



International Journal Of
**Recent Scientific
Research**

ISSN: 0976-3031
Volume: 7(4) April -2016

AN ANALYSIS OF FDI EFFECT IN PROMOTING FOREIGN TRADE EXPANSION:
ALBANIAN CASE

Aurel Koroci and Erjona Deshati



THE OFFICIAL PUBLICATION OF
INTERNATIONAL JOURNAL OF RECENT SCIENTIFIC RESEARCH (IJRSR)
<http://www.recentscientific.com/> recentscientific@gmail.com



ISSN: 0976-3031

Available Online at <http://www.recentscientific.com>

International Journal of Recent Scientific Research
Vol. 7, Issue, 4, pp. 10625-10628, April, 2016

**International Journal of
Recent Scientific
Research**

Research Article

AN ANALYSIS OF FDI EFFECT IN PROMOTING FOREIGN TRADE EXPANSION: ALBANIAN CASE

Aurel Koroci¹ and Erjona Deshati*²

¹Head of Department of Economic Sciences, Albanian University

²Department of Economic Sciences, Department Assistant, Albanian University

ARTICLE INFO

Article History:

Received 29th January, 2016
Received in revised form
19th February, 2016
Accepted 25th March, 2016
Published online 28th
April, 2016

Keywords:

Albania, FDI effect, trade growth,
international trade

ABSTRACT

Foreign direct investment (FDI) in developing countries brings economic development and enhances the international competitiveness of domestic enterprises. The entrance of FDI would normally be considered as a prerequisite for the success of the introduction of foreign capital. FDI accounts for the largest and most important proportion of foreign capital in Albania, which undoubtedly plays an important role in the Albania's economic development growth. However, as the country continues to taking various preferential policies to promote foreign investment and the good momentum of Albania's economic development, FDI increases. From this point of view, the study aims to make an empirical research how the FDI has influenced the trade growth of the country. Based on the theory of FDI, this paper through an FDI and foreign trade model tests the correlation between two of them and effect of FDI in Albania's international with data from 1996-2014.

The results of the study showed that there is a positive relation between FDI and international trade in Albania.

Copyright © Aurel Koroci and Erjona Deshati., 2016, this is an open-access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution and reproduction in any medium, provided the original work is properly cited.

INTRODUCTION

Financial and industrial globalization is increasing substantially and is creating new opportunities for both industrialized and developing countries. The largest impact has been on developing countries because they now are able to attract foreign investors and foreign capital. At present, by seeing direct investment as main factor of speeding up economic globalization process, foreign direct investment have presented a number of notable features in Albania: (1) the operation of foreign investment factors increasingly focuses on the larger multinational companies; (2) investment directions are mostly inclined to labor-intensive industries and service related industries; (3) increasing international direct investment has become the link of increase and development of international trade.

The keen interest of FDI within the trade community has been stimulated because they are interlinked in a variety of ways. For the issue that questions if FDI actually partly replaced or made possible creation of a large-scale international trade, the answer depends on the theoretical assumptions and practical tests. From this point of view, this article analyzes the role of foreign direct investment in promoting foreign trade expansion in Albania.

MATERIALS AND METHODS

The objective of this study is to investigate how FDI effects foreign trade development in Albania. We test hypotheses using data collected from Bank of Albania. The data represent annual time series of 1996-2014 FDI utilization and total trade, imports, exports. You can reach data at the Annex part of the study. In the first part of data analysis, the study aims to indicate the correlation between FDI and total trade. In the second part, we continue to verify if FDI promoted the export growth in Albania by positive analysis. In the third part of data analysis we try to examine if FDI can promote the import growth in Albania.

For analyzing FDI effect in promoting trade expansion, the proposed hypotheses are as following:

- H1:** There is a relationship between FDI utilization and the development of foreign trade
- H2:** There is a positive correlation between FDI and export growth
- H3:** There is a positive correlation between FDI and import growth

To get sustainable and statistically important results, the models below have been subject of some econometric tests.

*Corresponding author: **Erjona Deshati**

Department of Economic Sciences, Department Assistant, Albanian University

Descriptive Statistics tests and statistical tests for correlation between variables (Spearman and T Test) are applied.

LITERATURE REVIEW

FDI effects to foreign trade expansion

Relationship between International trade and transnational investment can be seen as early as [Mundell \(1957\)](#). Mundell made a substitution model of trade and investment, in the case of existence of international trade barriers, if an enterprise involves in international direct investment, in basis of relatively high efficiency or low switching costs based on factors of production, it can achieve the complete replacement of the merchandise trade. Vernon's (1966) research on product life cycle theory further developed an idea where he considered that FDI is the alternative to a higher level of foreign trade enterprise behavior. [Kiyoshi Kojima \(1975\)](#) raised the marginal production expansion theory saying that in the external sector, according to some relatively cost advantage, a country should develop a comparative advantage in the industry, correspondingly shall export that industry's products; in International Direct Investment (FDI), the capital flows from investing country shall go to industries with marginal comparative disadvantage industries and because host country due to a lack of capital, technology and management knowledge did not play all the potential comparative advantage in this industry before, so in this way between the two countries widening gap between the cost comparison and so makes better conditions for larger international trade.

For the issue that questions if FDI actually partly replaced or made possible creation of a large-scale international trade, the answer depends on the theoretical assumptions and practical tests. UNCTAD (1999) on the empirical study on relation between FDI inflows and foreign trade performance based on the sample data for 52 developed and developing countries, empirical results show that, in general terms, FDI on international trade has been facilitated. South Korean scholars, [Lim and Moon \(2001\)](#) research also confirmed that, when developed countries make investments to developing countries, if investment is newly established or investment industry is a sunset industry at home country, then between FDI and foreign trade there is a certain positive correlation. China scholars [Xi Junyang, Liu Weijiang \(2001\)](#) using econometric statistical analysis on China's data, pointed out that foreign capital flows associated with higher levels of imports, at early stages there are large foreign imports of machinery and equipment; and at the same time, overall exports of China have a large increase, especially export of industrial products. [Xian Guoming et al \(2003\)](#), [Fan Jiangjin \(2004\)](#) and other scholars also believe that FDI in China has an important role in promoting export trade. Overall, the host country attracting FDI, to a certain extent, promoted the growth of its foreign trade.

Host country's ability to use FDI for international trade expansion

The results show that the implementation of open policy and the development of a country's foreign trade is conducive to the promotion of economic development. We can check from the three components which make national economy demand, except that part of domestic demand (consumption and

investment), there are some external demand (net exports). Net exports regarded as part of country's gross domestic product, when it increases brings increase in the national disposable income, more funds can be used to expand production line; a country by using its export sector can improve other industries through input-output links effect, pass the impact of export expansion to other industries; export trade expands the scope of the market, so domestic production can be consumed out of the domestic market and so can overpass restrictions on market size. With increasing returns to scale industries can achieve economies of scale, at the same time, expansion of market promotes technological innovation; export trade also promotes development in country's resources and uses them without restrictions on the domestic market. [Kiyoshi Kojima \(1975\)](#) first studied the relationship between FDI and host country foreign trade to make complementary relationship model, the model shows that: (1) FDI is not only the international flow of capital but also includes multinational companies' technology and management knowledge transfer. FDI brings not only the funds needed to host economic development, but also brings advanced technology and business management business knowledge; (2) Based on FDI capital, technology and business management knowledge will pass from local branches of multinational corporations in host country's local firms so it produces a positive "spillover effect", making the host country related industries and enterprises to have significant improve in production technology and management experience which finally will create many new trade opportunities and promote the development of the host country's foreign trade.

DATA ANALYSIS

The correlation between FDI utilization and the development of foreign trade

Theoretically, there is a positive correlation between FDI utilization and the development of foreign trade: because general multinational investment in the host country always with a majority of processing elements, and then export the finished products. According to the data from Bank of Albania, from 1996 to 2014, the total imports and exports in Albania has increased from 513 million to 5.6362 billion (euro), the total trade got nearly 11 times increasing during 10 years. We use the annual time series data of 1996-2014 FDI utilization and total trade, imports, exports to conduct a Spearman rank correlation test, the result indicated that the correlation coefficient of FDI and total trade is 0.932, for FDI and exports is 0.956, and for FDI and imports is 0.947, this also confirmed the mutually reinforcing relationship between FDI utilization and foreign trade of Albania.

Tab.1 The correlation test on FDI utilization and the foreign trade development in Albania

			Total trade	Exports	Imports
Spearman's rho	FDI	Correlation Coefficient	.932(a)	.956(a)	.947(a)
		Sig. (2-tailed)	.000	.000	.000

Note: Correlation is significant at the 0.01 level (2-tailed).

FDI effects on export growth in Albania

The analysis in first part of this section indicated that FDI and total trade has a very high correlation. In this part, we will

continue to verify if FDI promoted the export growth in Albania by positive analysis.

The empirical equation as follows:

Take the total exports in Albania as explained variable, and FDI as explanatory variables, get the regression model:

$$LN(AL_EX) = \alpha + \beta LN(AL_FDI) + \varepsilon$$

α , β are the coefficient of constant and explanatory variables, ε is the random error term.

Using the annual statistic data from CEIC, BANK OF ALBANIA, 1996-2014, the regression results as follows:

$$LN(AL_EX) = 1.03 + 0.94LN(AL_FDI) \quad (1.39) \quad (6.27)$$

The R^2 in the regression equation is 0.69, adjusted R^2 equal to 0.68, the regression coefficient has already passed T test, the equation is well fitted in total. The variable coefficient suggested that if the FDI increase for 1%, the exports will increase 0.94%. The result shows that FDI has promoted the exports growth in Albania, improved the export capacity of Albania.

Annex

Annual time series of 1996-2014

Year	Exports total (euro mn)	Imports total (euro mn)	FDI (euro mn)	Foreign trade total (euro mn)
1996	79.61	54.72	19.5	134.33
1997	132.96	41.46	30.2	174.42
1998	84.04	48.44	41.7	132.47
1999	110.33	131.20	45.3	241.52
2000	136.59	228.27	56.9	364.86
2001	95.99	417.07	78.2	513.06
2002	85.61	293.35	97.3	378.96
2003	62.97	244.45	138	307.42
2004	263.68	1,139.51	185	1,403.19
2005	261.48	1,090.84	152.5	1,352.32
2006	304.93	1,330.70	207.3	1,635.63
2007	330.28	1,503.72	135	1,834.00
2008	447.93	1,864.06	178	2,311.99
2009	605.21	2,308.85	341.8	2,914.06
2010	658.22	2,618.05	264.5	3,276.27
2011	797.72	3,058.49	306.7	3,856.21
2012	1,077.58	4,187.51	389.4	5,265.09
2013	1,354.83	5,250.60	343.9	6,605.43
2014	1,087.92	4,548.28	305.6	5,636.20

Source: Bank of Albania

FDI effects on import growth in Albania

There is one famous theory in classical FDI theories, which is called comparative advantage theory, if there is a competitive advantage in natural resources in the host country, FDI go into the country and make use of this comparative advantage, and then import some semi-manufactured goods (processing), finally export the finished goods to other countries or areas. During this process, the problem of FDI improved the imports is involved.

In recent years, the scale of FDI utilization is extending in Albania, and with the policies for taxes relief for the FDI

enterprises on imported equipment, the imports of Albania increased in a very fast speed.

In this part we make use of the related data, try to examine if FDI can promote the import growth in Albania.

Our empirical equation is following

Take the total imports in Albania as explained variable, and FDI as explanatory variables, get the regression model:

$$LN(AL_IM) = \alpha + \beta LN(AL_FDI) + \varepsilon$$

α , β are the coefficient of constant and explanatory variables, ε is the random error term.

Using the annual statistic data from CEIC, BANK OF ALBANIA, 1996-2015, the regression results as follows:

$$LN(AL_IM) = -1.68 + 1.69LN(AL_FDI) \quad (-2.67) \quad (13.25)$$

The R^2 in the regression equation is 0.91adjusted value equal to 0.90, the regression coefficient has already passed T test, the equation is well fitted in total. The variable coefficient suggested that if the FDI increase for 1%, the imports will increase 1.69%. The result indicates that FDI has improved the imports growth, that is to say, the export increasing in actual fact is processing trade, by importing Semi-manufactured goods and then export to other countries in south-eastern Europe.

In short, the above-mentioned empirical has confirmed that FDI introduction indeed improved the international trade capacity of Albania.

CONCLUSIONS AND RECOMMENDATIONS

Relationship between international trade and transnational investment can be seen as substitution model of trade and investment, in the case of existence of international trade barriers, if an enterprise involves in international direct investment, in basis of relatively high efficiency or low switching costs based on factors of production, it can achieve the complete replacement of the merchandise trade. Overall, the host country attracting FDI, to a certain extent, promoted the growth of its foreign trade.

This study reflects a theoretical and empirical point of view about the role of FDI in promoting foreign trade expansion.

Proposed hypothesis **H1, H2 and H3** are supported.

After analyzing the data collected from Bank of Albania concluded these findings:

Conclusion 1: There is a reinforcing relationship between FDI utilization and foreign trade of Albania. FDI and total trade has a very high correlation.

Conclusion 2: FDI has promoted the exports growth in Albania, improved the export capacity of Albania.

Conclusion 3: FDI has improved the imports growth, that is to say, the export increasing in actual fact is processing trade, by importing Semi-manufactured goods and then export to other countries in south-eastern Europe.

Conclusion 4: The above-mentioned empirical has confirmed that FDI introduction indeed improved the international trade capacity of Albania.

Conclusion 5: Albania's trade relations are depending on the EU in a large extent.

Recommendation 1: In order to stimulate economic development, Albania should pay particular attention to improving the business environment by implementing regulatory reforms and adopting the new bankruptcy law.

Recommendation 2: Albania needs to diversify its economy and improve productivity by attracting foreign capital into tradable sectors among other things.

Recommendation 3: Additional efforts should be made in order to achieve economic integration with EU.

References

1. Almeida and Kogut, 1999, The Localization of Knowledge and the Mobility of Engineers in Regional Networks, *Management Science*, Vol.45, pp.905-917.
2. Aurel Koroci, "Is the China's FDI excessive? –Based on the empirical research of crowding-out (into) effect", International Conference, Tirana, Albania, May 2008, First Volume, pg 79.
3. Athukorala P., J. Menon, Developing with Foreign Investment : Malaysia, *The Australian Economic Review*, 1995,(1):9-12.
4. Arrken Brian J., Ann F. Harrison, Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela, *American Economic Review*, 1999, (89): 232-237.
5. Aitken, B. And A. Harrison, Are There Spillovers from Foreign Direct Investment? —Evidence from Panel Data from Venezuela, mimeo, MIT and the world bank, 1991, Nov.
6. Blomstrom, M. and Persson, H., 1983. Foreign Direct Investment and Spillover Efficiency in an Underdeveloped Economy: Evidence from the Mexican Manufacturing Industry. *World Development* 11,493 - 501.
7. Borensztein E., Gregorio J.D. and Lee J—W, How does Foreign Direct Investment Affect Economic Growth, NBER Working Papers 5057, National Bureau of Economic Research, 1995.
8. Borensztein E, J. De Gregorio and J. W. Lee. "How Does Foreign Direct Investment Affect Economics Growth?" *Journal of International Economics*, 1998, Vol. 45: 115~135.
9. Blomstrom, M.and Wolf, E., 1994. Multinational corporations and productivity convergence in Mexico, In W. Baumol, R. Nelson and E. Wolff, editors, *Convergence of Productivity: Cross-national Studies and Historical Evidence*, Oxford University Press.
10. Markets [J]. *Economica* 1974, Vol. 41, No. 162: 176 - 193: 176 – 193
11. Constantinos Alexiou, Doriana Toro, FDI Revisited: Empirical Evidence from Transition Economies - Case of Albania, *Zagreb International Review of Economics and Business*, 2006, vol. 9, issue 2, pages 59-94
12. Dyer and Singh, 1998, The Relational View: Cooperative Strategy and Sources of Inter organizational Competitive Advantage, *Academy of Management Review*, Vol.23, pp.660-679.
13. De Mello Luiz R. Jr., Foreign Direct Investment led Growth : Evidence from Time Series and Panel Data, *Oxford Economic Papers*, 1999, (51):133-151.
14. Damijan Joze P., Boris Majcen, Mark Knell and Matija Rojec, The Role of FDI, Absorptive Capacity and Trade in Transferring Technology to Transition Countries: Evidence from Firm Panel Data for Eight Transition Countries, UN Economic Commission for Europe, Geneva, 2001.
15. Domar, Capital Expansion, Rate of Growth and Employment, *Econometric*, 1946, 14 : 137—147.
16. Dimitri G. Demekas, Balázs Horváth, Elina Ribakova, Yi Wu," Foreign direct investment in European transition economies—the role of policies", *Journal of Comparative Economics* 35 (2007) 369–386.
17. Hymer S.H., the International Operations of National Firms: A Study of Direct Foreign Investment, Cambridge, MA : MITPress, 1976.
18. Harrod, An Essay in Dynamic Theory, *Economic Journal*, 1939, 49 : 14—33.
19. Haddad, M A. Harrison. Are There Positive Spillovers from Direct Foreign Investment? Evidence from Panel Data for Morocco [J]. *Journal of Development Economics*, 1993, 42:51-74.
20. Irina Tytell, Ksenia Yudaeva, Role of FDI in Eastern Europe and New Independent States: New Channels for the Spillover Effect. WORKING PAPER December 20, 2005.
21. Lim Sung—Hoon and Hwy—Chang Moon, Effects of Out—ward Foreign Direct Investment on Home Country Exports: the Case of Korean Firms, *Multinational Business Review*, 2001, Spring.
22. Lutz, Raymond. "The United States Direct Investment in Canada and Canadian Capital Formation, 1950-1962." Unpublished Ph.d. Dissertation, Harvard University, 1996.
23. Miao Wang, FDI and Domestic Investment: Crowding in or Crowding Out ? Photocopy, 2004.
24. Mundell R.A., International Trade and Factor Mobility, *American Economic Review*, 1957, Jun, 47:321-335.
25. Manuel R. Agosin and Ricardo Mayer: Foreign Investment in Developing Countries Does it Crowd in Domestic Investment? No. 146, February 2000, JEL classification: E22, F21, F23, O16.
26. Albania Progress Report 2015 http://ec.europa.eu/enlargement/pdf/key_documents/2015/20151110_report_albania.pdf

T.SSN 0976-3031



9 770976 303009 >