
Financial Incentives and their Impact for Attracting FDI Survey with Foreign Investitures in Albania

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Introduction to market economy brought the need to attract FDI in Albanian economy. Governments of different countries often used several incentives to attract foreign investors. In this aspect, Albania has attempted to attract FDI by applying several measures in order to create a favorable environment to foreign investments. This study considers the relation between demanders of financial aspects taking into account thus the incentive packages, the business sector where these packages are applied, tax levels and the opportunity for foreign investments in the coming years. In order to provide thorough information, the study will be focused on analyzing the conclusions of the interviews made to foreign investors who have their activity on Albania. The study will include also the results of a statistical analysis. It is used to verify if there exist a relation between incentives and FDI level. The contingency test is χ^2 .

Keywords: FDI, financial aspects, incentive packages, business sector, tax levels

Introduction

Albania, like many other countries, has intensified its efforts towards reforms in improvement the business climate. A special role played the incentive packages for attracting the foreign investors. If we have a quick look at FDI in Albania, it seems that during 1992-1996, it is 1996 which gives the highest growth level with 97 million US\$. 1997 and 1999 coincided respectively with the crisis caused from the pyramidal companies and troubles in Kosovo and they were reflected of course in the reduction of foreign investment flows. Since 2002, the level of FDI has been increased. 2005-2007 coincides with the highest FDI intensity on telecommunication sector, whereas 2008 resulted a successful year in attracting the FDI towards the extraction industry and banking sector.

Based on a study of the Bank of Albania (2010), during the second trimester of 2009 has been noticed an increasing tendency of FDI as result of increase of incomes from privatization process. According the last report of United Nations, the estimation of FDI in Albania in 2010 was 1.11 billion dollars, which classifies it in the second position in the Region, coming right after Serbia. The Institute of Statistics in Albania shows that FDI portfolio in Albania is made up of 70% coming from public privatization process and concessions. The economic sectors that have attracted more direct investments in Albania are energy, transport, tourism and banking-financial.

However, land ownership problems block long-term FDI which of course create new jobs, reduce unemployment, introduce new technologies and increase the competitiveness. According the World Bank, in the top of South-Eastern Europe countries, considering the FDI, is Croatia with over 4000 US\$ per capita, followed from Montenegro with 3800 US\$, Serbia with 2000 US\$, Bosnia-Herzegovina with 1600 US\$, Macedonia with 1268 US\$ and Albania with 1024 US\$ per capita.

As far as the origin country of foreign enterprises is concerned, the investors coming from EU countries are the main investors in Albania, possessing about 77% of the foreign enterprises. Italy takes the main place with about 40% and then Greece about 26%.

The countries of the Region have invested in about 13% of the foreign and joint enterprises in Albania and are represented from Turkey as the main investor taking 8% of the enterprises. Also, the number of Macedonian enterprises has been increased lately. The number of the American enterprises has been increased also taking 4% of them.¹ Thus, foreign capital companies operating in Albania have a wider geographical extension.

Concerning the geographical distribution of foreign enterprises, it is noticed that investments are concentrated in the main areas of Albania, where Tirana and Dures take about 65% of the total foreign and joint enterprises. The Albanian areas where foreign capital access is smaller are the northern and east-northern. Korca and Gjirokastra are an exception as there are 33% of foreign enterprises doing business mainly Greek ones. 9% of Italian enterprises have invested in Shkodra.²

The Albanian experience in attracting the foreign investments has been related mainly to privatization processes in strategic sectors. As far as the enterprises by economic sectors are concerned, the industry that represents the higher number of foreign enterprises is the processing industry, with about 47% of them. Within the processing industry, the textile and clothing industry takes an important place (about 18%), where a good part of the Italian capital is concentrated in the form of textile enterprises with fashion.

Methodology of study

In order to realize this research, secondary data as well as primary research were used. Secondary data concerned the information provided from literature study on FDI determinants, focusing special attention on financial and tax incentives in attracting FDI.

Special attention was focused on the primary research, so gathering the main data. Realization of the project was planned in such way to facilitate the cost of collecting information and in the same time achieve

¹ Bank of Albania, Economic Bulletin Volume 11 nr 4 December 2008 page 110

² Endrita Xhaferaj Bank of Albania "FDI Analysis in Albania", 2005

satisfactory results which would be helpful in producing accurate results. Efforts were made for the process to be as simple as possible.

Contacts with target companies were realized through personal interviews, e-mail or phone contacts, etc. The latter was made when personal interviewing was difficult.

Primary research was performed in two stages. During the first stage, a questionnaire was drawn which belonged to the production sector, and the second stage concerned the interviews to service companies. Samples were represented respectively from (1345 total population) and 14 service companies (20 total population).

Formulation of questions was done based on some studies: - Bitzenis study on the effect of financial and non-financial incentives in Bulgaria, and the Eclectic theory of John Dunning.

The statistical analysis of questionnaire was performed with SPSS 17 programs, making use of Guide for Doctorate Research. This guide was used not only for calculating the frequency of responses, but also for the creation of cross tabulation, verification of hypothesis by χ^2 test. In selecting the businesses according the towns, <http://www.directory.albic.net/> was used. This is the official webpage of business directory in Albania.

Analysis of research questionnaires

With regard to the business sector, among selected sectors, the processing industry was represented by 44 companies or (36.1%), agriculture 4 companies (3.3%), the textile industry 50 enterprise (41%), construction with 20 companies (16.3 %), and other businesses with 4 enterprises (3.3%).

Concerning the position of the interviewees, 23% of the respondents were business owners, 44% were directors or managers, 30% accountants and 3% were an unspecified category. In this research, 26% of companies interviewed belonged to joint-venture form, 53% fully foreign owned 21% belonged to the form of contracting production.

Providing incentives is considered from governments as a promotion in attracting foreign investors. The Albanian Government has applied several incentives. So, asked if there was any special incentive in

their investment, 54.1% of the respondents said “Yes”, whereas 45.9 % said “No”. The results are presented in the Figure 1.

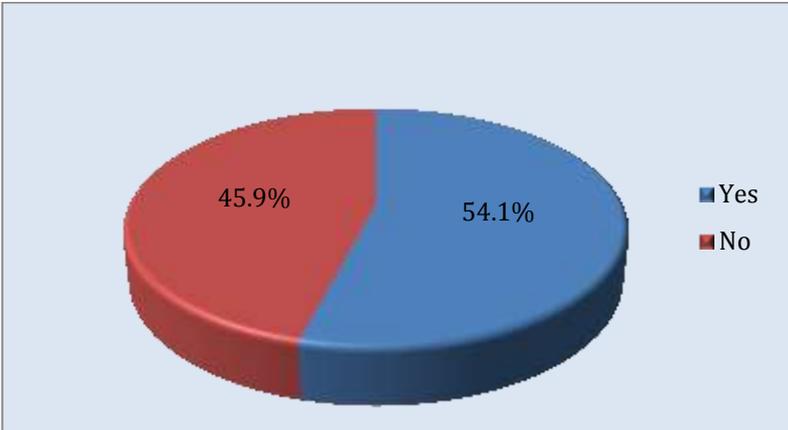


Figure 1: Is there any special incentive in your investment?

Another argument related to incentive packages. Asked if they decided to invest in Albania for this reason, 18% answered “none”, 26% of them chose to answer “very little”, 37% answered “little”, 16% answered “on average”, 3% chose to answer “very much”, and none of them or 0% answered “extremely”. It seems like incentives packages are not been considered as important for investment decisions. Results of these answers are presented in the Figure 2.

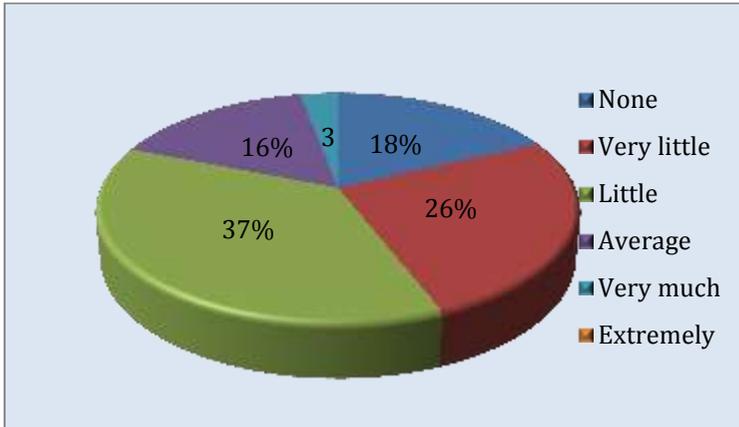


Figure 2: Did you decide to invest in Albania for incentive packages?

Tax levels are another discussion topic. Asked how do they consider the tax levels in Albania, none of them, so 0% thought that taxes are “very low”, 11% of them considered them “low”, 44% answered about “an average” level of them, 38% thought taxes are “high” and 7% considered them “very high”. From these results dominates the percentage of those respondents who think that levels of taxes are “average” and “high”. Results of these answers are presented in the Figure 3.

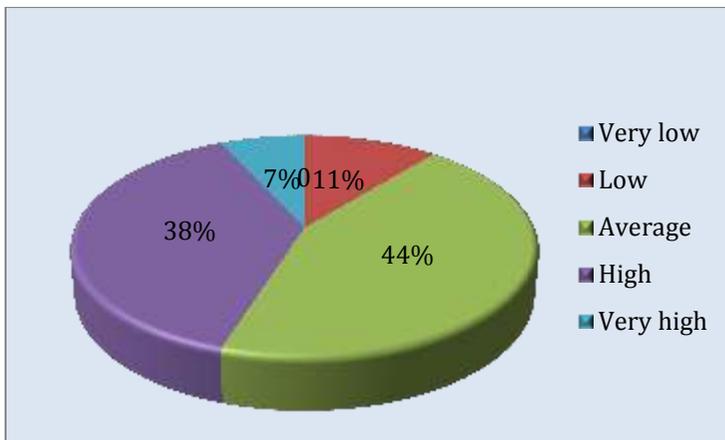


Figure 3: How do you consider the level of taxes in Albania?

Application of a favorable tax system helps in encouraging business activities, not only for domestic investors, but foreign ones as well. Often foreign investors are attracted from favorable policies on low business taxes. Related to this, there is an almost similar perception between those who consider taxes on “average” and “high” levels, whereas there is a small perception on “low” and “very high” levels.

Also, favorable tax policies are not always dominating factors in attracting foreign investors, and care should be taken after them, in order to not discriminate domestic investors compared to the foreign ones.

Formulation of hypotheses

Governments have always used tax incentives to influence business relocation, expansion and start-ups, or to promote some businesses' initiatives over others, rescuing them from failure and bankruptcy or alternatively protecting them against competition. (Buss 2001). In Central and East European countries, incentives have been used in order enhance positive spillovers (technology transfers, decrease of debt, budget financing, gross domestic product (GDP) growth and help in the transition to a market economy.³ UNCTAD studies, World Investment Report 1996, show that not always incentives are an important factor in investment decisions in a country. But, their role is of course important and foreign investors are not insensible to them.

Benacek et al. (2000), concludes in their literature review that according to Lankes and Venables (1997), “Tax incentives for foreign investment are not considered important to the location decision i CEECs, although individual agreements between the investor and the government are significant for a small group of investors. Such a fact is mentioned in the Hungarian experience, whereas the Czech Republic offered less incentives to foreign investors. OECD(1997, p 101) concluded that *“FDI incentives must not necessarily be seen as FDI promotion, but the consequent enforcement of*

³ Arstidis Bizenis “Did Financial Incentives affect Foreign Direct Investment Inflow in Bulgaria”? SEEJE 1(2003) pg 65-84

the law on bankruptcy can work better than any FDI incentive.. FDI incentive policies can drive an investor's decision of investment attractiveness given by macroeconomic and political stability is achieved or other disincentives for investment are eliminated (p 98).

OECD (1997.p96) pointed out that according to a survey carried out by Deloitte & Touche for foreign investors investing in Central and Eastern Europe the taxes in the host country constituted the single most decisive factor in the investment decisions of these investors. Moreover, most of 100 respondents (50 MNCs) stressed the need for a stable and transparent legislative framework for investment and argued that taxation influenced their decisions in a major way.

Brewer et al (1997,p 178) argued that *“there is anecdotal evidence that, even when incentives may be strictly unnecessary to attract an investment project, MNE s will still (inevitably) attempt to maximize aid levels at the point of negotiation with host governments or regional authorities”*

Bitzenis (2003) in his study on the role of fiscal incentives or taxes provided from the Bulgarian Government for the foreign investors, shows that fiscal incentives were successful in attracting foreign investors.

In this study (Bitzenis 2003) argued that the results indicate that when a host country provides incentives and especially tax incentives, the outcomes are infrastructure improvements, increased employment, growth, stability, and other positive spillovers due to the attraction of inward FDI flows.

Some professionals, economists and state officials who claim that tax incentives(corporate income tax exemption, job creation tax incentive exemption, equipment and machinery tax exemption etc.) are costly, ineffective and detrimental Buss (2001, p90).

Buss (2001,p 101)), argued that *“ taxes should matter to states, but researchers cannot say how, when, and where with much certainty. Firms may need tax incentives to increase their viability in some locations, but researchers cannot definitively say which businesses or which locations”*.

Bitzenis (2003) argued that the government will evaluate the costs and the benefits of different types of incentives that it will offer to foreign MNEs and to decide if there is a necessity to offer the incentives in a specific time period.

Researchers cannot say what is the most suitable type of incentives, that each country should apply. The study of the transition of the Bulgarian economy strongly suggests that the imposition of fiscal/financial incentives has only moderate results and thus the Bulgarian government has recently diminished or eliminated most of them. Bitzenis (2003)

The Albanian experience shows that foreign investors are provided with facilities in certain aspects such as the importers of machineries and equipments providing 100% VAT crediting by *Decision Nr. 3 date 30.01.2006*, corporate tax reduction from 20% in 10% (January 2008), new laws on concessions and public procurements, 30% reduction on the price of electric power on businesses, facilitation of business procedures on registering process and finally the establishment of National Licensing Center.

Although incentives could be offered to foreign investors, care must be taken to not discriminate the domestic investors and also beware of false and flimsy investors.

Other problems that appear during the application of incentives have to do with the bureaucracy, corruption and bribery. OECD (1997, p 92) argued that "the greater the number of conditions to be fulfilled by the investors, the less the transparency and the greater the possibility of manipulation. In addition, selective approaches also postpone decisions and in reality, dissuade investors while serving primarily to demonstrate who decides what in the country: the market or the bureaucrat?"

Based on these discussions and taking chance by the fact that investor incentive packages have been applied in Albania, the following hypotheses are drawn which aims the verification of financial aspects demanders.

- **Hypothesis 1a**

Increase of foreign investor incentive packages increases the probability of investment reasons being attributed to this very factor.

- **Hypothesis 1b**

Business sector where foreign investor belongs, determines the investment reasons which relate to the incentive packages being applied for this sector.

- **Hypothesis 1c**

The lowest tax levels for foreign investors in the country increase the probability of foreign investments in the future.

Results of the statistical analysis

After a general analysis to foreign companies being studied, which operate in Albania in production and service sectors, will follow the results of the statistical analysis in order to verify whether the drawn hypotheses are true. In this study, the statistical test is used for verifying the existence of a relation between two variables. To do this, the contingency χ^2 test is used which aims to verify the existence of an accordance between two variables.

As far as testing of financial aspects demanders is concerned, we draw these conclusions, hypothesis 1 a, was not true, for the production sector, ($\chi^2_{log} = 22.066, \alpha=0.05$, number of freedom levels 4, $\chi^2_{tab} = 9.49$, so, $\chi^2_{log} > \chi^2_{tab}$). (In this study χ^2_{log} is the calculated value by Chi Square test and χ^2_{tab} is the critical value found from the distribution of Pearson). Statistical results are displayed on Tables 1 and 2.

Table 1: Was there any special incentive on your investment? * Did you invest in Albania because of incentive packages? Cross-tabulation Count

		Did you invest in Albania because of incentive packages?					Total
		None	Very little	Little	Average	Very much	
Was there any special incentive on your investment?	Yes	8	4	36	14	4	66
	No	14	28	8	6	0	56
Total		22	32	44	20	4	122

Table 2: Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	22.066	4	.000
Likelihood Ratio	24.597	4	.000
Linear-by-Linear Association	11.298	1	.001
N of Valid Cases	122		

This shows that incentive packages are not a significant factor in determining the foreign investments in the coming years. Hypothesis 1 b was not true for the service sector. ($\chi^2_{log} = 14.000$, $\alpha=0.05$, number of freedom levels 3, $\chi^2_{tab} = 7.81$, so, $\chi^2_{log} > \chi^2_{tab}$).

This shows that there was no relation between the business sector and its sensibility toward incentive packages. Statistical results are displayed on Tables 3 and 4.

Table 3: Business sector *

Did you invest because of incentive packages? Cross-tabulation, Count

		Did you invest because of incentive packages				Total
		None	Very little	Little	Average	
Business sector	Banking services	7	0	2	3	12
	T/communication services	0	2	0	0	2
Total		7	2	2	3	14

Table 4: Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	14.000	3	.003
Likelihood Ratio	11.483	3	.009
Linear-by-Linear Association	.007	1	.931
N of Valid Cases	14		

So, this sector did not show sensibility toward the incentive packages. Hypothesis 1c was true, ($\chi^2_{log} = 6.243$, $\alpha=0.05$, number of freedom levels 3, $\chi^2_{tab}= 7.81$, so, $\chi^2_{log} < \chi^2_{tab}$). This shows that the lowest levels could affect the increase of investment levels. Statistical results are displayed on Tables 5 and 6.

Table 5: How do you consider the tax levels in Albania? * Are you going to undertake new investments in three coming years? Cross-tabulation

		Are you going to undertake new investments in three coming years?		Total
		Yes	No	
How do you consider the tax levels in Albania?	Low	2	2	4
	Average	48	6	54
	High	34	22	56
	Very high	6	2	8
Total		90	32	122

Table 6: Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	6.243	3	.100
Likelihood Ratio	6.575	3	.087
Linear-by-Linear Association	1.785	1	.182
N of Valid Cases	122		

Conclusions

UNCTAD studies, Benacek et al. (2000), Lankes and Venables (1997), Buss (2001), Bitzenis (2003), etc, show that incentives play a limited role in investment decisions, if compared with other factors.

From the results of this study we reached the conclusion that also in Albania incentive packages are not considered as dominating factors in attracting FDI. Such a result was confirmed from the statistical verification of hypothesis on financial aspects demanders.

Application of a favorable tax system helps stimulation of business activities, not only for domestic investors but foreigners as well. Often, foreign investors are attracted from favorable policies of low taxes on businesses. Concerning this problem, there is an almost similar perception among them who consider an average level of taxes and those who consider them high, while there is a narrow perception on “low” and “very high” levels.

Incentive packages are considered as elements which attract the foreign investors in a country; although, indicators on incentive packages should not be a main factor in investors’ motivation. This finding remains

inside the theoretical and empirical literature where incentives as FDI determinants are not considered to have a great impact.

In the present research, it is confirmed that incentive packages are considered “less important” for investment decisions in Albania, while the economic conditions are considered “average” and “extremely” important.

These results draw the conclusion that incentive packages should be studied carefully from policy makers, for not making undeserved favors to foreign investors and because of the fact that these incentive packages not always are dominant for investment decisions. Political and economic stability factors should be more important when an investment decision is made.

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