

Investments role in Albania's economic growth in the course of transition

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Abstract

In the early 90s, Albania embarked on the road to reforms for stabilization, liberalization, privatization and integration of its economy in the overall global and regional economic trends. Among the challenges facing the economy during transition, an important place is occupied by investments, which play a primary role in economic growth. This brief presentation focuses precisely on the range and issues of investments in the course of transition, while trying to give a brief outlook of the dynamics and effectiveness of investments in Albania, their role and impact on economic growth, key problems and challenges currently facing them, as well as some recommendations in the light of improvements of the situation in the future.

The presentation focuses specifically on the macro-economic situation and the dynamics of the investments in the course of transition. The analyses, which in fact is a comparative advantages analyses with other economies of South East Europe (SEE), points out that there has been progress in terms of

growth and macro-economic stability. Also, progress is dedicated to investments, which have increased substantially, except for two years, namely 1997 and 2002.

We have also stopped to look on the review of investments effectiveness. Data speak of a satisfactory level of feasibility of investments utilization. According to the indicator of investment spending per one percent of GDP growth, Albania is ranked fourth among the SEE economies. Even though effectiveness rates are high, still there is an undesirable trend of its aggravation in the course of time, which represents yet another challenge.

The structure of investments according to ownership points out to the private sector as the promoter of investments growth. An analyses of private investments based on the enterprise structure survey indicates the increasing positive trend of their volume and effectiveness. In order to maintain this trend there are recommendations for improvements to the business environment. Public investments show fluctuations throughout the period, while there is a declining trend after 2001. Given that there is a decline in the rates of external financings, preservation of the high levels of public investments remains an issue that needs to be addressed for the future.

As a conclusion, we have tried to come up with some concluding remarks and recommendations for improving the investments situation, mainly with regard to enhancing further their feasibility and role in the country's economic growth.

1. INTRODUCTION

In the recent year Albania has made progress regarding political stability, and economic growth. In 2006, Albania signed the SAA with the EU, and in 2008 in the Bucharest Summit it received the invitation for NATO membership. The economy was witnessed satisfactory growth, as a result of the

intensification of the role of the private sector, and due to structural reforms. During 1998-2005, real annual GDP growth was 6.3%. Currently, according to GDP size per inhabitant, Albania is ranked among middle income economies. Growth rates are high even when compared to the transition economies of the SEE.

Growth was accompanied by price stability, expressed in a moderate annual average inflation rate at 2.9%, and a reduced budget deficit. These together with favorable monetary terms, characterized by historically low interest rates, and stable exchange rates have enabled a fast growth of investments. However, there are also problems, gaps and challenges, which are mostly related with the not-so-motivating yet business climate. This is the reason why in this report we are focusing on the issues of the dynamics and effectiveness of investments during transition, and on their impact on economic growth.

Economic theory and practice have proven that the degree of the impact of investments on economic growth in any country is conditioned by two factors:

- (i) the volume or the dynamic of investments;
- (ii) the effectiveness of the use of those investments.

The volume and effectiveness of investments, as key growth indicators, help in the dynamization of the economic life, and yield the desired economic and social progress. Economies that ensure high rates investments and effectiveness in their use are truthfully developed and dynamic economies. Whereas on the contrary, countries with low and unsustainable investment growth rates, and in particular those that fail to use investments efficiently are generally characterized as undeveloped economies.

Given that the mission of investments is to foster economic growth, their dynamic in the macro perspective is expressed in the investments participation rate in the GDP (**Ipr**), which is calculated as the ratio of gross

investments (G_i) carried out during one given period with the volume of the GDP for that particular period:

$$Ipr = \left(\frac{G_i}{GDP} \right) \times 100$$

Ipr indicator influences the dynamics and the quality of development in terms of GDP annual growth rate. However, the same volume of investments could potentially lead to different GDP growth rates, and this is entirely dependent on the effectiveness of the utilization of the investments.

From the macro perspective, the effectiveness of the investments is expressed through two main indicators: marginal capital coefficient (Mcc) and the investments spending per one percent of GDP growth (Is). The Mcc indicator is calculated as the proportion between gross investments and the GDP increase during a given time interval. Whereas the Is indicator is calculated as a proportion between the investments participation rate and the percentage of the increase of the GDP during a given timeframe.

The relationships among gross investments, GDP growth rate, and the effectiveness indicators represent the substance of the Harrod-Domar model, which is broadly used in macro-economic reviews. According to this model, GDP growth rate on account of investments may be estimated as a ratio of the GDP investments participation rate and investments spending per one percent of GDP growth.

2. THE DYNAMICS OF INVESTMENTS AND THE MACRO-ECONOMIC SITUATION

The dynamic of investments and the macro-economic situation are closely and mutually related. The macro environment determines the business climate, and consequently the dynamics of investments as well, whereas investments on their end appear as an important factor for the country's growth and stability. In Albania's circumstances, with a relatively low development level, where unemployment and poverty rates are high, where

there is growing inflationary pressure, and the trade deficit is very high, etc., the issue of the dynamics and effectiveness of investments becomes particularly important for long-term sustainable growth.

Even though the subject of the presentation is the analyses and impact of investments on economic growth during transition, in order point out the changes that occurred after the 90s, comparisons are made also with the pre-transition period, as well as with the countries of the SEE region. The main indicators of the dynamics of investments, and of the changes in the macro-economic situation in Albania in the course of 1950-2007 are presented in Table no. 1.

Table no. 1. *Indicators of the dynamics of investments, and of the macro-economic situation in Albania during 1950-2007*

Years	Investments (in million Lek)	Ipr indicator (in %)	Growth rates (in %)		
			GDP	Inflation	Unemployment
1951-1990⁸¹	100,249	31.5	-	-	-
1996	48,806	15.5	9.1	12.7	12.4
1997	47,417	16.8	-10.2	32.1	14.9
1998	51,650	16.2	12.7	20.9	17.8
1999	69,812	19.9	10.1	0.4	18.4
2000	92,988	24.7	6.5	0.0	16.8
2001	117,624	29.2	7.1	3.1	16.4
2002	108,600	26.2	4.3	5.2	15.8
2003	109,533	25.0	5.7	2.4	15.0
2004	109,963	23.7	6.7	2.9	14.4
2005	130,228	26.6	5.5	2.4	14.2
2006	129,026	25.1	5.0	2.6	13.8

⁸¹ Because of gaps in the Social Product which contains also the domestic turn over for the calculation of the Ni indicator for the period 1950-1990 we have used national income indicator, which is closer to the GDP.

2007 ⁸²	142,219	26.1	6.0	3.0	13.5
1996-2007	1,157,866	23.7	5.1	7.3	15.2

Source: Institute of Statistics, Ministry of Finance, Bank of Albania, World Bank and IMF databases

The economic situation during the first years of transition deteriorated substantially. In the face of competition it became objectively impossible for majority of the capacities inherited from the former system given that they were based on backward technologies. In 1992, the GDP marked a decline of 33.2% compared to 1990, whereas the industry suffered a much deeper decline of 70%. The economy was faced with strong hyper inflationary pressure, which reached a three digit figure of 236.6%, and was accompanied by a rapid and expansive depreciation of the local currency; the budget deficit was very high and reached up to 60% of the GDP; galopant increase of unemployment rates of 27%, etc. This situation was further aggravated because the old centralized management structures were abandoned, while market institutions had not yet been established. Hence, a chaotic situation was created, where there was neither planning, nor market available. To this end also contributed the political conflicts, social tensions, strikes, and the absurd phenomenon of the destruction of the national properties.

Under these circumstances, in addition to the reforms for the liberalization, privatization and institutionalization of the market economy it became necessary to formulate a stabilization program, which began to be implemented in April 1992. The main objectives of this program, which was drafted with the assistance of the International Monetary Fund and that of the World Bank included: growth of GDP and reduction of inflation by 1996 to a level below 20%. These would be achieved through reduction of the budgetary deficit, reduction of the number of public administration; reduced expenses for wages, elimination of subsidies, and reallocation of budget expenditure, while giving priority to investments in infrastructure.

82 Most of 2007 data are preliminary.

In the course of four years, namely 1993–1996, the Albanian economy witnessed very promising progress: GDP increased to 46.7%, inflation in 1995 fell to 6% out of the three digit level of 1992, and unemployment was reduced from 26.5% in 1992 to 12.4% in 1996. Until 1996, all macro-economic parameters were optimistic, and continuously improving. However, the accumulation potential of the economy at this stage was limited and consequently investment levels were modest.

After 1996, considering the difficulties of the transition, the dynamics of investments introduces a growing positive trend. The investments flows are a lot higher when compared to the previous period. Thus, average investments per inhabitant during 1996-2007 were 26 times higher than those during 1950-1990. In addition to the ongoing pace of high growth of investments, in the course of this period macro-economic performance as well improved significantly, except for two years: 1997 and 2002.

In 1997, the promising macro-economic progress was interrupted due to the bankruptcy of the pyramid schemes (fund-raisers), which had accumulated the savings of over one third of the Albanian households, and which in monetary terms meant 1.2 billion USD, or approximately 50% of the GDP⁸³. The pyramid schemes in addition to creating a general chaos; they also promoted parasite behavior, and discouraged investment of savings in economic activities. After four years of annual growth at 13.8%, the GDP in 1997 fell at 10.2%, inflation from 6% in 1995 reached to 32.1%, whereas the exchange rate of Lek with USD reached 149 from 104.5 only a year ago.

Another unfavorable situation was that of 2002 as well. In 2002, investments fell by 7.7% compared to the previous year. This decline was particular sharp for public investments which are covered by external financings. The situation was reflected also in the deterioration of the macro-economic

⁸³Malaj, A., F. Mema. (1998): “Characteristics and impact of financial informal market”, *Journal Economy and Transition*

performance since GDP growth from 7.1% in 2001 fell to 4.3% in 2002, inflation increased from 3.1% to 5.2%, etc.

Despite the negative influence of the last two years, the dynamic of investments during transition has been relatively high. Real investments during 1996-2007 increased to 291%, i.e. with an annual high rate of 10.1 %. Average investments per inhabitant in 2007 resulted 248.5% higher than in 1996. The Ipr indicator for a period of 11 years reached the level of 23.6 %, and marked a substantial increase from 68.4% to 15.5 % in 1996 to 26.1% in 2007. The same trend is reflected by the Gross Fixed Capital Formation (GFCF) indicator, which shows the place they occupied in the GDP composition for each year of the investments and stock, and capital constructions. This indicator has marked an increase to 233% coming from the level of 26% of the GDP in 1996 to 60.6 % in 2005. From an analysis of the dynamics of investments, and of the macro-economic situation during transition, the conclusion can be drawn that the situation has kept improving continuously, and investments are one of the key factors that have led to this improvement.

Of interest are as well comparisons among different transition economies. It's only normal that the size, dynamics, and effectiveness of investments vary from one economy to the other, even so within the same economy in different years. These are the result of the economic policies applied in each country, and are conditioned by the real potential of the economies of those countries for the relative participation of gross investments in the shaping of the GDP. Meanwhile, these comparisons help in creating a more accurate image, and lead to more comprehensive evaluations regarding the dynamics and the level of effectiveness of utilization of investments for each country. The data of Table 2 serve for the comparison of the dynamics of investments in the SEE transition economies.

Table no. 2. Investments growth and average annual indicators during 2000-2005⁸⁴

Transition economies	Gi (2005 versus 2000 in %)	Average investments (in USD per inhabitant)	Ipr indicator (in % versus GDP)	Is indicator (per 1% growth of GDP)
Albania	143.1	1,174	25.86	4.46
Bosnia & Herzegovina	121.9	1,388	20.00	4.17
Bulgaria	165.5	1,717	21.17	4.70
Croatia	194.7	3,313	27.99	6.08
FYR of Macedonia	100.4	1,230	18.11	12.07
Moldavia	174.7	399	23.96	3.47
Rumania	153.5	1,735	22.16	3.89
Slovenia	115.0	5,175	25.30	7.23

Source: Transition report 2006⁸⁵

During 2000–2005, according to gross investments growth rate of 43.1%, Albania was ranked fifth among the SEE economies. But, this relative indicator is not very appropriate for comparison purposes, given that the stages of economic development of different countries, and the investments growth rate are influenced by their absolute size for the period that serves as the bases for the comparison.

⁸⁴ Indicators of investments per inhabitant, participation of investments in the GDP, and investments spending per one percentage of GDP growth in the transition countries

⁸⁵ Transition report 2006, Finance in transition, (EBRD)

The more appropriate indicator for comparisons among economies is the Ipr indicator. According to this indicator, Albania comes second after Croatia, leaving behind other countries economies. During 2000-2005, Albania spent on average annually for investments 25.86 USD per 100 USD GDP, while this indicator for Croatia, which is ranked first among the SEE economies, is 27.99 USD, whereas for FYR of Macedonia which is ranked last is 18.8 USD. Meantime, it is worth pointing out that the Ipr indicator also, as an indicator of the dynamics of investments, does not reflect the economic potential of each country. Equal Ipr indicators for two economies do not offer equal amounts of investments, since the latter depend not only from the Ipr indicator, but also from the absolute size of the GDP of each country. The more developed the economy, with a higher average GDP per capita ensures a high investments flow.

In order to fill the above mentioned gap of the Ipr indicator, we have opted for the average investments indicator per inhabitant, which reflects concomitantly the rate of investments participation in the GDP, but as well the absolute sizes of GDP, i.e., the potential of the country's economic development. According to annual average investments per inhabitant for 2000-2005, Albania with 1,174 USD is ranked penultimate, close to FYR of Macedonia and Bosnia-Herzegovina. According to this indicator, even though Albania's Ipr indicator is higher than that of Bulgaria and Rumania, it has average investment rates per inhabitant respectively 31.6% and 32.3% lower than these countries.

Under these circumstances, the challenge facing Albania is that because it is not possible to increase the Ipr indicator, it can at least maintain for the future as well the positive trends proven so far in the economic growth, and investments dynamic. Facing this challenge is related to further improvements in the investments climate. This is due to the important role of investments in the economic growth, generation of new employment, changes in the sector structure of the economy, improvements of technology, and increased production effectiveness. Among the main factors that would

determine the improvements in the investments climate, in addition to the macro-economic environment, and the political context would be the development and strengthening of the physical infrastructure of the economy, intensification of the fight against high levels of corruption, efforts to eliminate barriers that hamper the increase of the competitive capacities of the economy, and increased investments in activities of research and development, and establishment and strengthening of human capital capacities.

3. ECONOMIC EFFECTIVENESS OF INVESTMENTS

An analysis of investments economic effectiveness is necessary to determine their impact on economic growth, and macro-economic stability. Table 3 below shows the indicators of investments effectiveness for 1950-2007.

Table no. 3. *Investment expenditure and marginal coefficients of investments during 1950-2007*

Years	1950-90	1996	1997	1998	1999	2000	'01	'02	'03	'04	'05	'06	'07	'96-'07
Is indicator	8.18	1.49	1.52	1.32	1.97	3.37	3.94	8.45	4.11	4.03	4.29	5.02	4.35	4.47
Mcc indicator	8.15	-	0.0	1.43	2.17	3.60	1.29	-	4.34	4.22	4.53	5.27	4.75	4.67

Source: Institute of Statistics, Ministry of Finance, Bank of Albania, World Bank and IMF databases

For the period 1950-1990, investments effectiveness is low. This is indicated in the Mcc indicator, which as an average for the entire period is 8.15. The same situation is reflected by the Is indicator as well, which is 8.18. In the OECD countries, the Is indicator for 1960-1980 is 5.15. The situation of the effectiveness of investments during this period was a direct consequence of the isolation of the economy from the international market, and its

competition. In the arguments for the investments, the political logic prevailed over the economic one, and hence in most of the cases investments were translated into objects with backward technologies and low effectiveness.

The analyses of the efficiency of investments in the course of transition shows an increase compared to the precedent period. The *I_s* indicator, as annual average for 1996-2007 was 4.47 or 45.4% higher compared to that of the pre-transition period. The same applies for the *M_{cc}* indicator, which as an average for the transition period was 4.67. This indicator is 75% higher compared to that of the pre-transition period.

Of interest is the analysis of investments effectiveness by comparing its levels with those of the SEE transition economies. With reference to Table no. 2, in terms of effectiveness in the utilization of investments, Albania is ranked fourth in the list of SEE transition economies behind Moldova, Rumania and Bosnia- Herzegovina. The *I_s* indicator for Albania was 4.46, which means that for 1% of GDP growth, 4.46 USD have been spent, whereas the inverse of the effectiveness coefficient was 0.22. This indicator is 4.8% higher compared to that of Bulgaria, which comes behind Albania in terms of investments effectiveness, and 275% higher than that of FYR of Macedonia which is ranked last.

Even though according to the average level of investments effectiveness indicator for the period of transition, the situation in Albania is relatively good, even compared to that of other SEE economies, it must be pointed out that the trend of the change of indicators during the period is not satisfactory since it shows a continuous decline in terms of investments effectiveness. If before 2000, the *I_s* indicator was fluctuating in the 1.32-1.97 interval, which corresponds to a significantly high effectiveness rate, after 2000 the situation deteriorates since the *I_s* indicator is now at an interval between 3.37- 8.45. Thus, there is a decline in the effectiveness of investments. If the investments effectiveness coefficient in 1996 was 0.67, in 2006 it dropped to 0.20, so it suffered a decline of 70%. This indicates that the country is faced with the

challenge stopping the deteriorating trend of investments effectiveness through implementation of those investment policies that would guarantee maintaining the existing level of investment effectiveness at the macro-economic level.

Another problem of effectiveness is the low scale of the impact of investments on increases competitiveness of the Albanian business and products in the regional and international market. Statistical data testify that most of the GDP goes for final consumption by the households, administration and not-for-profit institutions. During 1996-2003, to this purpose went 84.5% of GDP. This situation is a consequence of the allocation of priority investments in the service sector dominated by: trade, hotel services, bars and restaurants, etc. This sector in 2006 accounted for 51.6% of the GDP, while agriculture and industry contributed only 32.6% of the GDP. This sector structure of the GDP indicates that Albania is a consumer country of goods and services that come from imports.

The above mentioned conclusion is reiterated by the foreign trade balance, which is running at a deficit, more so a continuously increasing one. In 2005, the deficit reached 196.4 billion Lek or 40% of the GDP, with an increase by 3.1 times compared to 1995. These data show that so far, allocation of investments has not always been in the right direction with the view to expanding the sectors of goods production and enhancing their competitiveness in the global market. It shows that investments are oriented mainly towards short-term benefits, with no regard for the future interests to guarantee sustainable and long-term growth of the national economy. Improvements in this direction are an important element for enhancing long-term effectiveness of investments.

4. PRIVATE AND PUBLIC INVESTMENTS

The investments structure can be reviewed according to different features. In our presentation we have limited ourselves only in the review of investments

according to types of ownership. This criterion serves to make the distinction between private and public sector investments. During transition, profound changes have occurred in the structure of investments according to ownership type, which are presented in the data of table 4 below.

Table no.4. *The structure of investments for 1996-2007 (in percentage of GDP)*

Years	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	07-96
Private investments	11.0	12.5	10.4	12.4	17.8	21.7	19.4	19.3	17.8	21.3	19.4	19.8	17.6
Public investments	4.5	4.3	5.8	7.5	6.9	7.5	6.8	5.7	5.9	5.3	5.6	6.3	6.1
Public investments with external financing	2.4	2.3	3.3	3.6	3.3	3.3	3.0	1.9	1.4	1.3	n/a	n/a	n/a

Source: Institute of Statistics, Ministry of Finance, Bank of Albania, World Bank and IMF databases

4.1. Private Investments

Law no. 7512 of 10.08.1991 “On the sanctioning and protection of private ownership, free initiative, etc., led to the birth of the private sector of the economy. During the transition, this sector has lived a more rapid development than that of the public sector, which has kept shrinking due to the process of privatization. Currently, the private sector accounts for 75 % of the GDP, employs 80% of the overall number of employees, and is responsible for 75% of the country’s overall investments.

The dynamic of the growth of private investments has been rapid. Private investments grew 3.11 times, while in the public sector this growth was 2.42 times. This allows us to come to the conclusion that the private sector not only dominates the country’s economy, but with the priorities that manifests vis-à-vis the public sector it has become the promoter of rapid growth of investments in the transition period in Albania.

Maintaining and enhancing the dynamics of private investments will require the contribution of all factors that determine the investments climate. Leaving aside the endogenous factor related to natural resources and the size of the domestic market, the quality of the investments climate is determined by three factors: (i) the macro-economic environment, (ii) infrastructure and (iii) the political context. If the first two factors are pre-requisites for the potential investors, the third factor, the policy of the government translated in the institutional framework is decisive since it defines the rules of the game in the business area.

In the course of transition, and in particular during the two last years, the institutional framework has improved. Thus, the tax burden has decreased: corporate profit tax has declined from 23% to 10%; social and health insurance contributions have decreased by 31%; simplified profit tax and local taxes have been reduced by 50%. With the establishment of the National Center for Business Registration, the time for registering a new business shall be only 1 day, from 40 days which was the case before. Likewise, the administrative burden has been reduced up to 40%, with regard to documents and the time for obtaining a license, etc.

However, despite all improvements, the business environment is not yet conducive. Thus, in the case of Albania, there is low scoring for the following: governance and enterprise restructuring score with 2+ points; competition policy scores 2 points; markets and non-bank financial institutions security scores 2- points; and the infrastructure reform scores 2 points⁸⁶. Also, in terms of the business conditions, Albania is ranked 136 among 178 countries, lagging behind other countries of the region⁸⁷. Doing business conditions in Albania are summarized in Table no. 5.

Table no. 5. *Albania's ranking according to some of the Doing business conditions (2007 and 2008)*

⁸⁶ Transition report 2006, Finance in transition, (EBRD)

⁸⁷ Doing business 2008, Country profile for Albania, World Bank

Doing business conditions	Ranking for 2007	Ranking for 2008	Change
Company registration	124	123	+1
Licensing	162	168	-6
Employment	110	109	+1
Property registration	77	82	-5
Borrowing	45	48	-3
Investor protection	165	165	0
Tax payment	138	118	+20
Trade	107	70	+37
Contractual power	76	74	+2
Business closure	178	178	0

The above-mentioned evaluations indicate that the environment for investments and doing business is still difficult, while the improvements in the business climate are slow. A comparison of 2008 with 2007 shows some slight improvements in terms of registration of companies, employment, trade, tax payment, and contractual power, while there is a worsening situation in terms of licensing, property registration and borrowing.

Among the negative phenomena related to the business climate, we can point out the legal steps taken recently for putting in the administrative channel of the reference prices for the estimation: of costs and prices of construction works; of the prices for the sale of apartments, reference wages of employees; customs reference prices, etc, which even though used with the good intention of fighting informality, fiscal evasion, abuse, unfair competition, etc, in truth they severely infringe the economic freedom of the market, creating a suffocating environment for the business, and seriously hampering new flows of private investments, and in particular FDIs.

Allocation of private investments has been the main factor, which has led to intensive changes of the sectoral structure of the economy during transition. For the study of this role, we made use of the data of the economic enterprises sample survey. The scope of this survey was collecting and processing of data

regarding the activity of enterprises in industry, construction, transport, and telecommunications, trade and some other service sectors.

The review of the structure of private investments according to sectors shows that during transition most of these investments have focused on the services sector. Consequently, services has witnessed faster growth compared to other sector, and thus becoming the main factor contributing to the growth of the GDP. During 1990–2005, the activity of this sector has increased 539.7%, whereas its contribution to the GDP in 2004 was 54.6% compared to 12.7% which was the figure for 1990. According to the contribution, services are currently the key branch of the Albanian economy. Within it there is a rapid development of tourism, with several positive developments such as: increased accommodation capacities, doubling of marketing expenses, increased volume of investments, and a satisfactory increase in the number of foreign visitors.

The tendency of priority allocation of private investments in the services sector is the result of not only market demand for services, but also of the interest of private entrepreneurship to invest in this sector where there are high rates of economic return. Between 1999-2003, the average time for investments repayment in the service sector was 11 months, while this indicator for producers of goods was 34 months. Thus, the effectiveness of investments in the service sector was 3 times higher compared to that of the production sectors.

The branch structure of private investments and their effectiveness for each branch are conditioned by the market demand. In the industry sector, private investments account for 37.5% and the repayment schedule is very high at 58.5 months. Within the industry, priorities in terms of investments has the processing industry which has absorbed approximately 60% of the industry investments. The transport and telecommunication have received 38.4% of the private investments, and the repayment schedule is 18.6 months. In the construction industry indicators are respectively 8% and 10.7 months, whereas in trade 16.1% and 6.3 months. Priority branches for private

investments included transport, telecommunication and industry, which have attracted the majority of private investments of enterprises of goods' producers.

The structure of private investments according to its integral elements indicates a prevalence of machineries and equipments, which absorb 39.6% of the investments. For the goods' producers this element accounts for 51.2% of the investments. This is an indication that under the new circumstances of the liberalized market economy, private entrepreneurship must focus particularly on the ownership of up-to-date modern technologies and techniques in order to face the challenges of competition.

4.2. Public Investments

The role of the Government in the economy for a long time now is subject of debate. Regarding this issue there is a great difference of opinion, starting with the suggestion for a very active intervention of the Government in all aspects of the economy, up to the minimization of the role of the Government as a minor regulator instrument. In the last decades, the developed countries and the developing ones are more inclined to support the neoclassic school regarding the role of the government. However, this does not mean that in practice the role of the government has been minimized. On the contrary, in the analyses of the long-term perspective we note that the percentage of the government budget against the GDP of the countries is increasing. However, modern governments' interventions in the markets are different from those of the past governments.

Public investments represent one of the most tangible forms of intervention of the governments in the markets. They contribute to the development of the country, while ensuring the production of public goods, which would have otherwise insufficiently been provided for by the private markets, or not with the appropriate efficiency. Thus, for instance, investments in infrastructure are generally considered as public goods. Public investments become

indispensable even in those cases when private markets fail to ensure efficient allocation of economic resources.

While private investments have introduced a clear increasing trend, public investments show major oscillations, and after 2001 there is again a declining trend. This phenomenon is explained mainly with the reduction of externally financed investments. However, despite this, the Ipr indicator of the public sector in Albania stands visibly above the accepted level of the economies of the region. During 1999-2003, the public Ipr indicator in Albania was 6.42, in Bulgaria and the Czech Republic 3.4, in Hungary and Greece 3.8, in Poland 5.1, in Rumania 3.4, in Slovakia and Slovenia 2.9.

The sectoral structure of public investments shows that investments have mainly focused for financing of infrastructure such as: roads, electricity, telecommunication, water and waste water. For the period between 1999-2005, in the sector structure of public investments, the main position is occupied by the transport sector, which has absorbed 34.3% of public investments. Investments in the water and waste water sector have increased substantially. This sector during 2005 absorbed 15.2% of public investments, while during 1999-2005 only 8.6% of these investments.

The priority of investments in infrastructure became indispensable due to the extreme inherited sector backwardness. In 2005, point scoring for the infrastructure development indicators for Albania looked like this: levels of penetration of fixed telecommunication per 100 inhabitants was 8.6; for the mobile telecommunication was 39.5; internet access per 10.000 inhabitants was 1.7, the electricity household tariff was 6.7 US cent per kwh, the average collection rate for the electricity bills was 74%⁸⁸. According to these indicators, Albania ranks behind other SEE transition countries. Improvements in infrastructure are minimal compared to those in the macro-economic environment, and the policy framework. By the end of 2005 and during 2006, the country faced a severe energy crisis. This was the result of

⁸⁸ Transition report 2006, Finance in transition, (EBRD)

the absence of investments for this sector for a period of more than 20 years, major technical losses due to the old transmission network, under cost prices which lead to the artificial consumption levels of electricity, lack of interest by the private capital for investments in the sector, which currently is a state monopoly, and where prices are lower than the cost is, etc.

The country will continue to show a need for high levels of public Ipr indicator in order to guarantee growth through priority development of infrastructure. Given that external confessional assistance, which until recently was financing the majority of public investments, has fallen substantially since 2001, and it will continue to decline even further, ensuring of sustainable levels of domestic financing for public investments should be an important integral part of the strategy for medium-term fiscal management of the Government. To this end, there will be an increased need for resources of available public resources through expansion of crediting, increased efforts for attracting higher FDI flows, but also through increasing the effectiveness in the use of domestically financed public investments, where there are currently problems and a large spread into a large number of small and very small projects with very high costs. The application of tariffs in line with the costs of public services, improvement of management of state enterprises, and the introduction of regulatory structures for the sectors of infrastructure will also be necessary for promoting the attraction of FDIs in these sectors as well. The creation of industrial parks would greatly benefit the improvement of the business infrastructure.

Even though the sector allocation of investments is done in line with the priorities of the National Strategy for Economic and Social Development, gaps in terms of the procedures for management of public investments only raise more concerns regarding the effectiveness of domestically financed public investments. The attention of the management of public investments is only focused externally financed projects. Domestically finances investments are subject of a minimal evaluation. The procedures for the identification, evaluation and approval of domestically financed projects are less strict than those for externally financed projects etc.

Avoiding the above mentioned gaps requires the introduction of new procedures for the identification, evaluation and management of public investments, with equal application both for domestically and externally financed projects. In this context, the following reform measures are recommended:

- (i) Rationalization of the domestically financed projects portfolio, freeing public investments from maintenance expenditure; merging the large number of small investments into a limited number of major projects, and avoiding projects which are not feasible.
- (ii) Introduction of new procedures regarding revaluation and approval of projects related to the Medium-Term Budget Framework, irrelevant from their financing source.
- (iii) The establishment of the Public Investments Committee, which will be responsible for the review and approval of public investments projects, according to strategic priorities of the Government.

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