

Frederik Çuçllari, Lecturer
Mirela Cini, MBA
„FAN S. NOLI“ UNIVERSITY, KORÇE, ALBANIA.

THE WAY TRANSPARENCY INFLUENCES UPON FOREIGN DIRECT INVESTMENTS (FDI)

The origin of non transparent economic policies

The term transparency of economic policies is a concept that refers to clearness and effectiveness of activities that have influence upon public policies. On the economic literature the discussion about transparency is focused in two main points: corruption and protection of the right of ownership, but the case is more complex as we will try to explain. All the literature is mainly focused on governmental activities and its institutions.

Let's begin considering the transparency case in economy and government policies.

Lack of transparency may have five different backgrounds:

First, economic policies will be evaluated as non-transparent if they are the subject of corruption. The bribe contains illegitimate payment which doesn't become public, even though, the corruption itself is known by everyone. Bribery is not transparent, not only because it is normally illegal, but also because non transparency is considered as „dealing of position“.

The effect of bribery can be described in different ways in economy. Different authors define it differently. Mauro (in 1995 and 1996), who investigated on influence of corruption in government activities explains its destructive effect even upon allocation of incomes and growth of poverty (Gupta 1998). Corruption and bribery have a negative influence upon amassment of capital and can threaten the stability programs supported by International Monetary Fund (Asilis et al. 1999).

These conclusions are emphasized by continuous studies of World Bank and also other researchers.

The second non transparency element is linked with the protection of the right of ownership.

The protection of the right of the ownership is vital for firms, especially for those which want to make new investments and which expect something in return, from these investments. Without these rights there will be no motivation for undertaking the investment and for facing the risk. This may cause serious problems, especially in those countries that have transformation in their institutions and in developing countries, in particular.

The third and fourth aspect of the lack of transparency is linked with the high level of bureaucratic inefficiency within the government and the low abide by the law.

These two factors can put tough barriers for the business. If the quality of governmental services leaves much to be desired then the exhibition of companies upon the risk will be higher. OECD (1997) shows that the bureaucratic inefficiency and weak legislation obstructs the economic activities by imposing increasingly economic costs. Licensing procedures and inability of contract elaboration, as well as enforcement of regulations will shorten the efficiency and effectiveness of the economy.

As a result, the fifth origin of the lack of transparency is linked with the management of economic policies. Economic policies are treated as not transparent if they are subject to continuous changes. These policy changes are harmful, especially when the investors are included. Let's take the example of the privatization in X country in which the government unexpectedly cancels the decisions of previous government for the privatization of the industries of that country. The reaction of foreign investors is negative. Unfortunately this is not a hypothetical case. In each of these countries the term of transparent policy has been suggested as one of the main reasons why the foreign investors have shown considerable care for the investments of the capital.

The transparency case is broader. The bribery and corruption are not the only „privilege“ of the government but in some countries they have „infected“ also the private businesses. Above all, transparency is criticized in institutions that have an important role in the public information, for example, in the case of government credit agencies, private businesses and other institutions. These agencies make a graduating evaluation of credits and have a considerable influence upon the investor's decisions.

International organizations have been the object of public critics recently. After some crises (FMN) has been criticized a lot for the practices of holding some information, as well for giving information to the public very early. As a result of these critics FMN is undertaking policies which depend on economic and financial information for every country, in particular, to see its practices with more transparency.

Why transparency is important for Foreign Direct Investments?

Transparent economic policies are vital for the foreign investments and there are different reasons.

The first reason is that the lack of transparency increases the businesses cost. These additional costs are as a result of the lack of firm's information that they can have through special government departments and different activities of government institutions.

Additional costs are also caused by the corruption which an additional element is identified as mentioned above. In many countries the bribery is illegal. When bribery increases the cost and the risk is increasing, too. For example bribes are evaluated to be around 7% of the incomes of Albanian firms.

This process will bring the selection of the investments because the companies will refuse to make business in countries where the bribes are part of the business. So, the existence of strong lawful measures, as well as, the effective strength will bring to new Foreign Direct Investments.

The second reason is linked with competitive policies. Foreign investors need transparency and protection of the ownership right.

A third argument for the transparency of economic policies is its positive influence upon businesses. Virtually all researchers on businesses show that companies base their decisions of foreign investments in what economists call „essential“.

Such macroeconomic indicators like low inflation for an economic growth and a strong position of the salaries. They include other factors like work force, nature resources, efficiency infrastructure etc. The most important context is that investors need economic policies that minimize the risk of surprises.

Measures for improving Transparency

The needed measures for improvement will change from one case to another. For example, bribery and corruption need totally different measures in comparison with other problems such as bureaucratic inefficiency or the right of ownership. Every non transparency case is to be discussed in separate way.

The reduction of corruption and bribery, some times may need a simple solution only by reducing the interference of government in trade. On the other hand, this may include the reduction of control on prices, the reduction of regulatory government activities, elimination or reduction of license schemes, etc.

Legislation must be sustainable, according to the international approved standards. Foreign investors must protect themselves by nationalism which is one of the worst forms of violation of human rights.

Today, administrative inefficiency stops the direct foreign investments. Many problems can be eliminated by adopting measures which raise the transparency and reduce the arbitrary decisions of government.

Another very important decision is that whether these measures must be according to the national legislation, or the countries must be stimulated by using international obligations. Maybe, both of them are necessary. National legislation is, of course, essential and must insure bases for all the firms and government activities.

Nevertheless, a recordation with foreign investments gives a support to all free trade actors. A law for foreign investments may help and become the legal frame more transparent.

A multilateral effort means a bigger trade, more investments and less corruption. Selowsky and Martin (1997) found out that opening towards trade and more investments have a positive reaction in the reduction of corruption.

Do multilateral efforts reduce corruption?

What we argue in this paper is that multilateral agreements about investments bring the reduction of trade and investment barriers. This means more transparency and less corruption. We are not suggesting that less corruption will influence directly upon the product of multilateral agreements for foreign investments.

Measurement of transparency influences upon foreign direct investments.

The model

Is the transparency important as a factor which influences the decisions about foreign direct investments?

If „yes“ what’s its influence?

Can we evaluate transparency upon foreign direct investments?

Our hypothesis is that non transparency brings an information asymmetry of capital international trades. In the case of non transparency investors will tend a bigger return for compensating the high risk without additional cost, in a way that the flow of foreign direct investments will be different.

Foreign direct investments can’t always have the best terms.

For testing our hypothesis we need to develop a general model about the behavior of foreign investments.

Let’s suppose that the flow of foreign investments depends on the level of transparency, the level of economic activities of the country, the level of interest rate, inflation and the exchange rate in that country, as well as, the level of opening new trades.

Let’s make it easier:

$$(1) \text{ FDI} = f(T, Y, r, i, \text{ER}, \text{TR}, C)$$

T – Transparency

Y – Economic growth

r – Interest rate

i – Inflation

ER – Exchange rates currency

TR – Opening of the trade

C – Country’s model

We expect that transparency, economic growth, stability of exchange rates and regime of opening trades will be positively linked with foreign direct investments. On the other hand, interest rates and inflation rate have an indirect correlation to foreign direct investment.

The mathematical expression of the model is:

$$\text{FDI/GDP} = a + \beta_1 \cdot T + \beta_2 \cdot Y + \beta_3 \cdot r + \beta_4 \cdot i + \beta_5 \cdot \text{ER} + \beta_6 \cdot \text{TR} + \beta_7 \cdot C + \mu$$

Where

μ – is a random variable

It is clear that this model is simplified. For example, here we haven’t mentioned the influence of the different technologies and the internal factors of the country, such as he practices treatment of the corruption.

The evaluation of the above mentioned model may have different technical difficulties. This means that it is rather difficult to separate the influence of some variables.

Albania and the Investments Climate.

The European Commission (2004) offers a number of indicators about the „investment environment“ and analysis them separately for every country, in order to evaluate the situation in the Balkans countries, especially, in the countries of Western Balkans. The results given in the following table which are picked up from an observation of the World Bank realized among 133 countries , including developed and developing countries.

Table Nr.1. Some indicators of the environmental business.

Beginning of business	Employment & day off			Contract implementation			
Nr. of procedures	1-Flexibility of employment	2-Flexibility of days off	of	Nr. of procedures Days and the cost in \$			
Albania	11.0	47.0	33.0	15.0	37.0	220.0	794.0
Bosnja&Her.	12.0	59.0	53.0	31.0	31.0	630.0	260.0
Croatia	13.0	50.0	76.0	31.0	20.0	330.0	305.0
Macedonia	13.0	48.0	65.0	32.0	27.0	509.0	750.0
Serbia	10.0	44.0	51.0	29.0	40.0	1.028.0	200.0
Western Balkans	11.8	48.6	55.2	28.0	29.4	579.5	347.0
ACC-s	9.6	48.6	39.1	34.0	19.4	624.1	69.2
EU	8.3	40.4	59.1	33.4	18.5	235.3	1.073

Resource of information: European Commission, 2004

Note: 1)-The index varies from 0 to 100, where the smaller values show less flexibility. The index of „employment“ shows the contract possibility with part-time and full-time, while the index of „days off“ is focused on the protection of the law towards the dismissing of the workers (bases, procedures, the notification time,, the payment for the holidays, etc).

2) It includes the waiting time between the action and the implementation of the contract.

3) ACCs – Countries which are entering or are candidate for entering in EU: Bulgaria, Check Republic, Hungarian, Latvia, Lithuania, Rumania, Slovak Republic, Slovenia.

The first indicator „The beginning of the business“, measures the number of procedures and days before practicing for the beginning of the activity in a new business. The number of procedures is approximately the same in these countries but the number of days is different. Albania has a good position compared to the average of all Central East European countries, and it is near to the average of EU countries for this indicator.

The indicator of „Employment and discharge“ represents the flexibility of labor trade. Albania is an exception for the high solidification that appears in West Balkan comparing to countries in transition, concerning the high index of employing and discharging from work. The Albanian indicator shows a high flexibility on both indexes.

The third indicator „Execution of the contract“ measures the efficiency of judicial system on the execution of trade contracts. Albania has a short period to wait until payment, but it has considerable procedures that bring higher cost.

Possibilities and stimulus for foreign investments.

In a study of OECD (2003), based on questionnaires, individual meetings, and study of Southeast European countries on „Motivations of foreign investors for investing in Albania“ is written:

„...when investing in Albania, foreign investors take in consideration all the strong and weak point that the country offers them. Asked for their motivation for investing in Albania, almost all the interviewed answered that they try to make a dynamic evaluation of the priorities and weaknesses of the country. They think that priorities of Albania are growing more and more. They believe that the association – stabilization process with Europeans well as the implementation of free trade agreement will improve the situation. (OECD, 2003, pg. 51).

Apart from the difficulties and challenges, Albania is a country that offers many possibilities for foreign investments.

REFERENCES

1. Alesina, Alberto and Weder, Beatrice (1999): *Do Corrupt Governments Receive Less Foreign Aid?*, NBER Working Paper No. W7108, Cambridge, Mass.: National Bureau of Economic Research.
2. Asilis, Carlos et al. (1994): *On Corruption and Capital Accumulation*; Washington, DC.: International Monetary Fund Working Paper 36–94.
3. Brunetti, Aymo and Weder, Beatrice (1999): *More Open Economies Have Better Governments*; mimeo, University of Basel, 1998.
4. Carbough, Robert (1995): *International Economics*; Cincinnati, OH: South Western Publishing Company, 1995.
5. Drabek, Zdenek. (1998): *A Multilateral Agreement on Investment: Convincing the Skeptics*; in J.J. Teunissen (ed.): *The Policy Challenges of Global Financial Integration*; The Hague: FONDAD, 1998.
6. Xhaferaj, Endrita: *Investimi i Huaj Direkt në vendet në zhvillim të Evropës Lindore: Rasti i Shqipërisë*, Banka e Shqipërisë, shtator, 2005.