host country.

General factors influencing foreign direct investment attract the foreign investors' attention. It is accepted that a stable political environment and a conducive business environment must be present. Often decisions are based on the desire to enter new markets that potentially benefit from cheaper labor and production costs. Specific natural resources and raw materials are often the deciding factor, especially if coupled with hostile country incentives and taxes.[24]

Another perspective on FDI can focus on the economic advantages drawing such investments into the host country, which also seeks to integrate into global production chains. This integration is seen as advantageous in terms of boosting exports and enhancing the trade balance. When conditions exist for either technological transfer or innovation, FDI will flow in; when government economic policies enhance the competitive position of the domestic economy vis-a-vis other

[24] Witold J. Henisz, "The Institutional Environment for Multinational Investment," *Journal of Law, Economics, & Organization* 16, no. 2 (2000): 334–64.

countries, FDI will find attraction; and when there is a requirement for jobs to increase GDP per capita, FDI is more favored.

Among the well-known theories of FDI, Hymer's Theory of ‘Firm-Specific Advantages’ stands out. The theory states that international companies invest in foreign countries because they possess firm-specific advantages superiority of technology or recognizable brands, for example, that sustain competitive advantages over the host country's investors.[25]

Yet another perspective is 'Internalization Theory', which proclaims direct investments from companies abroad to evade transactional costs in the market and the risks entailed with outside partnerships (like licensing or joint ventures). Dunning’s 'OLI Paradigm' is a fuller entrance into the phenomenon, which comprises three sets of advantages determining FDI. These include Ownership advantages (firm-specific strengths, like technology or brand); Location advantages (country market benefits from the host); and Internalization advantages (benefits of control over operations performed in-house as opposed to outsourced)[26].

Thus, Albania, since the 1990s, has had some periods of fiscal and financial stability, which support the emerging model for economic growth mainly driven by FDI alongside other reforms on wages and job creation, as well as the advancing development of tourism. Continuous investment in renewable energy during this time has also further improved the attractiveness of the country for FDI. An analysis

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[25] S. Estrin and M. Uvalic, “FDI into Transition Economies: Are the Balkans Different,” *Economics of Transition* 22, no. 2 (April 2014): 281–312, https://doi.org/10.1111/ecot.12040.

[26] Dunning, J. H. (1979). *Toward an Eclectic Theory of International Production: Some Empirical Tests*. *Journal of International Business Studies*, 11(1), 9–31. https://doi.org/10.1057/palgrave.jibs.8490593

of incoming foreign direct investment should, thus, not only focus on the volume but also the quality and real effects within the country's transformation.[27]

Economic growth (EG) refers to an increase in the capacity to produce goods and services for a given population over some time through very sustained effort. Some of the forces affecting EG include human capital development, labor force expansion, technical advances, and investments. Over time, several concepts and frameworks have been offered by researchers to provide a backdrop for analyzing the mechanisms of economic growth. The neoclassical growth theory by Robert Solow and Trevor Swan asserts that the long-run economic performance of an economy slightly relies on the joint contribution of labor and capital, while technology must power growth that is beyond capital accumulation.[28] In this scenario, FDI is a vital capital-inflow factor and technology transfer, affecting production capacity and workers' performance in host countries.

However, the model highlights the importance of external technological progress in addition to the two classical motivations of capital and labor in and of themselves. Consistent with this thought, the model considered that FDI may not be negatively viewed as in the traditional model because absence of such technology may hinder their productivity enhancement in host countries. Hence, the endogenous growth theory proposed by Romer provides a more detailed account. With this theory, Romer argues that FDI is an avenue through which technology is transferred from developed economies to host countries, stimulating their local innovation and productivity growth.[29] Additionally, according to

[27] World Bank (2023). Doing Business and Investment Climate Assessment: Albania Country Profile. Washingtio, D.C.: World Bank Group.
[28] Robert W. Demand and Barbara J. Spencer, "Trevor Swan and the Neoclassical Growth Model," *History of Political Economy* 41, no. Suppl_1 (December 1, 2009): 107–26, https://doi.org/10.1215/00182702-2009-019.
[29] Romer, "Endogenous Technological Change."

endogenous growth theory, FDI affects economic growth more than domestic investment does. In enabling specialization in high-value production and reducing costs, FDI enhances a host nation's competitive position in international markets.

In other words, economic growth considers the internal causative factors rather than the external conditioning. This theory gives a useful anvil for examining the internal forces, among which the advantages and disadvantages passed down from past arrangements like communism could be included, by which short- and long-term economic development occurs. It brings out the importance of human capital, innovation, and knowledge building for sustainable growth. That is why FDI could help create a transformative internal economic environment and assist in developing a competitive economic structure in Albania.[30]

According to Todaro and Smith, Economic Growth will therefore be characterized as a gradual increase in GDP, through the slow enhancement of an economy's capacity to generate goods and services. They point out that supporting sustainable economic development is critically dependent on the quality and quantity of resources. Theoretical perspectives concerning economic growth typically focus on long-term trends of GDP growth, as well as improvement in living conditions. In Sengtupa's view, economic growth indicates the equilibrium between the development of an economy and the promotion of social well-being. To add to this, Supriyanto also suggested that economic growth, invariably measured through indices like GDP or GNP, is an equally important indicator for measuring the health of an economy.[31] All these theoretical concepts incorporated together lead to understanding economic growth as a very comprehensive process that entails national economic policies, technology, and efficiency in using resources. They are

[30]Romer, Paul M. "The Origins of Endogenous Growth." *The Journal of Economic Perspectives*, vol. 8, no. 1, 1994, pp. 3–22.
[31] Todaro, M. P., & Smith, S. C. (2011). *Economic Development* (11th ed.). Pearson Education.

fundamental to the underlying approach to identifying patterns of growth in different contexts, such as post-communist Albania.

Analyzing the concept of institutional economics focuses on the role of institutional structures such as governance, legal systems and property rights in determining economic outcomes. Institutional frameworks are vital as they help build confidence among investors to be effective for economic stability.

From this centralized communist regime, Albania had to go through comprehensive reforms in terms of governance and legal systems. In fact, with these reforms, the investment climate will gradually change and consequently improve the country's attractiveness to foreign investors. Moreover, institutional economics compels one to pay attention to these structural transformations concerning creating a propitious environment for investment and long-term growth.

## 2.2.FDI PROGRESS IN POST-COMMUNIST ALBANIA

FDI in Albania dates back during the beginning of the political transition of 1990-1997, a period of profound transformation in the political and economic arenas. Shifting from a centrally planned to a market economy posed extraordinary difficulties that necessitated the need for external capital. That need went hand in hand with the requirements of new technology and management know-how. Hence, FDI was seen as a very important thematic area which is particularly important for energizing the process of economic development, international economic integration, and restructuring economic sectors.

However, the beginning efforts for the privatization of sectors, notably trade and agriculture were not very clear with regard to the real economic backdrop. Political instability and absence of a proper legal framework have also contributed to almost negligible foreign investment at the beginning.

The years 1998-2008 were set in the following recovery phase after the great crisis of 1997, which marked the onset of a consolidation phase. This meant that the rule of law would be enhanced, clearer legislation for investments would be drafted, and the European integration process would be commenced.[32] The privatization of key sectors of banking, telecommunications, and energy thus captured large amounts of investments from developed countries. During this time, the Bank of Albania (BoA)[33] and AIDA (Albanian Investment Development Agency) were playing effective roles in promoting and monitoring these investments.

The years 2009-2015 witnessed a surge in investment with emphasis on modern infrastructure. FDI had an important role in this period regarding the major energy and infrastructure projects, like the TAP pipeline, while it allowed foreign banks and corporations to enter the insurance and technology sectors. There were enhanced activities in the hydropower and renewable energy sector during this time. Continuing with the EU integration process led to a visible improvement in the business environment, which helped positively in the attraction of foreign investment. With FDI levels reaching up to 8% of the GDP for several years in this period.

In 2010, although many Southeastern European countries experienced significant declines in Foreign Direct Investment (FDI) and in their economic growth, the opposite occurred in Albania.[34] Interestingly, while most Southeastern European

[32] Xhepa, S. (2007). Investimet e Huaja Direjte në Shqipëri: Dinamika, Strukturë dhe Efekte. Revista Ekonomike Shqiptare, 2(1), 45-60.
[33] Banka e Shqipërisë. (2023). Raporti Vjetor mbi Investimet e Huaja Direkte. Tiranë.

[34] Hunya, Gábor (2010). "IHD in the CEECs hit hard by the global crisis,"wiiw Database on Foreign Direct Investment in Central, East and Southeast Europe, 2010. Vienna: Vienna Institute for International Economic Studies.

countries saw significant declines in both FDI and economic growth around 2010, Albania experienced the opposite trend. The indicators for this three-year period were notably positive: FDI inflows reached €717 million in 2009 (based on revised Bank of Albania data from the 2010 Foreign Investment Report and UNCTAD's WIR11) and climbed further to €793 million in 2010. This performance ranked Albania second for FDI inflows in Southeastern Europe in 2010, trailing only Serbia. Although inflows decreased slightly to €742 million in 2011, this figure still represented a relatively strong performance, especially considering the decline contrasted with the global recovery trend and even the FDI growth seen in regional neighbors like Croatia and Serbia during that period.

The period from 2016 onward, marked by business diversification, posed some challenges and led to a slight decrease in the level of FDI flowing to Albania, largely because of completion of some large projects such as TAP. However, the focus of FDI shifted to new and more sustainable sectors, including Information and Communication Technology (ICT) and technology services (with the setting up of centers for new project calls and startups), tourism (where investments in hotels and coastal areas increased tremendously), and the promotion of exports of agricultural products and those branded "Made in-Albania."

Post-2020, despite the short-term difficulties caused by the COVID-19 pandemic, new policies were launched to promote FDI in strategic sectors. This was reflected in improved indicators in the "Doing Business" report. Nonetheless, challenges persist, such as lack of transparency and accountability, and issues where the legal infrastructure, although aligned with the EU, requires supplementary sub-legal acts for effective implementation; a process often hampered by a lack of political will, consequently allowing institutional corruption to persist.

It can be derived from the above title based on statistics and empirical evidence that substantial growth has been experienced in the inflow of FDI to Albania. It increased from fewer than €50 million in 1995 to nearly billion euros in 2022. Among the main contributor countries in these figures are Italy, Greece, Turkey, Austria, Germany, and the USA. The dominant sectors attracting this investment are Energy (representing 25-30% of the total), Construction and Services (20%), Banking and Finance (20%), and Telecommunications (15%).[35]

Reflecting significant evolution, Albania has implemented reforms to stimulate FDI. In the last decade, the state has adopted favorable tax reforms for foreign investors and aimed to reduce corruption and administrative obstacles that might hinder investment. However, lack of transparency in public procurement and weak contract enforcement also present barriers to FDI in Albania, although the E-procurement portal, functional for several years, has simplified practices and application bureaucracies[36].

A negative impact that has accompanied the long socio-economic transition is that investment is often hindered by inadequate infrastructure and poorly defined property laws. Securing property rights remains challenging due to difficulties in obtaining clear titles. Foreign investors are permitted full ownership of domestic companies, except in certain sensitive sectors such as domestic and international air passenger transport, television broadcasting, and the capitalization of second-tier commercial banks.

Despite some volatility, the country has identified target sectors for foreign investment, including energy and mining, transport, telecommunications, infrastructure and waste management, tourism, agriculture, and fishing. Currently, Albania lacks an investment screening mechanism for incoming FDI. Nevertheless, indicators show the country ranked 83rd among 132 economies in the 2023 Global

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[35] INSTAT. (2022). Statistika Ekonomike të Shqipërisë. Tiranë.

[36] U.S. Department of State. (2024). *2024 Investment Climate Statements: Albania*. Retrieved from https://www.state.gov/reports/2024-investment-climate-statements/albania/

Innovation Index and 48th out of 177 countries in the Economic Freedom Index for the same year[37].

The following table describes the latest FDI situation using data on: FDI Inflows; FDI Stock; Number of Greenfield Investments; and the Value of Greenfield Investments (in million USD).[38]

TABLE 1: Inward FDI Flow; Stock; Number of Greenfield Investments; and Value of Greenfield Investments, in (million USD).

| Foreign Direct Investments in Albania | 2020 | 2021 | 2022 |
|---|---|---|---|
| Inward FDI flow (million USD) | 1,108 | 1,234 | 1,434 |
| Stock (million USD) | 9,608 | 10,081 | 11,397 |
| Number of Greenfield Investments* | 5 | 3 | 7 |
| Value of Greenfield Investments (million USD) | 339 | 113 | 160 |

Source: UNCTAD - World Investment Report 2023[39].

* Greenfield investments are a form of Foreign Direct Investment where a parent company starts a new venture in a foreign country by building new operational facilities from the ground up.

Albania is a developing country that needs foreign investors to develop large parts of its economy, which offers many interesting opportunities. On the other hand, it is an economy that is not very diversified and heavily dependent on agriculture,

[37] https://www.wipo.int/edocs/pubdocs/en/wipo-pub-2000-2023-en-main-report-global-innovation-index-2023-16th-edition.pdf
[38] https://www.lloydsbanktrade.com/en/market-potential/albania/investment
[39] https://unctad.org/system/files/official-document/wir2023_en.pdf.

accounting for 18.5% of GDP and 36.4% of jobs in 2019 (according to the World Bank, latest available data). It has a relatively poor population with standards below European levels and low public investment in education at 3.6% of GDP.

However, the government continuously takes measures to motivate foreign direct investment. In recent years, legislative and fiscal reforms have been adopted, as well as new laws on public-private partnerships, public procurement, free trade zones, business registration, and electronic signatures.

### 2.3.CLASSIFICATION AND OTHER ECONOMIC VARIABLES OF FDI

To achieve a realistic classification of FDI in Albania, it is necessary to provide an overview of the key criteria followed. These criteria help in analyzing the structure, impact, and development of these investments over time, which is essential for a deeper understanding of how and why FDI influence economic growth in a post-communist country like Albania.

The criterion of "Influence On The Local Economy", in which FDIs has a major impact on exports, provides technology and know-how transfer through training, creates direct and indirect jobs, and prefers short-term profits. The analytical variable: the criterion-increases productivity, affects rates of innovation, and raises export value for foreign-invested companies.

Criterion: "Economic Sector" - highlighting the sectors where foreign investments in Albania are mostly oriented and concentrated: Energy and hydrocarbons (mentioning investments from the TAP project and Bankers Petroleum), the banking and financial sector, the manufacturing industry (to a more limited extent), tourism, services, and telecommunications, and construction and real estate (which have seen significant growth in recent years).40 Analytic variable: This criterion of FDI distribution by sector determines the growth of employment in each sector and their share in GDP.

Criterion: "Mode of Market Entry" - showing that FDI have focused on new investments (greenfield investments), acquisitions of public enterprises or privatizations, and joint venture partnerships. Analytic variable: shows the number of newly established enterprises versus acquired ones and the degree of foreign control in companies.

Criterion: "Geographical Origin" - this criterion shows from which countries investors mainly come, e.g., neighboring countries like Kosovo, North Macedonia, Turkey; EU countries like Greece, Italy, Croatia, Austria, Germany, etc.; investors from the USA and other countries, for large specific projects. Analytic variable: shows the average value of FDI by country of origin and their percentage share in total economic growth.

Criterion: "Development Periods" - indicating the initial privatization period (1992-2000), where concentration was in banking and trade; the period 2001-2010, showing increased investment in infrastructure and energy; the period of regulatory approximation with the EU (2011-2020), 41, highlighting investments in services such as call centers, ICT, etc.; and the period after 2020, which was accompanied by the effects of the pandemic, with investments in digitalization, start-ups, and tourism. Analytic variable: shows annual FDI flows, the comparative trend over the years, and the number of new contracts in each decade of the economic transition.

[40] INSTAT. (2022). Statistika Ekonomike të Shqipërisë 2020-2022. Tiranë.
[41] Duci, E., & Musta, E. (2020). Tendenca e Investimeve të Huaja në Shqipëri. Revista Ekonomike Shqiptare, 5(2), 45-48.

To identify relationships with econometric studies and best suit the econometric application of the relationship between FDI and GDP growth, an equation model must be constructed to refute or support this relationship. Through multiple regressions, it is shown that economic growth as measured by the percentage increase in GDP is a dependent variable[42].

Meanwhile, since FDI inflows are an independent variable, the analysis becomes incomplete because GDP has other determining variables/determinants; therefore, it becomes necessary to include some of them in the analysis. Selecting capital formation, which represents the total investment in the economy over a given period, encompassing both domestic investments and FDI, or alternatively, the increase in the physical capital stock regardless of origin yields a realistic result.

The other important variable selected for discussion is net exports, which are defined as exports minus imports over a given period within the economy of a state. Using this sort of variable will enable us to see how much the external sector affects the economies of developing nations, particularly nations with high imports in comparison to exports and other goods.

Formula of Net Exports:

NX = X – M where, NX = Net Exports; X = Total exports of goods and services; M = Total imports of goods and services.

In this method, NX is one of the most important indicators reflecting an economy's relationship with international trade. The inclusion of this variable serves to measure the external sector of the economy. It shows that in developing countries

[42] Borensztein, E., De Gregorio, J., & Lee, J-W. (1998). *How Does Foreign Direct Investment Affect Economic Growth?* Journal of International Economics, 45(1), 115–135. https://doi.org/10.1016/S0022-1996(97)00033-0

like Albania, when imports exceed exports, a negative value of NX signals a trade deficit, thereby influencing the perception of economic stability related to FDI[43].

From the above, through classification, we can understand the analysis of economic impact, the structure of investments, and identify the elements that should be supported in policymaking for FDI. There is an interconnected relationship link: the category of variables (dependent and independent), the type of influencing factors (sector, employment, tax levels, political and legal stability, economic freedom, infrastructure, etc.), and the sectoral description with concrete effects. This framework classifies the Key FDI Variables in Albania, leading to the creation of matrices with concrete data regarding their impact as a percentage of GDP, growth in real monetary values, growth in per capita income, concrete employment outcomes, average labor costs, and profit tax as a percentage.

## 2.4.FDI FACTORS RELATED TO INCOME, COSTS, AND EMPLOYMENT

Based on our analysis of FDI and Albania, we can easily identify some of the factors related to their impact on the growth of income, costs, and employment.

The returns that a foreign investor expects to gain from a host country are one of the primary reasons for undertaking FDI, aiming to maximize income. These become attractive whenever the potential for high returns exists, influenced by factors such as economic and monetary stability, purchasing power (like market size and its demographics), the profit tax rate, the possibility of expanding access to regional markets and consequently increasing exports, and the level of competition in the relevant sector. Albania's case shows a small domestic market

[43] Robert C. Feenstra and Alan M. Taylor, *International Economics*, 5th ed. (New York: Worth Publishers, 2018), 334–337.

but a favorable geographical position as an entry point to the region and the EU. Furthermore, the stimulation of investments through favorable fiscal policies, tax exemptions for economic zones and tourism, as well as investments in telecoms, the banking sector, and technology, are driven by high potential returns within a modest market[44].

Another current stimulus for FDI is cost, such as the cost of labor, production, and infrastructure. As cost is a significant factor in the interest of most investors, it is important regarding competitiveness for developing countries; labor costs (wages plus social security); rent, transport, energy, and water costs; and infrastructure costs, including costs related to legal compliance and corruption-all of these costs motivate FDI. Compared to countries in the EU, labor is relatively cheap in Albania; there are also several improvements in road and digital infrastructures, especially in urban and tourist areas. This has largely encouraged FDI in contract manufacturing (tailor), text. services, IT, and start-ups.

A factor fuel FDI intake even more is employment; the qualified manpower available with pertinent skills and professional training, which makes an attractive labor market. The flexibility of labor market in Albania can be linked to factors as legislation, contracts, working hours, state investment in vocational university education in recent years, work culture and efficiency, which have enabled a young active workforce, all positively enhancing stimulus generating for FDI. In addition, these have created employment opportunities to women and youth in crucial areas like tourism and technology. Sometimes, however, there may be an imbalance between educational training and labor market needs, while continued migration of youth has been proven to be a serious challenge.

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[44] Gjebrea, Evis, and Oltjana Zoto. "Factors Determining Foreign Direct Investments in Albania." *European Academic Research*, vol. I, no. 3, June 2013, pp. 236–250.

Therefore, factors such as income potential, labor costs, employment, infrastructure, and taxes are indicators that promote FDI and sustained economic growth[45]. However, they show continuous improvement with only a moderate impact. Given that Albania is a small market and has experienced an outflow of qualified labor in recent years, there is a possibility that its attractiveness for foreign investment could decline.

Referring to the above, the question arises: Is there a stable relationship between the growth of FDI and macroeconomic indicators (GDP, employment, exports)?

According to sources, such a relationship exists in the case of FDI in Albania, according to this analysis.[46]

The relationship between FDI and GDP: This has consistently made a positive contribution to GDP growth, as Foreign Investments have brought new capital, technology, and knowledge, thereby improving productivity in sectors such as financial services, energy, oil and gas, and telecommunications. However, the impact of FDI on GDP growth was linear for several years, not resulting in immediate GDP increases, as some long-term projects existed whose effects were not instantaneous. Additionally, there have been investments concentrated in sectors that did not have a significant impact on the economic chain.

The relationship between FDI and exports: FDI has particularly influenced the growth of exports in oil and minerals, textiles and footwear (where many contract manufacturing companies have developed production in Albania) and electricity.

[45] U.S. Department of State. *2024 Investment Climate Statements: Albania*. Washington, D.C.: U.S. Department of State, 2024. https://www.state.gov/reports/2024-investment-climate-statements/albania/.

[46] Dzaferagic, A., and I. Granic. (2021). "FDI, Economic Growth, and Labor Market Dynamics in Transition Economies: The Case of Albania." *Journal of Balkan and Near Eastern Studies*, 23(5), 611-630.

The peak period for their impact on exports was observed in the mining and energy sectors between 2012-2018.

The relationship between FDI and employment: FDI has created jobs, especially in the services sector (call centers), construction, energy, and tourism. According to data from INSTAT and the World Bank, FDI contributed to reducing unemployment, particularly in the years 2016-2022 when investments were higher. Nevertheless, it has been reported that there were instances where investments showed positive indicators for capital growth but very little impact on employment.

In statistical correlation terms, according to analyses reported by UNCTAD and the World Bank for Albania: the correlation with employment has often been weak; the correlation with exports has been stronger; and finally, the correlation between FDI and GDP has not consistently shown strongly positive indicators or significant growth (reflecting nuances mentioned earlier)[47].

An econometric model clarifies the impact of FDI on GDP, Employment, and Exports in Albania. Using the level of FDI as the independent variable in a simple linear model, the primary dependent variables are Exports, GDP (which indicates economic decline or growth over the analyzed years), and Employment (as reflected by the unemployment rate).

This model is represented as:

$Yt = \beta0 + \beta1 \times FDIt + ct$, where: “Yt” shows the economic indicator (t) i GDP, Exports and Employment, “FDIt” denotes the level of foreign direct investment in year (t), “β0” is the intercept constant, “β1” represents the coefficient showing the impact of FDI and “ct” is the error term. Interpreting this model:

[47] https://unctad.org/webflyer/world-investment-report-2023

when "β1" > 0 → An increase in FDI positively impacts the growth of GDP, exports, and employment.

when "β1" < 0 →An increase in FDI negatively impacts the dependent variables. The strength of this relationship can be measured using the coefficient of determination $R^2$.[48]

Using this analysis requires real data to verify the impact of FDI. Furthermore, for the econometric analysis to accurately reflect the expected positive impact of FDI, it is necessary to account for other factors influencing the dependent variables, such as fiscal policies, the institutional climate, and the global situation, all of which also have an impact in Albania's case.

According to this model, it is evident that FDI have a positive and stable relationship with economic growth, employment growth, and export growth in Albania.

The following table presents data referring to GDP growth for every 100 million new capitals invested by FDI.[49]

TABLE 2: GDP growth for every 100 million new capitals invested by FDI.

| Dependent Variable | Coefficient β1 | Interpretation | Coefficient of Determination R2<br>(relationship strength between variables) |
|---|---|---|---|

[48] Borensztein, Eduardo, José De Gregorio, and Jong-Wha Lee. "How Does Foreign Direct Investment Affect Economic Growth?" *Journal of International Economics* 45, no. 1 (1998): 115–135.

[49] OECD (2010). SouthEast Europe - Investment Reform Index 2010: Monitoring Policies and Institutions for Direct Investment. Paris: OECD

| | | | |
|---|---|---|---|
| GDP in % | β1 = 0.008 | 0.8% Increase GDP | 0.72 |
| Exports | β1 = 0.015 | 1.5% exports increase | 0.78 |
| Employment | β1 = 0.002 | 0.2 % employment increase | 0.65 |

Source: Bank of Albania

Therefore, because of theoretical analyses of factors related to the income and costs of FDI, among other factors, it emerges that multinational companies (MNCs) operating in different countries seek to increase income through the following methods:

- Entering Profitable Markets: If one company enters other markets and has been profitable, then MNCs may also decide to enter those markets aiming to increase their own profits, potentially by lowering prices in that market to attract existing buyers and consumers.
- Reacting To Trade Restrictions: Often, MNCs undertake foreign direct investment not necessarily to increase profits but to overcome trade barriers.
- Reacting to trade restrictions, MNCs often make foreign direct investments not with the aim of increasing profits but to overcome trade barriers.
- Exploiting monopolistic advantages: According to the "Theory of Industrial Organization," MNCs can find themselves in a monopolistic position when specific MNCs operating in foreign markets possess unique characteristics (such as proprietary factors of production, technologies, etc.) that other companies lack. In such ways, MNCs aim to penetrate more markets and

market spaces to increase cash flow, as these income streams can be simultaneously stable, thereby reducing the MNCs' overall risk.[50]

Regarding cost-related factors, MNCs often make direct investments to minimize their costs, which are achieved through.[51]

- Using Foreign Factors of Production: According to this approach, labor and land costs can vary significantly from country to country. Therefore, MNCs engaging in FDI tend to relocate parts of their production process to countries where factors like land and labor are cheaper (e.g., well-known European MNCs have oriented parts of their production processes to Asia, in countries like China and India).
- Sourcing Foreign Raw Materials: Focusing on exploiting cost factors, MNCs often purchase raw materials from various countries, as the costs of these materials can differ significantly depending on the location.
- Maximizing Benefits from Economies of Scale: This mechanism involves utilizing production factors as efficiently as possible, especially maximizing the use of potential production capabilities. According to this analysis, an MNC aims to focus on selling products where production efficiencies are highest, as this lowers the average cost of production for the MNC.
- Reacting To Exchange Rate Fluctuations: This is a factor signaling to an MNC that when a foreign country's currency depreciates, it becomes more attractive to invest there, as the initial investment cost (in the MNC's home currency) is relatively lower. If this currency subsequently appreciates, the

[50] FMN (2010a). World Economic Outlook: Recovery, Risk and Rebalancing. Uashington, D.C.: FMN.

[51] Helpman, Elhanan, Melitz, Marc J., & Yeaple, Stephen R. (2004). *Export versus FDI with Heterogeneous Firms*. American Economic Review, 94(1), 300–316.

MNC can potentially achieve satisfactory profits aligned with its expectations.

- Using Foreign Technology: According to this factor, MNCs recently have increasingly been acquiring foreign technology to learn, utilize, and adopt it, potentially at a minimal cost compared to developing it internally.[52]

Regarding labor-related factors, low-cost labor is also an important determinant for attracting FDI. Companies (or MNCs) are usually inclined to utilize countries with low wage levels and low per capita income, which has been a consistent advantage in Albania's case. Furthermore, the general educational level and that of workers with vocational training has been an aspect where generations emerging from the communist system possessed diverse professional and technical skills, whereas generations emerging after 1991 have shown marked deficiencies in this respect. Only in recent years have employment policies mandated the government and the Ministry of Education[53] to invest and focus more on preparing new generations with vocational education and qualifications, training, or certifications relevant to the various production and technological processes of the current domestic labor market.[54]

Other general factors favorable to FDI include economic incentives such as low credit interest rates, grants, subsidies, tax relief, and the removal of production restrictions and limitations by the host country. Infrastructural factors, such as telecommunications and railways, play a significant role in FDI development

[52] Konig, G. (2009) “The impact of investment and concentration among food suppliers and retailers in various OECD countries”, paper presented at the VIIth global forum on international investment, OECD, 7-8 dhjetor.

[53] Banka Botërore (2010a). Shqipëria: Programi i Ri për Rritjen- Memorandumi Ekonomik. Uashington D.C., Banka Botërore.

[54] *National Employment and Skills Strategy (NESS) 2023–2030*. Tirana: Ministry of Education. https://meki.gov.al/wp-content/uploads/2024/10/FINAL-Draft_NESS_Annual-Progress-Report_2023_30.10.2024.pdf

within a country. In Albania's case, rail transport has consistently been a disadvantage, although this has been somewhat offset by maritime transport within the broader infrastructure category[55]. Based on the above, firms begin to consider investing abroad as FDI when they believe they have established competitive advantages, which they can better exploit elsewhere, while always maintaining direct control over the entire production process aiming to minimize costs. On the other hand, before investing, firms analyze a range of other host environment factors related to returns, risks, and market conditions, as well as the existing flow of FDI into that country.

The degree of market openness generally has positive effects on FDI inflows; conversely, trade restrictions such as tariffs on exports and imports, quotas, and non-tariff barriers can act as deterrents. Low levels of corruption are also crucial; the perception of corruption (governmental, administrative, judicial) in the business environment, often measured quantitatively, can discourage FDI and/or reduce its economic efficiency. Other influential elements include trade freedom, monetary freedom, investment freedom, financial freedom, and strong property rights, which are fundamental for operating and integrating effectively within an economy.

[55] Cacaj, P, *Development of transport in Albania and opportunities for a sustainable transport,* IOP Conference Series Earth and Environmental Science, December 2022, 1123(1):012049, 10.1088/1755-1315/1123/1/012049.

# 3. EMERGENCE AND DEVELOPMENT OF FDI IN ALBANIA, SPECIFIC DATA

This section of the thesis will analyze how political stability and governance reforms impact the stability of FDI in Albania against a backdrop of developments and dynamics shaping the trajectory of FDI in the country. The analysis considers elements contributing to FDI stability within periods of economic transition, periodic sectoral strategies guiding FDI, and identification of the most promising sectors for the economy. The specific selection of energy, tourism, and technology closely relates to the developmental goals sought through attracting foreign investment via monopoly reforms. Aiming for long-term investments, the policy objectives are also intertwined with the improvement of technologies and the skills of human resources in relevant production techniques, based on the sub-question: *How do political stability and governance reforms prove to be effective in the sustainability of foreign direct investment in Albania.*

## 3.1.THE ROLE OF FDI IN ALBANIA

The political changes of the 1990s, as in many countries of South-Eastern Europe, the Western Balkans, including Albania, brought effects that would be decisive for the fate of a post-communist country so centralized in all spheres of life. Unlike other countries, Albania faced more challenges in the transformation of the system since the concept of private property did not exist, and the long communist isolation of the country made Albania unsafe in the eyes of foreign investors.

Among those factors which acapital to be critical to economic recovery and development have been foreign investments, which were believed to be an opportunity for augmenting the capital, technologies, and managerial skills for engagement in international markets. This comprised economic growth through the various sectors in the economy, including agriculture, industry, trade, business and finance, tourism, and others.

In the first phase of 1991-2000, decentralized investments did not have a stable political condition, along with the immaturity of institutional and legal infrastructure. Hence, investments were generally small-scale businesses, which mainly originated from the diaspora in the initial stage. As for the first phase of FDI, it experienced marginal gradual development, according to the varying successes in attracting foreign capital, as indicated in millions of dollars with their corresponding investment units.

TABLE 3: Years correspond to FDI in Million $.

| Years | | | FDI in millions $ | | |
|---|---|---|---|---|---|
| 1991 | 1992 | 1993 | 8 | 12 | 20 |
| 1994 | 1995 | 1996 | 53 | 70 | 90 |
| 1997 | 1998 | 1999 | 47 | 63 | 41 |
| 2000 | | | 143 | | |

The second phase, 2001-2010, exhibited higher indicators and marked significant changes with much larger growth in FDI, accompanied by an improving climate of political and economic stability. Sectors such as telecommunications, banking, and energy developed, bringing technological modernization through FDI. Furthermore, according to the OECD (2007, 2010), significant privatizations of large Albanian enterprises like OSSH, ARMO, INSIG, and Albtelekom led to a substantial increase in FDI and signaled an improved business climate and fiscal policies. Data from this decade show that the value of FDI inflows increased from €143 million in 2000 to €793 million by the end of 2010.

During this period, despite the focus on identifying key economic sectors, it was noted that the transport sector, despite its importance, was initially underutilized. Transport, storage, and communication represented only 4% of the surveyed enterprises (with FDI) for several years. However, by the end of 2007, this sector surged to first place, constituting an important 41% of the total stock of invested capital in Albania.

TABLE 4: FDI Sector UNCTAD Albania 2000-2010.

| Year | Energy | Telecommunications | Financial Services | Processing industry | Construction and real estate | Other |
|---|---|---|---|---|---|---|
| 2000 | 20 | 15 | 10 | 30 | 25 | 43 |
| 2001 | 25 | 18 | 12 | 35 | 30 | 50 |
| 2002 | 30 | 22 | 15 | 40 | 35 | 68 |
| 2003 | 35 | 26 | 18 | 45 | 40 | 86 |
| 2004 | 40 | 30 | 25 | 50 | 45 | 110 |
| 2005 | 60 | 45 | 35 | 70 | 60 | 140 |
| 2006 | 80 | 55 | 40 | 90 | 75 | 180 |
| 2007 | 90 | 60 | 50 | 100 | 85 | 225 |
| 2008 | 100 | 70 | 55 | 110 | 90 | 255 |
| 2009 | 110 | 75 | 60 | 120 | 95 | 290 |
| 2010 | 115 | 80 | 65 | 125 | 100 | 308 |

TABLE 5: Total FDI in million € in Albania 2000-2010

| Year | Total FDI (€ million) |
|---|---|
| 2000 | 143 |
| 2001 | 170 |
| 2002 | 210 |
| 2003 | 250 |
| 2004 | 300 |
| 2005 | 410 |
| 2006 | 520 |
| 2007 | 610 |
| 2008 | 680 |
| 2009 | 750 |
| 2010 | 793 |

Source: UNCTAD for Albania[56]

Within this leading sector (transport/storage/communications), the Postal Service "Posta," played a dominant role, reportedly attracting 82% of the total investments in the sector and constituting around 33% of the total stock of the enterprises analyzed within this category. During this period, specifically within the telecommunications sector (2006-2007), the reinvestment of profits generated during the period, as well as investments stemming from privatizations, were notable.

Another sector that was observed during this period was financial and monetary intermediation. Although it represented a small share of the number of enterprises with FDI during the years (around 2.4%) until 2007, the sector held the second position in terms of the stock of invested capital, constituting approximately 33% of the total stock of FDI by the end of 2007, this sector still occupies a small place compared to sectors such as energy and telecommunications.

[56] Index Mundi – Foreign Direct Investment: Albania

Also, during 2007, a noticeable increase of around 50% occurred in investment activities within commercial banks, the insurance market, and pension funds. Attributed to high rates of return, 2007 was characterized by a significant inflow of foreign capital into financial institutions.

Although these were years of global crisis, Albania recorded significant growth, mainly in 2007-2008. The distribution of FDI stock during this period 2001-2010, as well as their role in the country's economic growth, will be presented below.[57]

TABLE 6: The distribution of the FDI stock during this period 2001-2010

| Sector Description | % total |
|---|---|
| Agriculture, hunting | 0.3 |
| Fishing | 0.0 |
| Mining and Quarrying (Extractive industry) | 0.7 |
| Manufacturing | 11 |
| Production of electricity, gas, steam, and hot water | 0.4 |
| Construction | 4.9 |
| Wholesale and retail trade; repair of motor vehicles | 5.9 |
| Hotels and restaurants | 1.1 |
| Transport, stock, and communication | 40.5 |

[57] FRANCIS, S. (2010). Foreign Direct Investment Concepts: Implications for Negotiations. Economic and Political Weekly, 45(22), 31–36. http://www.jstor.org/stable/27807076

| | |
|---|---|
| Financial and monetary intermediation | 33.0 |
| Real estate, renting, informatics (Business activities) | 0.9 |
| Education | 0.1 |
| Health | 0.0 |
| Total | 100.00 |

Source: Bank of Albania 2008 Annual Rapport

This performance reflects support for the country's economic development through the promotion of foreign direct investment in Albania. The years reflected in the table above contain data that also mirror the country's transitional progress, where each year's indicators are linked not only to domestic economic policies but also to the global economic and trade reality. The effects of the 2008 global crisis and subsequent years were also clearly reflected in investment trends in Albania. However, according to indicators, positive development was still observed in Albania's economy, thanks to the policies pursued to stimulate and promote FDI.

Between 2011 and 2020, increased penetration into world markets has been demonstrated by investments in particular strategic sectors and by the mining industry. This also affected positively the local investment climate of bilateral and regional agreements with major projects, translating into very good results on FDI as well as economic growth. Furthermore, this period showed indicators of more significant economic growth, driving increased competitive potential, with FDI contributing directly to the country's GDP through capital reinvestment.

Additionally, an indicator of FDI's potential, particularly evident during the years 2015-2024, lies in the benefits derived from them, such as: enhanced competitiveness among companies (related to gross output), transfer of managerial expertise and skills, the introduction of new technologies, increased production knowledge gained from contacts with foreign investors, as well as opportunities for the optimal utilization and professional development of human resources. These factors have demonstrated a significant impact on the country's economic growth.

Policymaking now aims not only to attract foreign capital but also to increase domestic benefits and enhance human capital, facilitating more effective engagement with international management practices and markets. This is supported by increased credibility spurred by the recent Justice Reform and the fight against institutional corruption in recent years.

In the first quarter of 2023, GDP growth (from the supply side) in Albania increased by 2.7%. Services led to this growth, followed by construction, tourism, and industry/manufacturing. Increases in income, lending, employment, wages, and tax revenues also contributed to this growth. However, from the expenditure side, net exports (particularly in the second and third quarters) and investments made a larger contribution to GDP growth[58].

An evident rise in employment was observed, which depicted a steady year-on-year trend with 4.4% more employment, and significant wage increases for about 64% beginning in the first quarter of 2024 until it peaked at the highest income level in five years. Furthermore, the trend contributed towards dropping the unemployment figure in 2023 to 10.9%, thereby reducing the poverty level by 1.9 percentage points compared to 2022[59].

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[58] INSTAT (Albanian Institute of Statistics). "Gross Domestic Product, Q1 – 2023." *Instat.gov.al*, June 2023. https://www.instat.gov.al/en/themes/economy-and-finance/national-accounts-gdp/publication/2023/gross-domestic-product-q1-2023.

[59] World Bank, *Albania Economic Monitor – Spring 2024* (Washington, DC: The World Bank, 2024), https://www.worldbank.org.

In the last quarter of 2024 alone, foreign companies invested €423 million in Albania. The country continues to attract not only tourists but also foreign investors. As per the official report of the Bank of Albania, the foreign direct investment (FDI) flow in 2024 to Albania totaled €1.58 billion, an increase of €92 million over 2023.

FDI in Albania from 2022 to 2024 can be analyzed through two key concepts: FDI flows and FDI stock as follows:

FDI Flows: Annual Inflows of FDI

FDI flows represent the amount of foreign investment entering Albania within a specific period, measured annually. These flows indicate the attractiveness of the country for foreign investors in each year, such as.

• 2022: FDI inflows were approximately 1.44 billion US dollars, reflecting an increase of 18.3% from the previous year.

• 2023: FDI inflows increased to approximately 1.6 billion US dollars, with an increase of 12% from 2022.

• 2024: Preliminary data show that FDI inflows reached approximately 1.1 billion euros in the first nine months, increasing by 56 million euros compared to the same period in 2023, and

FDI Stock: Cumulative to the FDI

The FDI stock refers to the total accumulated value of foreign investment in Albania in the period 2022-2024. It includes all past investments, adjusted for non-investments and changes in financial value.

The stock of inward FDI in 2022 was approximately 11.1 billion US dollars.

The stock in 2023 increased to approximately 14 billion US dollars, reflecting the steady growth of investment.

Until December 2024, the stock of FDI had increased to approximately 15.4 billion euros, from 14.9 billion euros[60].

Most of this amount is composed of profits reinvested in the country, thus proving the long-term trustworthiness of the business environment. This increasing escalation of foreign direct investment signals that Albania is becoming increasingly attractive to international businesses, especially in the context of real estate, extractive industries, and manufacturing. These investments are vital to support economic growth, job generation, and infrastructure growth in the country. Albania's economic growth rate in 2024 was 4.1%, showcasing economic stability buffered by EU integration-oriented policies, albeit amid global uncertainties.[61]

This progression of FDI through phases and its concentration in strategic sectors have accompanied the transformation of the country's socio-economic development in the context of European integration. The stable development of the domestic financial market has now also led to the attraction of investments in this host market, where exports have also noticeably increased.[62]

Currently, Albania aims for FDI growth not just to remain a transitional trend, but to take on the role of a sustainable engine for economic development. This is

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[60] https://www.wipo.int/global_innovation_index/en/2023/

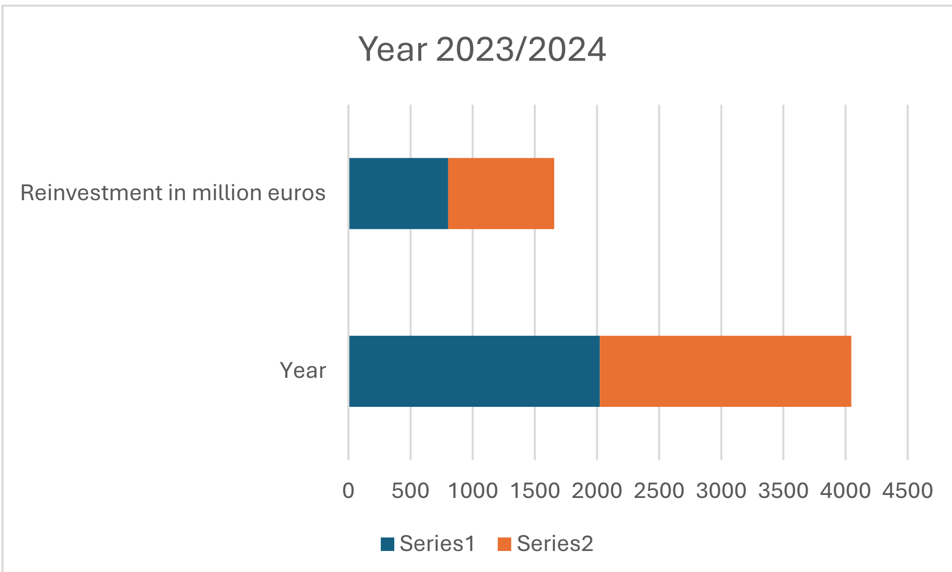
[61] https://altax.al/investimet-e-huaja-direkte-ne-shqiperi-2023-2024-rritje-pozitive-apo-iluzion-stabiliteti/

[62] Maximizing potential benefits of FDI for competitiveness and sustainable development, World Bank Group, Report on Investment Policy and Promotion diagnostics and Tools. (WORLD BANK Group, 2017)

evidenced by the increased reinvestment from existing FDI companies choosing to maintain and expand their activities in Albania.[63]

Following, referencing the Bank of Albania, a graph of reinvestment for the years 2023 and 2024 will be presented. This indicator shows €803 million in reinvestments by FDI sources for 2023 and €853 million reinvested in 2024.

FIGURE 1: Reinvestments from FDI 2023-2024




Source: Bank of Albania Annual Rapport 2024[64].

Within this framework, the Albanian government's aim is now evident: to guarantee sustainable and ongoing development in priority sectors by encouraging and increasing foreign investment in agribusiness, tourism, energy, the manufacturing industry, ICT, etc.

63 https://altax.al/investimet-e-huaja-direkte-ne-shqiperi-2023-2024-rritje-pozitive-apo-iluzion-stabiliteti/
64 https://www.bankofalbania.org/Publications/Periodic/Annual_Report/

## 3.2.THE IMPACT OF FDI ON ECONOMIC GROWTH IN ALBANIA

Currently, Albania offers a friendly climate for FDI, based on legal principles, and poses no barriers for foreign investors. From the system change in 1991 until now, regarding the policies the state has offered to attract foreign investment, the following are clearly reflected:

The possibility of 100% foreign ownership of a company,

No prior authorization is needed for foreign investors to establish a business in Albania,

Foreign investors receive the same treatment as domestic businesses and are also permitted to employ foreign nationals in their companies.

Foreign investors have the right to repatriate all funds and contributions related to their investments, etc.

These and many other elements have stimulated the attraction of foreign investment over the years and have also served as a catalyst for economic growth and socio-economic well-being. Specifically, these indicators of FDI development have also clearly defined the economic sectors where investments have concentrated and developed, thereby contributing their effect to Albania's economic growth.

The following table illustrates, according to the Bank of Albania, some of the main FDI activities and the value of their flows in millions of euros during 2024.[65]

[65] Banka e Shqipërisë. (2024)

TABLE 7: Main FDI activities and the value of their flows in millions of euros.

| ECONOMIC ACTIVITY | FLOW VALUE 2024 (mln EURO) |
|---|---|
| Real estate activities | 379 |
| Financial and insurance activities | 287 |
| Extractive industry | 214 |
| Manufacturing industry | 173 |
| Electricity and gas | 166 |

Source: Bank of Albania.[66]

Therefore, regarding the inflow of FDI in recent years, the country has shown a stable and solid performance, maintaining what is now a stable and long-term upward trend. This FDI trend, in terms of the multi-year flow, is as follows:

TABLE 8: FDI in flow for 7 years (million EUR).

| YEAR | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|
| FLOW (mln EURO) | 1,020 | 1,073 | 937 | 1,033 | 1,372 | 1,499 | 1,583 |

[66]https://www.bankofalbania.org/?crd=0,8,1,8,0,18666&uni=2025060414112817270240122102801 5&ln=2&mode=alone

Source: Bank of Albania[67]

Analyzing the fluctuating curve of FDI flows after 1991, which have been continuously influenced by policymaking and stability effects, the high level of FDI attraction during 2008-2012 is notable (distinct from resulting income streams). This level is comparable to the growth trend seen in the flows of the last 7 years. For the last operational year alone (2024), the flow indicator reached approximately €1.6 Billion, a figure marking the highest FDI flow recorded to date and representing an increase of 5.6% compared to 2023.

According to these indicators, a transformation of the economic phase is suggested for Albania. The economy, contrary to the decade of the 1990s, now shows signs of stabilization and some growth after a relatively long transition, while the policy indicators for sustainable investments are still stable. This is supported by a legal infrastructure progressively moving toward EU norms through the country's integration into the European family.

Economic growth indicators in Albania in recent years have been accompanied by the transfer of technology and knowledge. Through FDI, advanced technologies and managerial expertise have been integrated into the Albanian economy, which has improved efficiency and productivity in various economic sectors[68].

On the other hand, infrastructure improvement is also very important to this growth impact. Much FDI has now been oriented towards and focused on strategic sectors such as transport, energy, and road infrastructure, etc., which are essential for long-

[67] "Foreign Direct Investments Flow." Accessed June 4, 2025. https://www.bankofalbania.org/Statistics/External_sector_statistics/Foreign_Direct_Investments/Foreign_direct_investments_flow.html.

[68] Çakërri, L., Muharremi, O., & Madani, F. (2021). *An empirical analysis of the FDI and economic growth relations in Albania: A focus on the absorption capital variables*. Risk Governance and Control: Financial Markets & Institutions, 11(1), 20-32.

term and sustainable economic development. Such investments have significantly improved the road network, telecommunications, and the energy grid.

Job creation by FDI is now an important source, particularly in sectors such as services, construction, and industry, contributing to reducing unemployment and increasing the level of well-being in the country. Since foreign direct investment (FDI) has increased competition and raised standards in many industries, it has also brought significant development effects in the areas of tourism, agriculture, and construction, which was demonstrated by very positive indicators appearing toward the end of 2024. With this increase, foreign direct investment grew by 5.6% to €1,583 million from €1,499 million in the previous year (an increase of €84 million), now signaling an increased interest from investors in the Albanian market, auspicious for the sustainable economic development of this country.

### 3.3.CLASSIFICATION, DISTRIBUTION, AND POTENTIAL SECTORS IN ALBANIA

Economic development policies in recent years have resulted in a liberalized economic framework, improving the conditions for doing business and the attraction of FDI. The effectiveness of this objective became apparent through satisfactory indicators during 2008-2012, when the country's economic growth showed positive progress, reaching one of the highest economic growth rates in Europe, a period when many countries faced financial crisis. According to UNCTAD data on FDI inflows for 2010, Albania ranked 18th, up from the 68th position it held in 2005, in a list encompassing 141 developing economies.[69]

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[69] UNCTAD World Investment Reports. Where? Which one? Year. Website.

This phase of FDI progress marked real economic indicators, guaranteeing the country several benefits, such as:

i. Participation in international markets: Through FDI, the country gained export opportunities and entry into global supply chains.
ii. Improvement of strategic sectors offering long-term economic development, such as information technology and infrastructure, tourism, and energy.
iii. Stability and confidence regarding FDI attraction: This led to the strengthening of the country's macroeconomic stability, increasing foreign investors' confidence and enhancing opportunities for better integration into international markets.

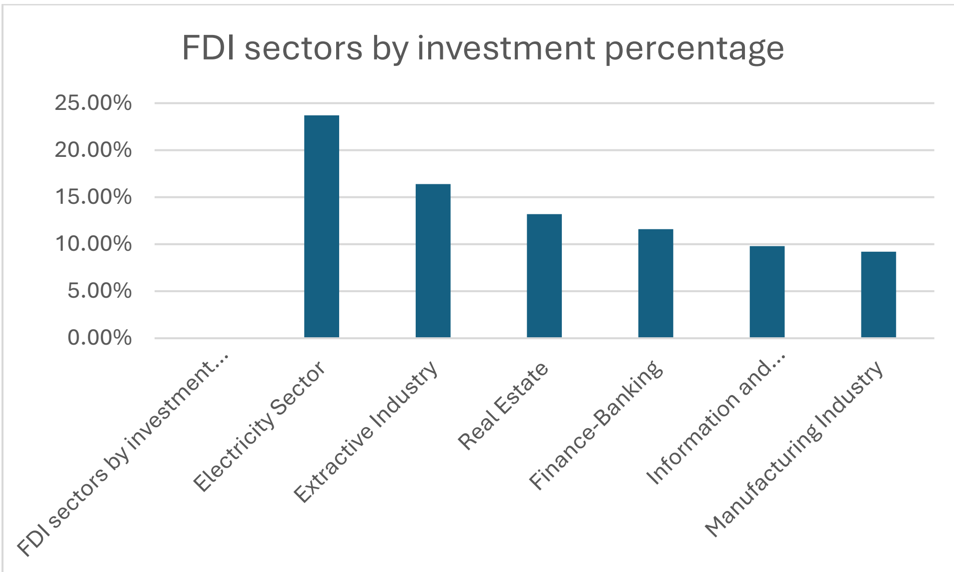
Having passed through periods of fluctuations in FDI over the years, classification and distribution have emerged based on the growing development of the different sectors where foreign investments are now concentrated. The latest indicators for 2024 rank the sectors by percentage share of investment as follows:

- The Electricity, Gas, and Water Supply sector represents 23.7% of total investments.
- The Extractive Industry accounts for 16.4% of foreign investments.
- Real Estate Activities represent 13.2% of foreign investments.
- Financial, Banking, and Insurance Activities account for 11.6% of foreign investments.
- Information and Communication represents 9.8% of foreign investments.
- The Manufacturing Industry accounts for 9.2% of foreign investments.[70]

[70] https://aida.gov.al/investimet-ne-shqiperi/ihd

Below all these sectors are represented in the chart:

FIGURE 2: Graph of the percentage of sectoral FDI investments in Albania.




Another form of classifying FDI in Albania is based on structural and economic characteristics:

Grouping new investments (greenfield) which create new service and production capacities, impacting not only employment but also economic growth,

Investments by capital form, including acquisitions, mergers, equity capital, reinvestment of profits, and joint ventures involving domestic capital,

Geographical and sectoral distribution of investments, distinguished by the level of concentration in specific zones (regional), urban areas, or particularly in key sectors such as: energy, hydrocarbons, financial services and banks, tourism and hospitality, telecommunications and technology, and agro-processing, etc.

Attracting factors also play a role in promoting FDI in Albania, influenced by:

Bilateral, regional, multilateral trade agreements (including with the EU and other countries),

Improvement of the business climate through legal and fiscal reforms, the young age of the workforce, education/qualifications,

Competitive costs compared to other countries and EU member states.

Based on performance indicators, FDI in Albania can also be classified by form, where the most common types are equity capital, capital from reinvested earnings, and other forms of capital, such as intra-company loans (primarily covering debts from the parent FDI company).

Referring to the periods of investment attraction, FDI can be classified:
In the years 1991-2005, they were primarily investments oriented towards ownership and capital growth; In the years 2006-2015, they were investments oriented towards equity capital in medium and large enterprises; In subsequent years up to the present, they are investments oriented towards reinvested earnings, aiming for capital growth and market expansion.

This reflects the result of the economy's growing development path and the sectoral concentration of FDI. Excluded from these specific FDI classifications are forms of corporate capital (like bonds) and projects financed by loans, grants, government funding, or international financial institutions. The following table presents an overview of FDI attraction in Albania by form for the years 2006-2011, in million euros.

TABLE 9: FDI attraction in Albania by form for the years 2006-2011, in million euros.

| Components | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| FDI–Total | 259 | 481 | 665 | 717 | 793 | 742 |
| Equity Capital | 199 | 487 | 420 | 516 | 600 | 755 |
| Reinvested Earnings | 0 | 0 | 182 | 229 | 186 | 64 |
| Other Capital | 60 | -6 | 63 | -27 | 7 | -77 |

Source: Available data from Bank of Albania

Another classification is based on the mode of entry and economic activity, distinguishing between investments in new businesses (greenfield) and cross-border mergers and acquisitions (M&A). The data regarding new FDI projects used in this study are based on information compiled by UNCTAD, FDI Markets and Financial Times.

FDI Markets, as greenfield project monitoring measure, is concerned with newly established projects in a host country, as well as the expansion of those already established within it. No minimum investment requirement needs to be fulfilled by a project for inclusion within the definition; however, it should create new jobs and require new capital investments. The year with the most new projects ever recorded in history happened to be 2008, the same year those in energy and hydrocarbons had massive concessionary investments. By contrast, the period correlating with the lowest number of new projects was between 2009 and 2011, in correspondence with the global financial crisis.

The following table presents the number of new Foreign Direct Investment projects by business activity, 2003–2011.[71]

TABLE 10: Foreign Direct Investment projects by business activity, 2003–2011

| Activities | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Mining | 2 | | | | | 1 | | | | 3 |
| Manifacturing | 3 | 4 | 3 | 1 | 3 | 5 | | 1 | 2 | 22 |
| Electricity | 1 | | | 1 | 3 | 2 | | | | 7 |
| Construction | | | 1 | 1 | 1 | | | 1 | | 4 |
| Sales, Marketing & Retail | 1 | 1 | 3 | 5 | | 7 | 4 | 2 | 3 | 26 |
| Transport & Services | 2 | 2 | 6 | 3 | 1 | 1 | 3 | 2 | 2 | 23 |
| Total | 9 | 7 | 13 | 11 | 8 | 16 | 7 | 6 | 7 | 84 |

Source: UNCTAD, based in FDI markets, Financial Times Ltd (www.FDImarkets.com).

The numerical distribution over the years reflected in the table above shows that the period 2000-2010 had satisfactory economic indicators achieved by foreign direct investment, in a post-communist country, and after emerging from the social, political and economic turmoil of the 1990s.

[71] UNCTAD, and www.FDImarkets.com

## 3.4.TECHNOLOGY TRANSFER THROUGH FDI IN ALBANIA

FDI in Albania has played a primary role in technology transfer, directly impacting economic development within the context of globalization. This potential for technological benefits has been evident since the beginning of the 1990s, when the complex reality required technological renewal in existing sectors privatized from the former system.

Empirical analysis shows that the nature of technology transferred by FDI in different periods has included: medium-level technologies or those adapted for countries with low-cost labor, equipment and processes, and, in limited cases, advanced technologies.

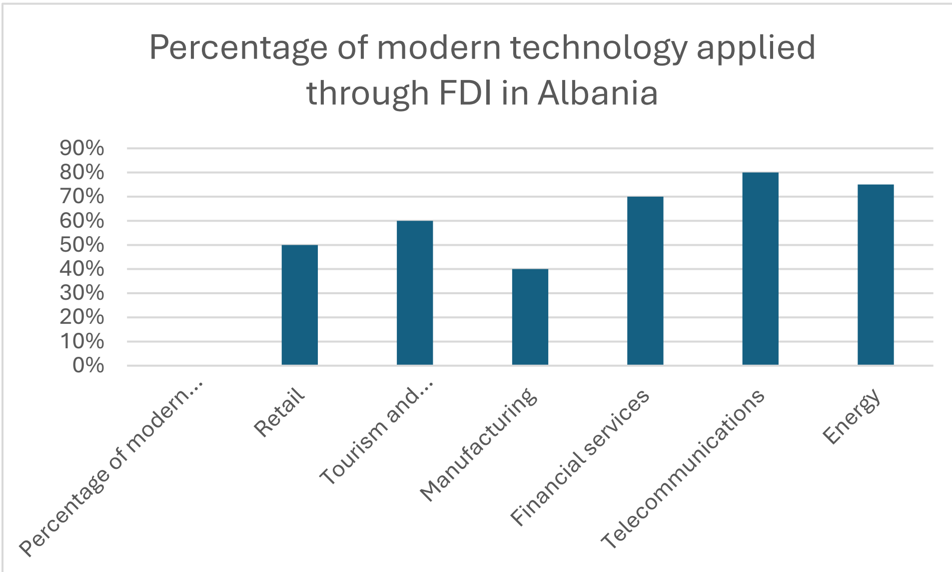
The most impacted sectors have been energy and telecommunications, particularly highlighted by hydropower plants (HECs) and photovoltaic parks, where modern equipment meeting contemporary standards has been installed. The banking sector and financial services have implemented new digital systems aligned with the international banking and financial network.

On the other hand, manufacturing industries have mainly seen the transfer of medium or basic technologies, influenced by free market conditions and the qualification level of the workforce.

Regarding the methods through which transfer has occurred, key forms include: international training of the workforce, partnerships with FDI parent companies (leading to exposure to unified technological standards), the import of production lines and equipment, and indirect transfers involving management methods, accounting practices, IT systems, etc.

Following, the sectors and the level of technological transfer within them, achieved through FDI, will be presented graphically.

FIGURE 3: Sectoral distribution of the impact of FDI on the transfer of modern technologies in Albania.




Also, part of the analysis are negative factors such as: the lack of research and innovation infrastructure in many sectors; weak linkages between FDI, universities, and scientific research centers; limited technical and professional capacities to absorb new technologies; and the lack of stimulating policies for technological cooperation.

Some of the companies with the largest investments have been: foreign telecom operators like Vodafone and Telekom Albania, which have invested in modern and contemporary systems; Bankers Petroleum and Statkraft are companies utilizing modern technology and equipment. Additionally, companies investing in the contract manufacturing industry have brought technology and production lines enabling increased apparel production, etc. Though it is true that Albania has benefited from technology transfer through FDI, this benefit has not been acquired across all the sectors. This implies the necessity of formulating clear policies vis-a-vis improving the absorptive capacity of the economy, enhancing innovation, and constructing actual partnerships between industry and research and science and innovation, both at home and abroad.

Case Study: A specific case study concerning technology transfer involves the Norwegian state-owned energy company, Statkraft. As one of the largest foreign investors, it operates through its local subsidiary, Devolli Hydropower, in the construction and operation of the Devoll, Banjë, and Moglicë hydropower plants. The primary elements of technology transfer resulting from Statkraft's activities are linked to the specific fields or sectors where its operations are realized, such as:

- Engineering and Construction: Construction of dams and tunnels is executed to European standards, thereby enhancing local technical capacities with respect to engineering fields
- Environmental Protection: The company employs advanced biodiversity-environmental protocols for protection and rehabilitation of work sites, therefore raising the bar of environmental standards for the energy industry.
- Energy Management: Statkraft is in automated control and monitoring systems and turbine technologies that incorporate European technologies, thereby upgrading and improving operational efficiency.
- Human Capacities: Training of local staff is conducted by an international expert with a view to knowledge transfer and the professional development of local employees.
- Local Development: Contributions to these include local infrastructure projects and support to the local communities, promoting social inclusion and maximizing community benefits.
- Sectoral Impact: The involved fields and sectors experience technological growth and benefit from transferred practices, bringing advantages to Albania.

The investment made by the public company Statkraft in Albania is a success case for the transfer and advancement of foreign direct investment technologies for sustainable development in rural areas. It demonstrates using foreign direct investment (FDI) as an effective instrument for transfer of change in host countries.

Referring to the illustrative case of Statkraft for post-communist Albania and the impact of FDI, the following infographic presents:

- The start of the transition in 1990 and the shift to a market economy following the fall of communism.
- Theoretically, expected outcomes from FDI in host countries included effects on: human capital development, increased technological level, increased exports, increased employment, etc. These are the resulting investments in this behalf: privatizations, greenfield investments, and joint ventures.
- In the case of focusing on the FDI tendencies that occurred in Albania from 1992 up until 2024, this gave a linear progression (or relationship) between the years and the FDI flows) and signified priority sectors such as energy, tourism, telecommunications, and the financial market (including banks and insurance).
- Bonuses given to the host country for the FDI in return are: an increase in employment with new job opportunities creation, an increase in exports, and transfer of technology.
- Obstacles and challenges to FDI have most frequently been: lack of infrastructure, corruption, an inadequate legal framework, and insufficient legal certainty/rule of law.[72]

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[72] http://unctad. Org/en/PublicationsLibrary/webdiaeia2015d3_en. pdf

The infographic aptly illustrates that Albania must build an architecture for forward movement in policy formulation and structural reforms to become more investor-attractive, thereby enhancing transparency and legal protection to attract FDI, ultimately creating an increasingly conducive climate for such investments and for a sustainable domestic economy.

# 4. IMPACT AND EMPIRICAL ANALYSIS OF FDI ON ECONOMIC DEVELOPMENT IN ALBANIA

In this chapter of the thesis, the impact of FDI on the real development of the economy will be analyzed, examining how significant their contribution is compared to other determinants of GDP growth, as well as which economic sectors have benefited most from FDI. Furthermore, through quantitative and qualitative analysis, it will be determined how effective economic reforms have been in creating a favorable climate for foreign investment. The clear definition of economic policies is a concrete indicator of FDI progress and, simultaneously, a determinant for the perspective of direct investment in Albania. Utilizing reliable sources, this thesis will examine econometric models to provide a factual basis of data regarding the indicators of concrete impact on Albania's economic development.

## 4.1.VALUES AND CONCRETE IMPACTS OF FDI

The specific objective of the empirical analysis covering the post-communist period (1991-2025) is multifaceted: firstly, to measure the impact on key macroeconomic indicators such as GDP growth, trade balance, productivity, and employment; secondly, to identify the sectors most attractive to foreign investors; thirdly, to discern the primary reasons why foreign investors choose Albania; and finally, to evaluate the effectiveness of government policies in attracting FDI. An overview of these concrete values and impacts will be presented, categorized according to economic, social, and technological perspectives.

An overview of the concrete values and impacts of Foreign Direct Investment (FDI) can be analyzed through economic, social, and technological perspectives.

Economic FDI's impact: is evident in several areas where firstly, it contributes to the growth of Gross Domestic Product (GDP) through capital injection and increased production; secondly, it increases fiscal revenues, as taxes and contributions from foreign investments provide significant additional income sources for the host country; thirdly, it boosts exports, with foreign firms often using the host country, like Albania, as an export base, thereby enhancing domestic competitiveness; and fourthly, it creates additional jobs, with the foreign private sector frequently offering more efficient and often better-compensated employment compared to the public sector in Albania.

In terms of technical and technological impact, the most important advantages of FDI are technology and the production line. Most of the time, foreign investments bring in much more up-to-date equipment and technology than the country has even dreamed about and work much more efficiently by up-to-date management approaches and work patterns. Furthermore, through training and developing skills, they enhance the technical and qualification capacity of the workforce, which lays a permanent asset after an investor's exit.

On social and institutional grounds, benefits accrued directly or indirectly are increasing labor standards. Foreign companies often implement stricter safety protocols, and they tend to afford their employees wider legal rights than might be the case with some domestics. FDI further promotes domestic competitiveness as it motivates local companies to hike their service quality and efficiency while implying a positive impact on regional development by revitalizing underdeveloped areas within an enabling environment where local infrastructure will improve.

All things considered, however, these advantages come with several challenges that need to be addressed along with careful handling of issues especially in host countries like Albania, where the impacts of FDI are enormous. Some of these include the risks of dependence on foreign capital for sustainable development by tightening the domestic sector at the same time, limited benefits of lack of well-coordinated policies, for example, when investors do not reinvest profits back into the host economy.73

A SWOT analysis will follow to look into these aspects in greater detail.

FIGURE 4: A SWOT analysis FDI for Albania:

| STRENGTHS | WEAKNESSES |
|---|---|
| Growing market potential<br>Competitive level of labor costs<br>Macroeconomic stability | Corruption and weak legal framework<br>Inadequate infrastructure<br>Inefficient administration |
| OPPORTUNITIES | THREATS |
| Progress towards EU Integration<br>Pro-business policies and reforms<br>Infrastructure development | Vulnerability to political uncertainties<br>Economic and financial crises<br>Competition from neighboring countries |

[73] Konig, G. (2009) “The impact of investment and concentration among food suppliers and retailers in various OECD countries”, paper presented at the VIIth global forum on international investment, OECD, 7-8 dhjetor.

## 4.2.FDI IN THE REGION AND THE IMPACT ON ALBANIA

FDI refers to investments made by non-resident economic entities into the economy of a host country with the aim of having a long-term interest and influential role in the direction and management of the enterprise where the investment occurs. With lots of economic growth, employment generation, increased competition within the market, and technology transfer, they are vital to many countries in bringing foreign direct investment (FDI). Therefore, factors impacting the attraction of FDI into the region are basically political stability, regulatory and fiscal policies, corruption level, and rule of law.

Following this, this thesis shall follow an analytical structure comparing the situation in the region and highlighting both direct and indirect impacts on Albania, given the country's standing in the Western Balkans region after 1990.74

To illustrate the regional context of FDI in the Western Balkans, the major countries are analyzed below for comparative purposes:

- Serbia: Currently the most attractive destination in the region for FDI, having implemented free economic zones, fiscal incentives, and strong relationships with global investors.
- North Macedonia: Has implemented aggressive pro-investment policies, prioritized the business climate and offered tax reductions.
- Montenegro: Primarily attracts foreign investment in tourism, energy, and real estate.
- Bosnia and Herzegovina: Mainly attracts investment in energy, tourism, and agriculture.

[74] Cela, R., Marku, S. dhe Imami, D. (2010). “Rishikim i sektorit bujqësor dhe politikave bujqësore në Shqipëri” (Kapitulli 2) në vendet e Ballkanit Perendimor, Insitituti Leibniz për Zhvillimin Bujqësor në Evropën Qendrore dhe Lindore (IAMO), vëllimi 57, pp. 37-62.

- Kosovo: As a state with less than complete political stability and unstable relations with Serbia, it attracts fewer investments, primarily in sectors like energy, trade, and infrastructure.

Referring to a 2023 comparison made by the World Bank for some Western Balkan countries, the results are as follows:

TABLE 11: World Bank for some Western Balkan countries for 2023

| Country | FDI/GDP in % | Main Sectors | Transparency Level |
|---|---|---|---|
| Albania | ~ 5.4 % | Tourism, Energy, Agriculture | Medium-Low |
| Serbia | ~ 7 % | Manufacturing, Technology | Medium-High |
| North Macedonia | ~ 6.2 % | Services, Energy | Medium |
| Montenegro | ~ 6.5 % | Tourism, Infrastructure | Medium |

Source: World Bank

Situated within this regional FDI climate, Albania experiences both positive and negative impacts:

Positive Impact: There are lots of opportunities for Albania due to the competition within the region for Foreign Direct Investment. The first benefit consists of garnering commitment from the state so that it would develop more favorable policies to attract investors. The second point is that by observing the foreign-direct-investment performance of its neighbors, Albania can learn and adapt similar successful practices for attracting them. Finally, the activities implemented within big regional projects such as transport and energy corridors would, by their nature, engender foreign investment to be attracted to the whole area within participation, including Albania.

Negative Impact: However, this regional dynamic can also be reverse-negative for Albania. The country may have investment opportunities slipping away because of internal policy inconsistencies that would deter investors who are looking for stable and predictable markets. Besides, aggressive competition among Albania and its neighbors has been increasing, some of which are also recruiting heavily around the same pool of long-term investors, thus diverting investments that could have found their way to Albania.

Given these conditions within the regional context, Albania should develop: more competitive tax and incentive policies, particularly in agriculture, manufacturing, and technology; strengthen legal and administrative transparency to improve the business climate; and engage more strongly in regional economic initiatives such as CEFTA and the transport corridors (road, rail) and energy transmission projects.

As per the official data provided by AIDA for fiscal 2023-2024 in Albania, the new record set in 2023 traced for FDI in terms of value and contribution to economic growth. The country received nearly €1.5 billion in FDI, which is nearly 9% more than in 2022. Currently, FDI for the first 9 months of 2024 sits at €1.1 billion, a jump of €56 million from the corresponding period in 2023.[75]

[75]http://meki.gov.al/en/newsroom/rekord-ne-investime-te-huaja-direkte-ne-shqiperi-per-2024/

**4.3.GRAPHICAL, ECONOMETRIC ANALYSIS AND STUDY METHODOLOGY**

In this section, a detailed analysis based on graphical and econometric data for FDI in Albania will be presented, with the analysis focusing on the period from 2010 to 2024. By examining the flow of Foreign Investment divided into groups of years, and focusing on the description of the main sectors in which FDI has shown a positive impact during 2010-2024, these include: agriculture and fishing, manufacturing and extractive industry, electricity, hydrocarbons and gas, water supply, waste treatment and management, construction and real estate activities, wholesale and retail trade, transport, infrastructure and storage, accommodation and food services (hospitality), information and communication, etc. The performance of these growing sectors has been coordinated with the government's commitment towards EU integration and has had a noticeable impact on the business climate.

The following table presents a grouping of years and the actual flow of FDI in Albania.

TABLE 12: flow of FDI in Albania.

| Years | FDI (€ billion) |
|---|---|
| 2010 | 0.79 |
| 2015 | 0.89 |
| 2020 | 1.04 |
| 2023 | 1.49 |
| 2024 | 1.58 |

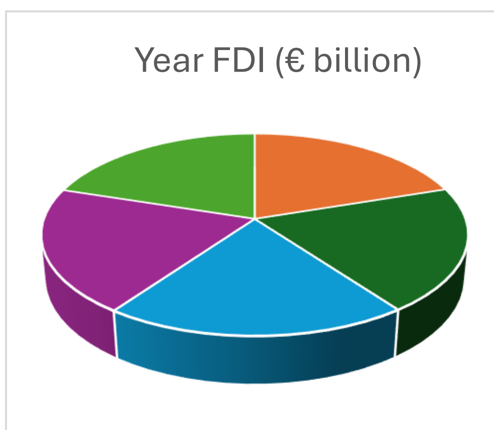



FIGURE 5: Year FDI (€ billion)

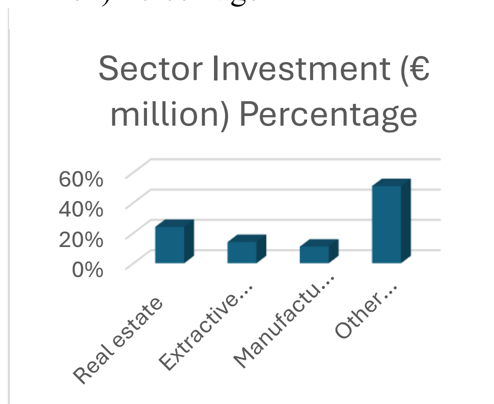
Source: Bank of Albania

Another tabular and graphical representation presents the highest-performing sectors for 2024, a year which also marked the most positive indicators for foreign investment in the last decade.

TABLE 13: Sectors for 2024

| Sector | Investments (€ million) | Percent |
|---|---|---|
| Real estate | 379 | 24% |
| Extractive industry | 214 | 14% |
| Production | 173 | 11% |
| Other | 814 | 51% |

FIGURE 6: Sector Investment (€ million) Percentage




Source: World Bank

The econometric analysis of FDI in post-communist Albania within this thesis refers to the Simple Linear Regression model to evaluate the impact of GDP and political stability on the flow of FDI:

FDI_x = β0 + β1 × GDP_x + β2 × Political Stability_x + ε_x

Ku: FDI_x, represents Foreign Direct Investments in year (x), GDP_x, represents the Gross Domestic Product in year (x), Political Stability_x, is the index of political stability in year (x) and ε_x, is the error term. The expected results from this analysis are: $\beta1 > 0$, GDP growth is expected to have a positive impact on FDI, and when: $\beta2 > 0$, Improvement in political stability is expected to increase FDI.76

Analysis using the Panel Regression Model for Western Balkan countries, aimed at specifying the factors influencing FDI in Albania and its neighbors, examines the following variables:

$FDI\_it = \alpha + \beta1 \times GDP\_it + \beta2 \times Inflation\_it + \beta3 \times Market\ Openness\_it + \mu\_i + \varepsilon\_it$

FDI_it represents Foreign Direct Investments for country (i) in year (t)

GDP_it represents Gross Domestic Product for country (i) in year (t)

Inflation_it represents the inflation rate for country (i) in year (t)

Market Openness _it represents the percentage of foreign trade relative to GDP for country (i) in year (t)

μ_i signifies the country-specific fixed effects(i)

ε_it signifies the error term.

In situations when: $\beta1 > 0$, $\beta2 < 0$ and $\beta3 > 0$ the following results are expected:

$\beta1 > 0$, suggests that GDP growth increases FDI within the same period,

$\beta2 < 0$, implies that high inflation may negatively impact FDI during the calculation period,

$\beta3 > 0$, indicates that greater international market openness boosts FDI.

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[76] Edward C. Prescott, "Robert M. Solow's Neoclassical Growth Model: An Influential Contribution to Economics," *The Scandinavian Journal of Economics* 90, no. 1 (March 1988): 7, https://doi.org/10.2307/3440145.

To econometrically identify and best examine the relationship between FDI and GDP growth, an equation model, typically utilizing multiple regression, must be constructed to confirm or deny this link, treating economic growth (measured as the percentage increase in GDP) as the dependent variable.

Meanwhile, since FDI inflows are treated as an independent variable, the analysis becomes incomplete because GDP is influenced by other determining factors/determinants; therefore, it is necessary to include some of these in the analysis. Selecting capital formation, which represents the total investment in the economy over a given period, encompassing both domestic investments and FDI, or alternatively, the increase in the physical capital stock irrespective of the capital's origin; yields a more realistic result.

Another important variable selected for analysis is net exports, that is, the difference in total exports and total imports over a specified time interval within an economy of a country. This variable measures the effects of the external sector on a given economy, especially in developing countries such as Albania, which tend to import more than they meet export with their nominated goods and services.

Formula of net exports:

$NX = X - M$ where, NX = Net Exports; X = total export of goods and services; M = is the total import of goods and services.

Using this variable, NX is one of the most important indicators reflecting an economy's relationship with international trade. The inclusion of this variable serves to measure the external sector of the economy. It shows that in developing countries like Albania, when imports exceed exports, a negative value of NX signals a trade deficit, influencing the perception of economic stability related to FDI attraction.

A distinct finding of a simple econometric analysis outlining the impact of FDI on the economic growth of Albania during the period 2000-2025 is that an increase of 1% in FDI equals a direct annual GDP growth of 0.36%. This is an important indicator that indicates a positive and significant impact of FDI on the economy of Albania. Following the methodology of accurately assessing the impact of FDI in Albania would require an examination of three main components of Direct Investment.

Methodologically, to accurately assess the impact of FDI in Albania, the 3 (three) main components of Direct Investment must be analyzed:

Firstly: Equity Capital, which refers to the investment by a direct investor either for the creation of a new company in Albania (outside the investor's home economy) or the acquisition of equity/shares (ownership titles) in an existing company;

Secondly: Reinvested Earnings, which refers to the direct investor's share of profits generated by the direct investment enterprise that are not distributed as dividends but are instead reinvested back into the enterprise, proportionate to the foreign investor's equity share;

Thirdly: Debt Instruments, this component refers to debt instruments between related enterprises (e.g., parent company and affiliate) that are in a direct investment relationship. This can include loans, currency and deposits, bonds, and/or other inter-company accounts (like trade credits).

So, Direct Investments = Equity Capital + Reinvested Earning + Debt Instruments

Another perspective that clarifies FDI flows, referencing methodologies used by the Bank of Albania, breaks down Direct Investment according to the relationship and transactions between the Investor and the Enterprise receiving the investment:

Usual (or Standard) Direct Investment: These are Direct Investments flowing from the Direct Investor to the Direct Investment Enterprise. This category applies when an entity or a group of related entities can exercise control or significant influence over the direct investment enterprise (typically defined as holding 10% or more of the voting power).

Reverse Investment: These are Direct Investments flowing from the Direct Investment Enterprise to the Direct Investor. This category covers financial flows from the affiliate back to the parent company, such as when the affiliate acquires a (usually small, less than 10%) equity stake in the parent or extends a loan to the parent.

Direct Investments Between Related Enterprises Abroad: These are Direct Investments where the reporting enterprise holds less than 10% of the capital in the other enterprise, but both the reporting enterprise and the other enterprise belong to the same group (i.e., are 'fellow enterprises'). In this category, both enterprises are under the control or influence of the same direct or indirect ultimate investor, but these enterprises do not control or influence each other directly.

Furthermore, in calculating FDI flows, their recording follows the principle of the time when a financial asset or liability is created, acquired, or disposed of, implying recording at market value. Conversely, the calculation of the stock position of direct investments at the end of the reference period is valued according to book value as recorded in the accounting books.

The primary distribution of FDI according to international standards is by country, based on the country of origin of the Direct Investor and/or the economic territory and the concept of residence. The concept of residence is a fundamental factor for direct investment statistics, which measure cross-border investments between residents of two or more economic territories. Foreign direct investment includes transactions/positions between a resident and a non-resident institutional unit but excludes all transactions/positions between units that are residents of the same economy.

Another type of distribution is by economic activity, referring to the international classification NACE Rev. 2. FDI statistics also strictly adhere to the principle of confidentiality.[77]

### 4.3.1. QUANTITATIVE DATA AND INSTITUTIONAL ANALYSIS

The methodology followed in this empirical analysis is related to several elements such as:

The time periods covering 1991-2025, divided into three main periods:

1991-2000, the transition period and the beginning of FDI attraction, mainly in trade. This period had results from non-productive sectors such as construction and services, which gave modest indicators in economic development (GDP) and employment, since the main obstacle was the country's political instability.

2001-2010, the period of institutional consolidation and approximation with the EU (SAA), mainly privatizations of public sectors. This period was characterized by a progressive increase in FDI flows, especially in the energy and telecommunications sectors, as well as the beginning of a positive impact on exports and a decrease in urban unemployment.

2011-2025, the period of more intensive development and the definition of strategic sectors. This period, analyzed as the longest but also the most

[77] Ligji nr.9180.dt.05.02.2014 “Për statistikat zyrtare” I ndryshuar, neni 15.

consolidated, is characterized by FDI results that contribute strongly to strategic sectors such as: renewable energy, tourism, more modern agriculture with increased export indicators according to EU standards and construction with real estate. Also, the expected result of this period is: It is expected that the impact on GDP will be more stable, closely linked to stable and competitive fiscal policies with the region as well as more distinct institutional stability.

Types of data that are quantitative data extracted from the Bank of Albania, INSTAT, AIDA, UNCTAD, Open Data Albania, etc. Through these quantitative indicators, the presence of FDI at any time in the Albanian economy and the amount of income generated by them in the economy can be seen.

Analytical instruments related to descriptive statistical analyses such as: mean, standard deviation and annual growth which we have treated more extensively in the material, correlation analysis and simple linear regression to measure the impact of FDI on Albania's economic growth over the years, as well as data matrices with variables such as: FDI and the percentage they occupy in GDP, Exports, Public Investments (this includes energy and infrastructure), inflation, employment, etc.

Another indicator of the analysis of FDI in Albania is the presence of foreign companies in Albania, which according to the National Business Center at the beginning of 2023 reports that in the territory of the Republic of Albania, 22,436 companies with 100% foreign/joint capital are registered, of which about 66% or 14,801 companies are active and the remaining 7,635 companies or 34% are in inactive status: passive, deregistered, bankrupt, suspended, companies in liquidation, or companies in bankruptcy proceedings.

TABLE 14: The total number of companies FDI in Albania, 2025.

| Total number of companies FDI | Active | Passive |
|---|---|---|
| 22 436 | 14 801 | 7 635 |

Source: National Business Center, Albania. https://qkb.gov.al/

From the quantitative aspect and the indicators found regarding FDI in Albania, there is a positive correlation between FDI and economic growth, this is noticeable with the entry of 2025, there is also a significant decrease in unemployment which has been more noticeable in cities with a high presence of FDI, as well as an increase in exports where investments in fason production, online commerce and electricity are evident.

Finally, regarding the conception of real quantitative indicators analyzed in this thesis, challenges remain in terms of: informality, lack of sustainable infrastructure attractive to FDI, and corruption. However, FDI in Albania has played an important role in the country's economic development, but their effects are influenced by the institutional environment and economic policies. Referring to FDI, it is expected that in the period until 2030, their economic potential will be higher, being influenced and influenced by the country's integration into the EU.

### 4.3.2. QUALITATIVE DATA AND TECHNIQUES OF ANALYSIS

In order to make a more concrete and realistic analysis of FDI in Albania, it is important to include qualitative data and to use analysis techniques that are as accurate as possible. This type of analysis should be based mainly on state policies for attracting FDI, which include: an adequate legal framework, fiscal reforms and packages, bilateral, regional and multilateral agreements. A reliable source of analysis also remains the model of concrete interviews with representatives of direct investments and also from the state side with representatives from: economic experts, managers of domestic and foreign firms, AIDA.

The data that help in a real study on the impact of FDI in the host country are mainly found in institutional reports such as: reports from the Bank of Albania, the World Bank, EBRD, IMF, Eurostat, UNCTAD, etc. These data become even more reliable when based on scientific research, articles, theses and public policy documents, where scientific indicators related to the real parameters of FDI in the host country (Albania) are identified.

Based on the data obtained from the concrete experience of foreign investors in Albania with a long transition and political fluctuations with unstable indicators, the concrete experience of foreign investors can be identified for analysis, which accurately determine the benefits, but also the barriers, their perceptions about the business climate in Albania.

Also, geopolitical and regional developments highlight the progress with the help of Albania's FDI in the network of international markets, as well as the impacts stemming from regional projects, where their data are reflected with the effects of agreements such as CEFTA and financing reports for developing economies.

Referring to the techniques of analysis of qualitative data for FDI in Albania, several types of analysis are used, such as[78]:

[78] E. Borensztein, J. De Gregorio, and J-W. Lee, "How Does Foreign Direct Investment Affect Economic Growth," *Journal of International Economics* 45, no. 1 (June 1998): 115–35, https://doi.org/10.1016/S0022-1996(97)00033-0.

- Thematic analysis, which identifies the most recurring themes that have direct or indirect effects on FDI performance, including infrastructure, corruption, legal certainty, etc.

- Analysis of public policies, which affect the attraction of FDI based on the real measures taken by the government and their effectiveness.

- Discursive analysis, which analyzes how FDI is described and justified in political and institutional narratives in Albania,

- Comparative analysis, which compares the performance of FDI in Albania with neighboring countries, or the region, on similar political and economic grounds.

- Driangular analysis, which simultaneously analyzes three types of data for the same indicator or phenomenon, such as statistical data, legal documents and interviews.

Qualitative analysis of FDI is an indicator of assessment of their impact and structure. In terms of Structure and Quality, Albania has attracted significant investments in highly strategic sectors, where the economic impact has considerable indicators, such as: the energy sector, services and construction. Also, the majority of foreign investments are focused on creating added value, long-term employment and professional training qualifications of staff.

The transfer of knowledge and technologies is currently another qualitative indicator where FDI in Albania has brought improvements in sectors such as telecommunications, digital and financial services. These types of investments usually create “economic islands” where they lack cooperation with local businesses and local universities to link those investments with local scientific research.

Another qualitative indicator of FDI is legal and institutional security, which has a negative impact in terms of attracting quality businesses to Albania, but this does not diminish the positive result that they have brought to the country's economy. Referring to regional development and geographical equality, the flow of FDI is analyzed in a qualitative aspect, since their impact is related to the location of investments and the development of direct benefits of the areas.

The aspect of social impact and public perception of investments is one of the indicators that analyzes the impact of FDI. This indicator represents the social impact and community interest of investments, as it increases employment and development opportunities, but criticism is often reflected towards these investments, which means that the social impact in terms of natural or cultural heritage, disturbs the government-community relationship, in some cases.

In conclusion, the qualitative analysis of FDI in the country shows the importance of the quality of direct investments not only in terms of quantity but also in terms of quality. To benefit from FDI in a qualitative way, Albania needs to strengthen the legal environment, business climate, fiscal policies and orient investments towards strategic sectors through the transfer of technologies and knowledge, with the aim of sustainable economic development and growth of the country.

## 4.4.FDI POLICIES IN ALBANIA

The entire performance of FDI in Albania for the period 1991-2025 is based on the policies undertaken by policymakers, which have guided the country in this long economic and social transition that the country has gone through. The governing political system (position) has usually attempted to focus on the orientation of policies for attracting FDI, but the indicators have not always had positive results, which has also highlighted the quality of governance at the time.

The turnover of foreign subsidiaries represents 27% of the total, while in the manufacturing industry this figure is 50%. The main industries with the highest involvement of foreign companies are the same as those of added value. The turnover of foreign subsidiaries is provided by four main economic activities: industry (30%), transport and telecommunications (26%), construction (22%) and trade (20%), data from for an overall average of FDI over the years[79].

One of the most concrete policies that has been implemented in Albania has been the Favorable Fiscal Policy, which is characterized by elements such as: tax exemptions for strategic investments that have operated for a certain period (6 months to 18 months); reduced VAT, which has focused on a certain category of sectors such as agriculture and tourism; Low profit tax, which for specific sectors such as IT and agrotourism has been applied from 15% to 5% profit tax.

The Regulatory Legal Framework has also been part of the policies for promoting foreign investments and specifically the 2015 law, amended, which aimed to encourage government FDI by creating the "Strategic Investor" status, which exempts investments from bureaucratic processes and administrative permits, as well as from relations with local authorities[80]. Also, in order to encourage foreign investment, expropriation procedures, use of public assets have been facilitated and the use of state land for long periods at competitive prices has been facilitated,

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[79] Bank of Albania (2023). Foreign Investment Statistics in Albania: Turnover of Foreign Sub-Enterprises. Tirana: Bank of Albania. https://www.bankofalbania.org/Statistics/External_sector_statistics/Foreign_Direct_Investments/

[80] WTO (2010), Albania – Trade Policy Review 2010: Reaping the benefits of reform and liberalization. Geneva, WTO.

Other policies through programs such as: "creation of free zones", or "industrial zones", policies that exempt strategic investments for 10 years from taxes, investors are offered areas with infrastructure ready for their investment, and the state applies reduced tariffs for: rent, water, electricity, e.g. the Hospital Zone in Durrës or the Koplik Zone in Malesia e Madhe. Another policy for attracting strategic investments has been the one, "Albania 1 euro" where strategic investors have focused their investment with increasing indicators of their commercial activities, as well as state rent for 99 years.

Part of the implemented policies are also the International Agreements for the Protection of Investments, where Albania has signed the very important Agreement with the EU which aims at Market Access and Equal Protection for Investors. Also, over 40 bilateral agreements for the protection of investments have been signed with countries such as: Turkey, Italy, Greece, France, Austria, Germany, USA, etc.

Another very important indicator for the policies followed or undertaken has been the creation of the Albanian Investment Development Agency (AIDA) which has given a very positive and concrete contribution to: Providing Legal and Economic information to the interests of Investors, has acted as a connecting bridge in the Mediation with Albanian institutions and has facilitated the procedures and steps for registrations and licensing of foreign investors.

Reforming the business climate has also served as one of the policies implemented to encourage FDI and economic growth, through: the Investment Council which has created a business consultation and communication platform, the improvement of the position in the “Doing Business” monitoring ranking which operated until 2020 when it was discontinued by the World Bank, as well as the Digitalization of Public Services for citizens and businesses carried out through the e-Albania platform.

Not less important, as part of the incentive policies, have been Regional Policies and European Integration, the impact of which is a very important indicator for: attracting investors from Albania's potential as a door to the EU market, the path towards EU membership affects as a factor and guarantee of stability and security for investments, as well as the country's commitment to the Berlin Process, CEFTA - the agreement for a regional common market, have had their impact on attracting and increasing foreign direct investments.

## 5. CONCLUSIONS AND RECOMMENDATIONS

The final concluding chapter of the thesis reflects the findings analyzed on how the relationship between Foreign Direct Investment (FDI) and Albania's Economic Growth has evolved after the 1990s, what have been the impacts of government policies and the regulatory framework in Albania on the attraction and effectiveness of Foreign Direct Investment (FDI), which increases the credibility of foreign investors. Through the parameters and indicators resulting from the analysis of factors with influence in this prism of economic development, it has been found to what extent political stability and governance reforms have influenced the sustainability of FDI in Albania. Also, with concrete recommendations and proposals, this thesis shows the reader how important the contribution of FDI is compared to other determinants of GDP growth, and what needs to be done better politically in order to achieve stability and economic growth in the country. Through the real elements of sustainable development, recommendations are given at the end of the paper related to the aspect of which economic sectors have benefited the most from FDI and how effective economic reforms have been in creating a favorable climate for foreign investments, with the aim of increasing the economic development and sustainability of Albania.

## 5.1.CONCLUSION

To conclude the analysis of the performance of FDI in Albania in terms of the essence of the quantitative analysis with concrete indicators, the institutional aspect and econometric indicators, this chapter brings concrete conclusions and conclusions that come as a result of the findings during the research on FDI and Albania. These conclusions will define the research questions, which in the continuation of this chapter will also be concluded with concrete recommendations, which aim to improve the economic indicators achieved by FDI in Albania. Also, through the recommendations it is envisaged that through components such as: Political stability and the advancement of EU integration, they will serve as parameters that will further regulate the business climate in Albania, as well as increase credibility towards foreign investors.

The aim is for the conclusions and recommendations in this thesis to bring and reflect, in addition to reality, a more hopeful future for greater and sustainable economic growth and for a stabilized market with international standards.

- Foreign Direct Investment in Albania constitutes one of the most important pillars of the country's economic development, especially in the era of the entire post-communist transition that the country went through for several decades. Currently, Albania has transformed from a country with a closed economy, into a country with an open, but developing market, where policy-making every year increasingly aims and strives to attract more foreign capital, technical knowledge, modern management standards and new technologies.
- If we take a perspective of the analysis by periods, in the institutional aspect, the essential role of state structures and the legal framework, the direct impact that they have in creating a favorable environment for investments, comes to the fore. However, challenges such as: poor infrastructure, legal

uncertainty, corruption and problems of political instability still remain obstacles that require long-term and systematic solutions in favor of FDI.

- Based on the econometric analysis and comparative analysis with the countries of the region, it appears that currently, despite the long transition, there is a stable connection between FDI and economic growth, where sustainable sectors such as energy and tourism are highlighted. This reality reconfirms the need for proactive policies that not only attract foreign investments, but also orient them towards sectors with added value, sustainable social impact and growth with long-term economic sustainability.
- Based on the quantitative data that were analyzed, it was concluded that a gradual and stable increase in FDI is shown, especially in strategic sectors such as energy, financial services, tourism and construction. In contrast to the initial trend of attracting FDI, where Albania had not yet defined sectors, the current investment trend in recent years has shown positive indicators and is oriented towards strategic sectors. In addition, investor confidence has increased in the business climate and the more stable institutional structure in their favor.
- In conclusion, Albania is still at a crossroads, as political and institutional choices will determine not only the quantitative but also the qualitative perspective of foreign investments and the long-term impact of FDI on the sustainable economic development of the country. In addition to the deep reforms of EU membership, it is necessary to create a more competitive, fair, transparent and reliable climate for foreign investments. This climate will serve as the key to moving from the phase of capital absorption to the phase towards sustainable economic growth with maximum contribution of FDI, based on knowledge, coherent managerial knowledge, technology, innovation and comprehensive welfare.

## 5.2.RECOMMENDATIONS

From all the research in this thesis, it results that the impact of FDI on the economic growth of Albania has been positive and with a significant effect on the contribution to GDP. The period of years when the economic crisis of 2008 was reflected is particularly striking, when the economic growth indicators in Albania were positive. This also includes the contribution made by FDI and the increase in employment in the country during those years (2006-2009).

Considered as recommendations for increasing FDIs in Albania, at the conclusion of the analysis on the role, contribution and effect of FDI in the developing economy of post-communist Albania, it is very important and necessary to highlight some key recommendations. These recommendations will significantly impact the improvement of the investment climate, with the aim of long-term economic maximization.

Firstly, it is required to achieve and fulfill several key criteria: Sanctioning property and property rights in Albania, which is necessary as a guarantee before EU membership; Strengthening legal certainty through an independent and efficient judicial system, which guarantees the full and correct implementation of contracts and guarantees confidence in foreign investors.

Secondly, improving the competitive regional infrastructure, where technological and digital parameters are considered a necessity to enable easy business operations. Also, fiscal stability and transparent tax policies that are not closely linked and independent of political changes will be essential for attracting sustainable investments with a high impact on the country's sustainable economic growth.

Also, the development of human capital through vocational education, technological knowledge and qualifications, as well as cooperation with the private sector, will increase the possibility of creating a job market and providing qualified employees who are suitable for the demands of the global labor market.

A very important role in this proper development is also played by AIDA and its economic diplomacy, which, according to investors, should be more oriented towards identifying and serving investors by offering a proactive and organized approach.

To guarantee transparency, the country should focus on the creation of industrial clusters and free economic zones, as well as focusing on directing investments towards the most priority sectors such as technology, innovation, telecommunications, agriculture, renewable energy, etc.

The country has ratified the "Investment Charter": a Stability Pact initiative aimed at reforming the legal environment in order to facilitate foreign direct investment in the Balkans. Steps have also been taken to halve non-tariff barriers and shorten the time needed to register a business. The government, driven by its desire to join the European Union, is working to reform the country and restructure it to consolidate the dynamism of its economy. Thus, reforms have been introduced to reduce the country's fiscal deficit in 2019, the government deficit reached 1.9% of GDP (according to the IMF), to reorganize the key electricity sector and to increase pensions.

Finally, with the aim of improving institutional transparency, building an efficient and uncorrupted public administration, they would increase investor confidence and serve as the core of a more attractive environment for international investment.

The coordinated adoption of these measures could serve as a package with strong foundations to ensure a more promising future for FDI in Albania and for overall and sustainable economic development.

Considering the recommendations for a better future of FDI as strategically arranged, the following will be listed:

- Improving national infrastructure through investments in: roads, ports, airports, water and energy networks, access to sustainable energy and competitive costs, perfecting the digitalization of public services to facilitate operations by foreign investors.
- Improving sustainable fiscal and tax policies with the aim of increasing long-term trust through: stable tax policies, transparency of customs procedures, avoiding administrative corruption, providing sectoral fiscal facilities such as in, IT, industrial production and tourism.[81]
- The rule of law and stronger legal certainty through: fulfilling contractual obligations, guaranteeing an independent judicial system, efficiency in resolving disputes between investors, as well as increasing credibility in alternative judgments such as commercial arbitration and mediation.
- Improving the business climate and increasing transparency by: increasing public-private partnerships in strategic projects, implementing anti-corruption reforms in the administration, and developing a unique digital platform for services to investors.
- Improving and developing human capital through: encouraging "brain gain" to return human capital from emigration to the country, collaborating with investors to increase training, qualifications and certifications, and investing in technologically oriented vocational education.
- Increasing and developing strategic sectors and industrial clusters such as free economic zones or industrial regions and parks, where many companies develop similar or related industries, taking advantage of mutual

[81] WTO (2010), Albania – Trade Policy Review 2010: Reaping the benefits of reform and liberalization. Geneva, WTO.

capabilities to increase efficiency and innovation. Their development increases competitiveness, labor recruitment, stimulates innovation, increasing investments and exports with internationalization. Also, support for new sectors such as technology, green energy and agritourism.

- Last but not least, it is recommended to increase the role of AIDA, which through the provision of consulting services, diplomatic promotions of the business climate and potential sectors, cooperation with Albanian embassies can increase the identification of opportunities for more FDI.

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