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## AN ALTERNATIVE PROCESS FOR ATTRACTING INVESTORS

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Genti BEQIRI

*European University of Tirana, Department of Management, Albania*

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### **Abstract**

*Foreign investment is essential for a country's economic growth and prosperity. Specifically, investment by multinational businesses leads to an increase in standard of living of individuals. Globalization and its effects have attracted the attention of researchers, who assess the possibility of international fragmentation. This means the production process should be shared and realized in several components and in different countries. This process affects positively international trade and leads to faster globalization. The statistics reveal that almost in all Western Balkan countries, exports of finished goods or semi-finished goods (SFG), which are subject of inward processing, represent a considerable share in the foreign trade volume, which in some cases exceed 50% of total exports of the country. However, for small countries is more difficult to attract multinational companies which produce, utilizing outward processing and to compete with outsized countries with cheap labor cost. These large manufacturing multinational companies have concentrated their outward activities in the countries of East Asia and Africa due to low costs of labor, despite the geographical distance of these countries. A detailed analysis of inward processing exports of Albania over the last years will be presented in this paper, with the main focus on categories of goods, their trade volume and destination countries of exported goods that are processed in Albania, concluding in the prevailing trend. The paper also aims to analyze the investment environment in Albania and the key issues facing the business that operates in inward processing. The results of data analysis and the main findings will be presented and discussed in the concluding part of the paper.*

Keywords: Manufacturing, Foreign Trade, Albania

### **1. INTRODUCTION**

Globalization and its effects have attracted the attention of researchers, who assess the possibility of international fragmentation that means sharing the production process in several components, which can be realized in different countries. This process affects positively international trade and leads to faster globalization. The statistics reveal that almost in all Western Balkan countries, exports of finished goods or semi-finished goods (SFG), which are subject of inward processing, represent a considerable share in the foreign trade volume, that in some cases exceed 50% of total exports of the country. However, for small countries is more difficult to attract multinational companies with the aim of producing and utilizing outward processing in order to compete with outsized countries with cheap labour cost. These large manufacturing multinational companies

have concentrated their outward activities in South East Asia and Africa countries due to low costs of labour, despite the geographical distance and shipping costs from these countries.

A detailed analysis of inward processing exports of Albania over the last years will be presented in this paper, with the main focus in categories of goods, their trade volume, originated countries of imported goods for inward processing in Albania, concluding in the prevailing trend. Data used for analyzing the inward processed goods in Albania are taken from the database of Albanian Customs, Institute of Statistics in Albania (INSTAT) and World Bank. These data take in consideration and analyze the period of time between 2006 and 2011, given that the installation of the new automated system (*Asycuda++*) in the Albanian customs in late 2005. This system enables the accurateness of data provided.

This short study also aims to analyze investment background in Albanian economy and key issues that business which operates in inward processing, encounters. The results of data analysis and the main findings will be presented and discussed in the concluding part of this paper.

## **2.1 DO HOST COUNTRIES BENEFIT FROM INWARD PROCESSING INDUSTRY?**

The integration process of the world's economies as a result of the rapid globalization has increasingly attracted the attention of researchers. The international fragmentation of production has become an important form of economic integration, whereby the production activities are segmented and spread over an international network of production locations across borders. This fragmentation is mostly based on the argument of differenced labour costs, factor prices and geographic approximation.

The rising integration of world markets has brought with it a disintegration of the production process, in which manufacturing or services activities completed abroad are combined with those performed at home (Feenstra 1998). Materials and components produced in one country may cross the national borders in order to be subject of fabrication, assembly, or other processing. Thus, the countries are tied in a vertical trade chain of intermediate goods, because of their specialization in different stages of the production process, due to cost factor or other local advantages (Borga & Zeile 2004).

The trade evidence on textile and garment of the Balkan countries point out the importance of the exported intermediate goods and finished goods, which has been processed in these countries, that affects positively the countries' trade growth and therefore the economic performance. In order to expand their exports, the Balkan countries should follow favourable policies toward foreign direct investments, related to the reduction of obstacles, requirements, restrictions and introduction of incentives for multinational companies.

The manufacturing multinational companies may help the host countries to boost their manufactured exports. The host countries can take advantages on entering the world markets easily, because the foreign multinational companies ensure the link to the final buyers and have experience in international marketing, distribution, and bring new technologies to them (host countries). The multinational companies may build also the transfer channels for knowledge and technology diffusion from foreign multinationals to local country firms.

The effects of multinational companies on host countries can be classified as direct and indirect effects, wherein the direct effects refer to exports from the host countries by the multinational companies affiliates themselves. The indirect effects are related to the impact of the multinational companies on the export activities of the host country firms. Such indirect effects

affect the economy welfare by rising exports, government revenue, tax collection and positive influence in terms of trade and the balance of payments (Blomström 1990).

According to (Helleiner 1973) exports and multinational companies' activities can be classified into four different categories according to production characteristics:

- I. *Local processing of raw materials;*
- II. *Alteration of import - substituting industry to exporting;*
- III. *New labour-intensive final product exports; and*
- IV. *Labour-intensive processes and component specialization within vertically integrated international industries.*

The inward processed exports of Albania, which are in focus of this study fall under the two last categories. Usually, firms in developed European countries seek out manufacturers in East countries like Albania and bring them under contract as suppliers. The Albanian manufacturing companies benefit from access to foreign markets and this may permit them to expand output and achieve economies of scale.

In general, there are many opportunities for less developed countries as exporter of new labour-intensive final products, such as textiles, garment, and other consumer goods. These countries can be noteworthy exporters even without the help from foreign firms. However, the multinational companies plays an important role in this category of exports, helping firms in host countries in setting up the distribution network, keeping in touch with the rapid change in consumer tastes, mastering the technicalities of industrial norms and safety standards and building up a new product image. The design, packaging, distribution, and servicing of the products are of great importance and the lack of such skills makes up a key barrier for less developed country manufacturing companies to enter toward world markets.

The exports of labour-intensive processes and components can be considered as intrafirm trade, but most of them are transactions between multinational companies and domestic firms in less developed countries. This type of production is often reliant on imports of raw materials and intermediate goods; hence it is not obvious that net earnings of foreign exchange will be significant. The main benefits from export processing are instead related to increased employment, skills, wages, and taxes, at least in the short run.

It should be considered that the parent companies, who orders intermediate goods, can change the production process, without necessarily taking into account the interest of host countries. This may happen as a result of changes in the costs of production, the perception of risks, or the policy environment in different host countries (Blomström 1996).

In his survey of the empirical literature on international R&D spillovers Mohnen (1996) identified the fact that foreign R&D contributes to productivity growth more in small countries than in large countries (empirically tested by Mohnen). Later through econometric estimates by Pottelberg with the focus study on a sample comprised of the U.S., Japan, and eleven European countries.

However, according to (Blomström & Kokko, 2003) the potential spillover benefits are realized only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. To motivate subsidization of foreign investment, it is therefore necessary, at the same time, to support learning and investment in local firms as well.

The benefits take the form of various types of externalities or spillovers. For instance, local firms may be able to improve their productivity as a result of forward or backward linkages with multinational companies' affiliates; they may imitate multinational companies technologies, or hire workers trained by them. The increase in competition that occurs as a result of foreign

entry may also be considered a benefit, in particular if it forces local firms to introduce new technology and work harder.

The well-functioning of inward processing regime is of great importance for inward processed exports. It provides relief on customs duty of imported non-domestic goods, which are processed in the country and then exported/ re-exported. The regime provides relief from customs duty, VAT, antidumping duty, countervailing duty and excise duties. There are **two systems of duty relief**, suspension system and drawback system. In both cases there must be an intention to re-export/export the obtained compensating products from the country. Goods must be processed within a certain period and records must be kept for all operations carried out at that time.

In the suspension system import duties are suspended when the goods are entered under inward processing regime to the country. This system is likely to be more suitable, if the goods manufactured are planned for re-export, or transfer them to another inward processing regime suspension authorization holder. If a part of the imported goods is not planned to be re-exported, it should be entered for free circulation with full payment of import duties.

If the goods are imported under the drawback system, the import duties are paid when the goods are entered to inward processing regime. The import duties may be claimed back only if the goods or products are re-exported, or transferred to an IPR suspension authorization holder. This system usually is suitable in the case that is not certain how much of the imported goods will be re-exported.

Considering that almost all imported goods, which are subject for inward processing in Albania, are planned to be re-exported, the import has been realized under the suspension system. The companies should apply for an authorization, which enables them to import raw materials for production process without payment of customs duties, VAT, or other applicable taxes, depending on the type of goods.

The main positive impacts of inward processing industry for the exporting countries can be summarized as follows:

- *Expansion of the domestic export industry with positive effects on the trade balance and the balance of payments;*
- *Creation of jobs;*
- *Training of technical and managerial staff with modern management and organizational know-how;*
- *Production and process technology acquisition;*
- *FDI can help to channel capital into industries that have the potential to compete internationally, and the global linkages of multinational companies can facilitate their access to foreign markets.*
- *Promote exports;*
- *Advantages in entering world markets, such as established global marketing networks;*
- *Multinational companies also brings in, new technologies that may be diffused among host country firms, making them more competitive abroad*
- *Technology transfers and spillovers of R&D and knowledge;*
- *Positive impact on employment, trade, growth rate, welfare etc.*

## 2.2 ALBANIAN GARMENT INDUSTRY

Albania is a country with a long tradition in textile and garment production industry. Until 1990s this sector represented one of the strongest and potential sectors of the economy. The system was organized on state-based ownership companies with a high number of qualified workers, where

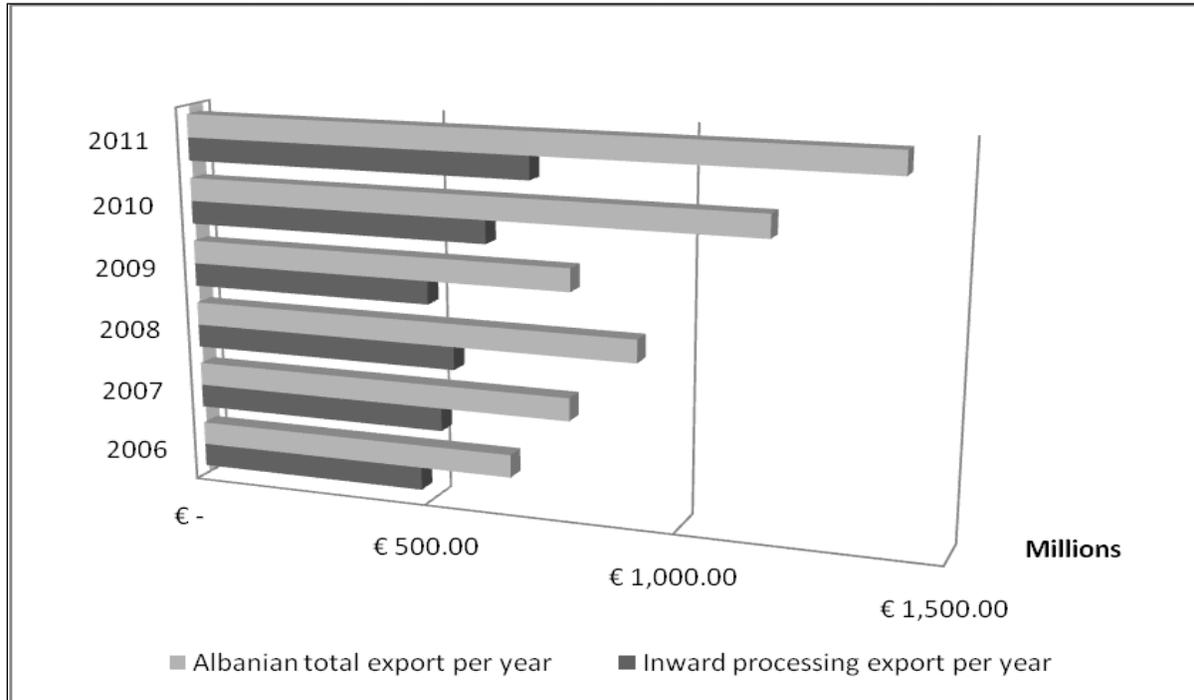
the experience and handcrafting tradition were used. Operating under the conditions of a centralized economy, the industry handled the entire chain of production from the raw materials to the final product. A considerable amount of the raw material was produced locally. The production included a wide variety of value added chain products starting with raw materials (fibres) up to final products. Due to the political and economic transformations of the 1990's, state factories were privatized and both the function of the textile industry and the philosophy of production were subject of substantial changes. In the last 20 years Albanian textile industry is not handling any local raw materials; the entire needed amount is imported.

The manufacturing industry of clothing and shoes is focused on the inward processing regime, where the raw materials and the semi finished goods are imported, processed and then re-exported. After 1990's hundreds of factories have been producing clothes and shoes for the European market under the inward processing regime, even for the well-known brands, such as Dolce Gabana, Nike, Miss Sixty, Pierre Cardin, etc. However, the relationship between the Albanian manufacturing companies with multinational companies and distribution channels is relatively weak. It needs to be underlined that there is a lack of national brands in this manufacturing sector in Albania.

The manufacturing industry and the export of garment products and footwear represent a key factor in the economic development in Albania. The statistics show that in 2011, the main trade partner of Albania remains the EU with 72.5% of total Albanian exports and 64.1% of total imports.

The analysis shows that inward processed export volume accounted for almost 2/3 of the total exports until 2009 (see Figure 1). In order to understand the relationship between the volume of inward processed export versus total export during the last six years, we have gathered and analyzed a series of export data. The 2009 crisis is reflected in the two following years (2010 and 2011), where it can be seen that the export of inward processed goods shows a slight increase in figures. Despite the positive trend of inward processed goods export in 2011, data analysis presents a declining trend in their share on total exports, accounting only for 50% of total export. This can be argued by the fact that during this year the export of electricity, crude oil and other minerals has increased substantially, thus causing the increase of the total exports volume, as shown in Figure 1. Albania's main industries are food processing, textiles and clothing, lumber, oil, cement, chemicals, mining, basic metals and hydropower.

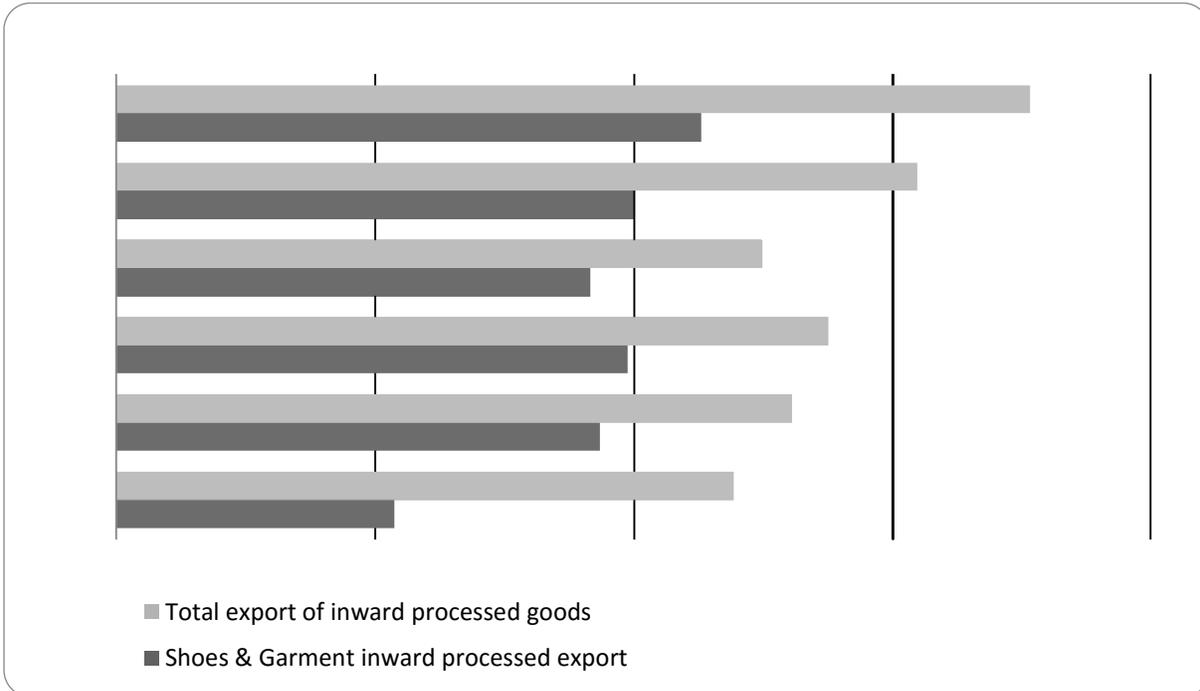
**Figure 1.** Inward processed export versus total export in Albania during the years 2006-2011



*Source: General Directorate of Albanian Customs*

Figure 2 represents the volume of shoes and garment export versus inward total processed export for the period of time 2006-2013. As shown in Figure 2, the export of garment and footwear accounts for about 64% of the total export of inward processed goods. This manufacturing sector still remains the most important part of the Albanian industry.

**Figure 2.** Albanian shoes and garment export versus inward total processed export during 2006-2011

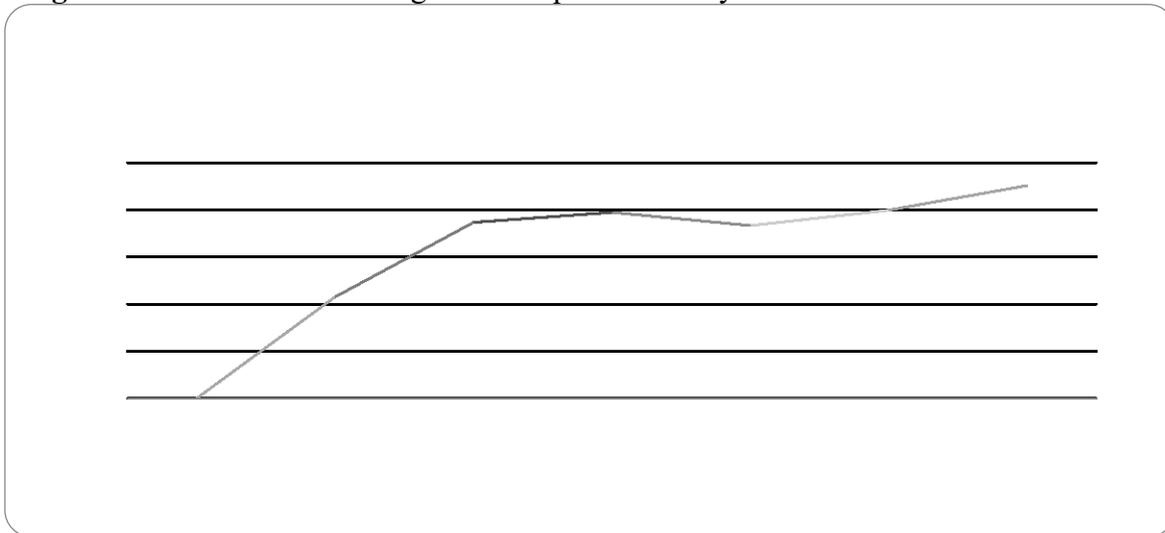


*Source: General Directorate of Albanian Customs*

Albania exports almost exclusively and especially to bounded EU countries. In 2011 the main destinations were almost entirely European, and the majority of Albanian garment and footwear processed exports were destined to Western European countries. The main three destinations in 2011 were Italy, Germany and Greece with 84%, 6% and 5% respectively. Altogether, they represent 95% of total Albanian garment and footwear exports. Many Italian retailers and clothing designers and brokers have taken advantage of the geographic proximity and low labour costs of the Albanian garment manufacturing industry as well as the fact that many Albanians are fluent in Italian.

It should be also noted that the number of products in the export portfolio of Albania is rather small, making it not very diversified and thus vulnerable. Furthermore, the profit does not remain within the country, especially in the cases of foreign investments, due to a lack of fiscal incentives and economic policies. The garment industry (oriented towards garment products, tapestry, rugs and preliminary refinement textile natural fibres) and the shoes industry are the leading sectors in the Albanian industry in terms of employment, with more than 300 garment and shoe companies operating in the country.

Data taken by General Directorate of Albanian Customs show that the number of exporting companies of garment and shoes has decreased in 2009 and 2010, as a result of the negative impact of the global crisis, and increased slightly in 2011. However, the import-export levels have had a tendency to increase, as shown in Figure 3. In this aspect it is important to emphasize the positive commercial balance of this industry.

**Figure 3.** Albanian shoes and garment export trend in years

*Source: General Directorate of Albanian Customs*

### 2.3 INVESTMENT ENVIRONMENT

Albania is gradually accumulating a consistent history of the economic expansion based on the export increase and on a low and stable inflation. The low inflation is a clear signal of a secure environment for foreign investment and the trading companies wish a more secure environment where they can operate. The low inflation, increasing gross yearly income show that Albania can offer the economic stability needed from the foreign investors. Albania is an affirmed commercial partner country. 72.5% of the Albanian exports go to the European countries and referring to that Albania should continuously meet the commercial EU models, which already have been met. Furthermore, Albania represents an entrance toward the free trade zone in Balkan.

According to the World Bank to start up a new business in Albania needs a few more procedures compared to the average steps in Europe, while the work flexibility is equal to that in many other countries in EU and Balkan region. Albania has made it easier and less costly for companies to pay taxes by amending several laws, reducing social security contributions and introducing electronic filing and payment. One stop shop business registration has been applying successfully by the National Register Centre (NRC). Foreign companies are allowed 100% ownership in Albania and the country is ranked 3rd in the world for protecting investor's needs.

There are many foreign investors operating in the garment manufacturing sector in Albania. They are mostly located in Italy, Greece, and Germany. The foreign investments in the garment sector are positively influenced by the geographic position of Albania because of its access with other Balkan countries and other Western European countries such as Italy and Greece. Albania is an excellent gate between western European countries and Balkan markets. This attractive geographical position favours the cost and the time of transport.

A strong comparative advantage is the fact that the wages and relative costs are lower than in the other neighbour countries. The working labour force is qualified, well experienced and with good skills compared to its prices, but there is a lack of successful managers. The management staff is composed of engineers, production managers, financial persons and selling managers who, because of the nature of production, are more focused on production and

investment and not on market research, fashion trends and demands, nor on laboratory testing and research work.

The timely adoption of the working force to the new technology is also one of the competitive most important advantages of the clothing sector and that puts it among three most important and strategic sectors of the manufacturing industry. The investors could benefit from the low wages that are still competitive comparing to the countries in the region. The increase of the human capacities in this industry will allow the increase of the independence of the Albanian enterprises and the orientation of the production for the home market.

However, the garment industry in Albania operates mostly with ready-made patterns coming from the partner European countries. There is a lack of investment on research, development, innovation and creativity, and also a lack of vocational and professional training programs for the workers and specialists in this sector of industry.

Foreign investors can have agreements and contracts with Albanian sub contractors that enable an extra profit because of the lower taxes and the import of materials without customs duties under the inward processing regime, as well as from the export of the finished goods.

It should be noted that according to Doing Business Report, in the last two years Albania has shown progress in terms of lower time of import, time of export and also lower import/export costs. The garment and footwear sector also benefit from a favourable tax treatment (income tax 10% and corporate tax 10%). Furthermore, there is a relief from customs duties on imported equipments and machineries for production.

The work premises in the garment production companies include all the necessary work environment and area for production and administration. The water and energy costs are also competitive with the other regional countries. On the other hand, it should be mentioned, that the industrial premises in Albania are slightly more expensive than in other Balkan countries. The manufacturing buildings in some cases are state property and the government offers rent agreements based on the number of the working posts that the activity will create.

## SWOT analysis pro-s and con-s for foreign investments

### Strengths

Confirmed data for the success of the foreign investors  
 Favourable geographic position with EU countries therefore low shipping costs and timing.  
 Enhanced connectivity in the term of transport means.  
 Favourable customs handling for the import of the raw materials (under the inward processing regime) and manufacturing machines without additional taxes  
 Good language skills  
 Flexible, well experienced young working force  
 Competitive working conditions  
 Access to the Albanian subcontractors during the highest work volume

### Weaknesses

Relatively low level of new investments in mentioned industry sector  
 Difficulties in finding a structure/facilities  
 Fragile financial services and legal framework enforcement.  
 Processors' might not easily sell or export to other countries  
 Fluctuation of working force  
 Lack of trainings, qualifications, experience.  
 Production with ready-made patterns.  
 Inexperienced managerial and technical labour force

### Opportunities

Enhanced collaboration with the Italian and Greek investors  
 High level respective government subsidies to Italian and Greek entrepreneurs  
 Government and foreign aid funds sustaining small and medium size enterprises  
 Favourable geographic position with EU countries  
 Favourable situation in inward processing sector for Albania due to Arab spring turmoil

### Threats

Competition with China and South East Asian countries will influence in many producers decisions  
 Foreign producers operating in Albania might close or reduce the production due to crises effects in EU  
 Strong competition with bounded counties in this sector  
 Unconstructive recent political situation in Albania

## 3. CONCLUSIONS

Albanian garment and footwear manufacturing sectors show an increasing interest in the European market. The garment sector in Albania continuously is being attractive and interesting to foreign investors, who invest in the country either directly or through subcontractors. Knowing this tendency, having a proper expertise, meeting the EU standards and having high quality, Albania has good chances to benefit from the opportunities offered by the EU, especially in those countries with very high consuming demands and incomes. What makes Albania a potential investment country is its good geographic position which enables fast delivery, as well as having

a low labour cost and knowing the competitors. The challenge remains the foundation of the Albanian brand names and their promotion.

Globalization is putting all the countries in front of difficult solutions, due to the increasing interest for investments in countries offering lower production cost. The main problem for Albania is the tendency of the investors and well known brand names producers being attracted more and more by countries offering lower cost of production than Albania and other countries of Central Eastern European countries. The Western European countries strategy has started to expand and develop the textile industry in the third countries like India and Africa that offer more, despite the geographic advantage that Albania offers.

An important factor remains the international standards and quality requirements in the multinational companies and their branches in Albania. These standards need to be improved, so that the Albanian companies in this sector can fulfil further the EU standard requirements. Reconstruction of the textile and garment sector towards the infrastructure of the machines and equipment is needed. At the same time, trainings and specialisations should be offered to the human resources in this sector, making possible producing high quality products in Albania. Setting up standards could lead to the reduction of the technical obstacles and there must be more efforts in this process. Trainings on production management, planning and control, as well as tailoring courses for garment production needs, will secure the necessary human resources for the Albanian industry of garment production. It also enables the transfer of technology and will increase the competition in the home and foreign markets.

The challenge is investment in scientific research through academic and research centres in technology, which will provide advanced and modern technology. It is notable to increase the human capacities in the quality management issues within the domestic garment production industry, so that it could offer quality management services to the domestic textile industry regarding management, procedures, and certification of Albanian products, that is of a very high interest for the domestic producers and foreign investments.

The introduction of the automation systems on design and manufacturing process to the highest level of employees will ensure the opportunity to use these systems in the textile/garment industry in Albania and to be more competitive in the international market.

The collaboration between the garment industry and academic institutions has high importance in order to develop technology transfer activities and trainings especially in quality management, quick response, quality control, fashion design, garment production, sewing engineering, and computer-aided design and manufacturing software systems.

The scientific research capacities in the field of textile technology at the textile and fashion departments and academic institutions should be increased with a common interest in quality control of textile materials, study of technological potential of domestic natural raw materials and computerisation in garment domestic industry. The improvement of materials and human capacities of the textile laboratories in Albania, would improve their abilities in quality control of textile materials and products for the Albanian textile industry and it will help to promote the use of Albanian textile raw materials.

Albania is missing a full database for technological potential and characteristics of domestic natural fibres. One of the tasks in the future for the institutions and universities is to complete such projects in order to have a real situation of the potential that Albania has in the textile sector. Research and development as well as the set up of a broad informative database in the industrial potential of Albanian raw materials, possible industrial utilisation, and opportunities of marketing them as raw materials are necessary. It will stimulate a better orientation in race

selection from the wool production point of view and a wider possible cultivation of flax and silk in Albania. It will also stimulate the export of those raw materials towards third countries.

The multinational companies have focused the production of high tech products in Asian countries, such as China, Korea, etc. In order for Albania to be attractive for these investors is to expand the production range of inward processed goods, so that most advanced technologies in producing high tech products with a high value in use should be carried out.

Any improvements in the textile and garment industry will have a significant impact on economy of Albania as well as on the country's stability.

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