

# Albanian Industry Problems and Perspectives, in Front of the Crisis and International Labor Allocation

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## ABSTRACT

Recently the Albanian economy has continuously recorded a significant reduction of the GDP growth rate, from 7.5 % in 2008 to 1.3% in 2013. This decline is followed by the deficit and public debt increase, where the latter reached in 70.4% in March 2014, compared to 59.9% in 2009. The interesting fact to note is that, although the 2008 financial crisis first was initiated in USA, it has influenced the economic development of all the countries. While our country that was indirectly affected by the crisis has experienced a substantial decline of remittances, significant reduction of FDI, and shrunken labor market dynamics even in those activities that generated employment at a large extent although under the legal and vital minimum wage such as fasson or call-center services, which has directly affected unemployment growth and domestic consumption reduction.

This paper aims to provide an analysis of the Albanian economy from two main aspects, both macroeconomic and microeconomic. In the first part it will be discussed recently Albania's economic performance and the main factors affecting its growth in the long term. While in the second part it will be discussed Albanian productive structure, analyzing the changes of export structure of Albania, its production specialization, speaking about labor intensive sectors and their impact on the domestic economy.

*Keywords:* foreign trade, economic development, commercial specialization.

## 1. The Problems of Albanian Industry and its Transformation in Post- Transition Period.

Like every other post-comunism country, the economic structure of Albania was radically transformed with the liberalisation of prices and markets during '90. The transition process resulted to a new restructuring of country's economic structure. The industry in the 90s constituted 58.4% of GDP; in '95 the percentage decreased in 19.6%, while it touched its historical minimum at about 7.8% in 2000. Meanwhile agriculture in the 90s accounted for 25.1% of GDP, and in '95 it reached 36.2% of GDP<sup>1</sup>. According to Stieglitz, the path from a planned to a market economy was even more harder from the initial prediction (Stieglitz, 2002).

Market liberalization in the early '90s was followed by a strong increase of market prices. To face this increment, the Government was forced to raise wages fostering in this way

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<sup>1</sup> Statistical annuals, 1945-1990, INSTAT, Albania

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the inflation with dramatic consequences for the country<sup>2</sup>. According to International Monetary Fund the export declined by 50% in 1992. Stabilization program prepared by the World Bank and IMF had a strong monetarist trace as its primary target was inflation stabilization<sup>3</sup>. A further significant reform in that period was that of mass privatization and full market liberalization.

According to Sachs market liberalization was important to face the massive licensees and other social costs (Sachs, 1990). While according to Blanchard, privatization of public enterprises was very important for the development of a communist country (Blanchard et. al 1991). While Stieglitz adds that rapid privatization would improve public balance and generate revenues for the country (Stieglitz, 1992). Later it became clear that the stabilization and liberalization of the economy, associated with restrictive monetary policy, market liberalization, trade openness all accompanied with the privatization of all public industry within a few years, moreover with a lack of private investors class, was almost impossible.

For the economic development of Albania, WB decided to apply the Harrod - Domar model<sup>4</sup>. Once there was a lack of financial capital to invest and privatize public enterprises, foreign investors were invited<sup>5</sup>. However, the final result was not the expected one; initially the securities were distributed which gave no result in the long term. According Angjeli privatization process failed, due to the lack of reputable buyers and also as a consequence of compromising the privatization auctions (Angjeli, 2007). While Stieglitz adds that privatization does not help the economy if it is not associated with significant institutional reforms. He argues that privatized enterprises need to be restructured, and also need advantageous fiscal and monetary reforms that encourage investments (Stieglitz 1999). Mc Dermott (2002) has shown that privatizations in Czech Republic are also problematic because the governments have not able to attract investors.

A part of public enterprises in Albania were privatized by those who worked there and the managers who were unable to draw up medium and long term strategies (King, 2003). While the other part had a huge lack of financial capital, backward technology or were damaged and stolen over time. This made even more difficult their functioning in the future (Kule et. al 2002). Finally the failure of privatization process brought a significant reduction of industrial sector, as can be observed from the chart below.

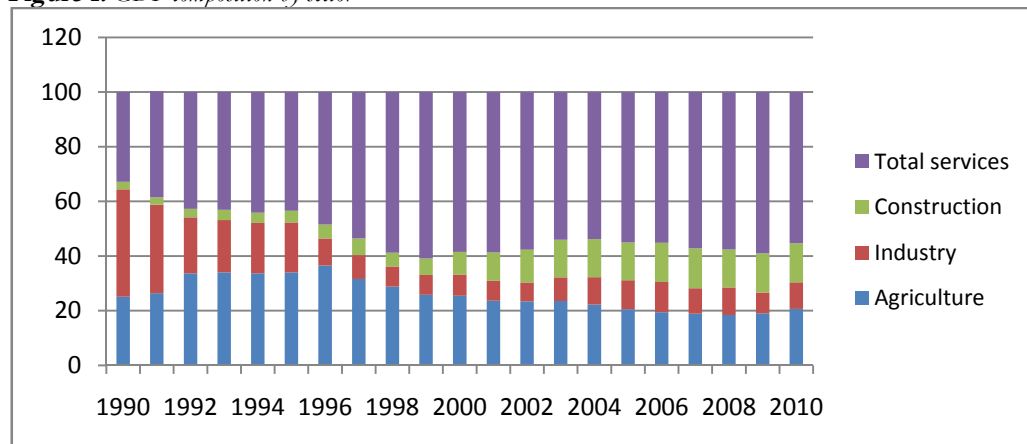
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<sup>2</sup> It is necessary to mention that monetary policy was newness for Albania at that time, the interest rates was firstly reviewed in November 1991.

<sup>3</sup> W. Easterly, *The non- reached Development*, Bruno Mondadori, Milano, 2010, pg.38.

<sup>4</sup> ITEM, pg 39.

<sup>5</sup> Law no. 7406 and 7407 for Foreign Investors' Protection.

**Figure 1.** GDP composition by sector

Source: *World development Indicators, 2013*

As it can be seen from the graph, Albania in the early '90s had a considerable increase of agriculture in the total GDP. After the 7501 reform that transformed state cooperatives in small private activities, which on one side improved the standard living of families as they managed to produce the minimum vital for surviving<sup>6</sup>, and on the other side it is noted a change in agriculture production, therefore a significant reduction of Albanian traditional products like cotton, sunflower, potatoes, sugar-beets, which had a negative impact on trade balance. According to Ancone privatization of state farms has led to improved living conditions and has positively affected mass emigration restriction. Another feature of the Albanian economic structure at this period is the level of private consumption as can be seen from the following table.

The majority of consumption consists mainly of primary goods consume or more precisely about one half of the total consumption are food products<sup>7</sup>. This shows once again the difficulties of Albanian economic system not only in terms of production structure (supply) but also from the standpoint of demand, which in the short term would not have significant modification as a result of the internal market but severe lack of domestic consumption.

<sup>6</sup> D. Soto, H. Gordon, P. Gedeshi, I. Sinoimeri, Poverty in Albania, A qualitative assessment, World Bank, Washington DC, 2002, p.11 e p.12.

<sup>7</sup> INSTAT, Figures by theme, GDP by expenditure approach, 2014.

**Table 1:** Consumption per capita in Albania and some Balkan countries, 1990-2012 in \$

Year	Albania	Greece	Macedonia	Montenegro	Serbia
1990	464	6692	945	2602	3039
1991	434	7124	948	2110	2896
1992	696	7923	903	1783	2104
1993	615	7360	1011	974	1445
1994	561	7851	1320	1006	1574
1995	655	9089	1627	1447	1704
1996	958	9574	1620	1059	1837
1997	690	9046	1355	1011	1711
1998	752	8993	1292	1029	1718
1999	844	9134	1278	1031	1114
2000	847	8009	1316	1129	905
2001	883	8263	1162	1422	1266
2002	1011	9342	1398	1634	1733
2003	1328	11965	1778	2121	2139
2004	1772	14046	2061	2439	2412
2005	2003	15215	2201	2597	2553
2006	2170	16466	2436	3404	3103
2007	3001	19246	3004	5178	4064
2008	3484	22286	3764	6624	5034
2009	3047	20905	3379	5654	4371
2010	2825	19442	3330	5484	4115
2011	3171	19426	3707	5958	4673
2012	2973	16449	3419	5475	4004

Source: Ivan Kusbnir's Research Center, 2014

Facing this situation, Albania after the 90s had to rebuild the country's economy which had touched the end, to reduce the level of unemployment with alarming figures<sup>8</sup> which at the same time was the most social important objective. Another important problem was the extremely overused infrastructure and beyond any standard. Another huge problem was the trade balance. The country was in a vicious circle and in order to pay for the imports, had to export more; but this was hard to be realized due to the lack of production capacity, technology and culture.

### 1.1 Last years economic performance of Albania

After the financial collapse of '97, created as a result of the Ponzi<sup>9</sup> pyramid scheme, with huge consequences for Albania, about 1300 people were killed and

<sup>8</sup> 1/3 of labour force resulted unemployed in the early of 90s, while in 2000 the level of unemployment was 16.75% according INSTAT, 2014.

<sup>9</sup> A fraudulent investing scam promising high rates of return with little risk to investors. The Ponzi scheme generates returns for older investors by acquiring new investors.

hundreds thousands of families lost their savings, which were valued at around \$ 1 billion, while the country's GDP in that year was only 2.3 billion dollars (Jarvis, 1999). Albania began a new phase of development where economic growth averaged about 5% per year, reached its higher level in 2008 when this figure was 7.5%. Later on this growth began to fall to 3.3% in 2009 and reached 0.7%<sup>10</sup> in 2013. In the same period it is also noted the increase of investment to GDP ratio which from 25.4% in 2003 reached to 33.4% in 2009. After that, a progressive decline of this ratio is observed reaching 23.4% in 2013<sup>11</sup>. During 2003 -2009 it is noticed a considerable increase not only of GDP level but also a fast growth of construction sector. Somehow in this period it is observed the first steps of Albanian trade specialization in labor-intensive sectors. From one part this phenomenon has a positive impact, as it is noted a progressive increase of labor demand in labor-intensive sectors (especially in fasson and construction sector which uses a significant amount of labor force recording a significant increase of production), however the wages in these economic sectors has been stagnant and income distribution in these sectors only goes in the interest of entrepreneurs.

As it is mentioned above, 2008, has been a golden year for the Albanian economy. In this year the aggregate demand for consumption went from 9.5 to 11 billion dollars and investments from 4.1 billion reached 4.7 billion dollars. After 2008 all the economic parameters has worsened, where prevails a considerable decline in consumption which was 9.4 billion dollars in 2012, while investments fell to \$ 3.9 billion<sup>12</sup> in this year. Regarding economy crediting and its growth over the years, it is noticed that in 2008 the lending level rose significantly and reached a surplus of 102 billion ALL, which is the higher surplus in these 23 years. Later on the pace of credit growth falls dramatically: in 2009 the increase is only 44 billion ALL, while in 2013 the growth is negative, thus we have a decline of 7 billion ALL, reaching the value of 548 billion ALL (Meksi, 2014). A paradox figure is also the growth of employment during 2009-2013, where the number of employees rose by 49,092. In this period the employment growth in the non-agricultural sector was only 0.12% for 4 years while real GDP growth has been 2.3 %. Thus, we can certainly say that the Okun law finds no application in Albania<sup>13</sup>.

In conclusion it can be said that Albanian economy after 2008 began to have an inversion of economic growth tendency therefore, a considerable reduction of growth rate. It is worth mentioning that during this period all developed countries were "infected" by economic and financial crisis firstly emerged in America. Albania unlike other countries, felt the crises effects after 2 years.

## 1.2. Global economic context and the economic crises consequences in Albania

During 2003-2008 the Albanian economy grew at high rates, at about 6% per year<sup>14</sup>. Low costs of labor force, lower taxes and favorable geographical position, made Albania an attractive country to foreigners. In this period a significant increase if FDI is seen, where in 2010 they reached the amount of 789 million Euros<sup>15</sup>.

<sup>10</sup> Bank of Albania, financial account in euro, 2013

<sup>11</sup> Word economic outlook database, 2013

<sup>12</sup> Ivan Kushnir's Research Center, GDP by expenditure approach, 2014

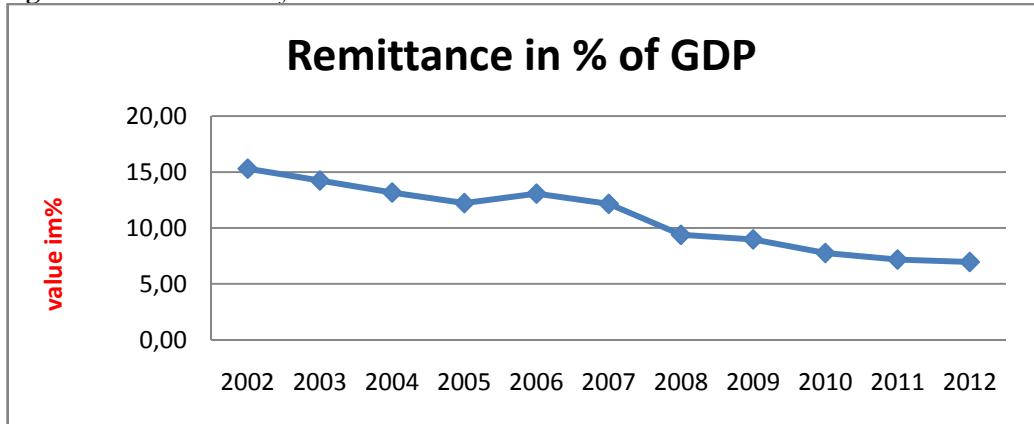
<sup>13</sup> A law proposed by A.M. Okun in 1962 where is stated that an increase of unemployment by 1%, would cause the decrease of GDP by 2%.

<sup>14</sup> INSTAT Albania, Real Sector Statistics, GDP, 2014

<sup>15</sup> Bank of Albania, Current Account in Euro, 2014

As global economic-financial crisis emerged, the Albanian economy began to lose year after year its economic growth rates. In 2009, the growth rate was only 3.3 %, while in 2010 due to the government intervention, the economic growth reached 3.8%, but after this year economic growth rates began to fall significantly. Before we analyze this fall, initially we will mention emigrants' transfers which in 2007 captured a record level of 719 million Euros, i.e. about 13.7 % of GDP. While after this year, as the chart below shows, it is noticed a drastic decline, because only in the first 9 months of 2013, there is a decrease of 32% compared with a year ago, i.e. about 349 million Euros less.

**Figure 2.** Remittances in % of GDP



Source: Bank of Albania, 2014

The first explanation for this severe decline comes from the fact that after 20 years the emigrants began to “cut the relationships” with their motherland, and another other important factor remains the economic crises that the neighbor countries like Greece or Italy are experiencing, where the major part of Albanian emigrants live in these countries. Nearly one fifth of the Albanian population, or about 0.75 million Albanians live abroad as emigrants. Other estimates, calculate this figure from 0.8 to 1 million<sup>16</sup>. The decline of remittances has negatively affected not only the GDP shrunk but also the consumption reduction. According to a report by the International Organization for Migration is cited that 68% of Albanians send remittances to their families and only one part of it goes for consumption. A drastic decline of remittances has negatively affected the consumption reduction (IOM, 2005). The same thing has happened with investments in the construction sector, a very important sector for country's economy. (In 2008 about 15% of GDP consisted precisely from this sector). After 2008 this sector began the decrease. During 2009-2011, this sector had a shrinkage of 21.1%, which was directly followed by a decline in the number of employees in this sector<sup>17</sup>.

According to a report issued by the Bank of Albania, the sector of construction is in big difficulties<sup>18</sup>. Remittances fall and economic crisis were accompanied by a blockage of apartments market where only in Saranda district according to unofficial sources are

<sup>16</sup> Barjaba 2004: INSTAT Albania, annual report of 2002

<sup>17</sup> Bank of Albania, the results of Business and Consumer Survey, November 2011, pg. 7.

<sup>18</sup> Bank of Albania, The results of Business and Consumer Survey, December 2012, pg.6.

counted about 5,000 unsold apartments. The same phenomenon is happening in Tirana market even though there is a price fall that goes up to 25%<sup>19</sup>.

To summarize, if we analyze the Albania's trade balance by country it is noticed that Italy is our main partner. In 2008 from 1,356 billion that was the total export of Albania, 836 million dollars was the export towards Italy (61%) and 120 million (8%) in Greece. Whereas in 2012 exports toward the Italy reached the value of one billion dollars although in total it is noticed a reduction of the export shares to this country which reaches 51 % of the total. Meanwhile the Albanian exports to Greece have fallen sharply, from 84 million dollars in 2010 to 87 million in 2012<sup>20</sup>. Thus, two main trade partners of Albania, Italy and Greece are among the countries most affected by the financial economic crisis and currently are heavily immersed in the economic recession. This of course has a negative impact on Albanian exports.

## 2. Economic Development, Employment and the Challenges Ahead

According to Garofoli, the role of investments in an economic system is to guarantee the increment of economic efficiency and productivity of work (i.e. to raise wages, life quality) and among all, to create the necessary conditions for changing the economic structure, realizing a new strategic vision that revitalizes production sectors with a wider use of technology (Garoffoli, 2014). After the political elections of 2005, the new government asked for a rapid polarization of the economy towards those sectors that reflect the comparative advantages of Albania, rich in raw materials, with a perfect geographical position (exit in the Ionian and Adriatic Sea) and very competitive salaries. At the same time, a series of reforms has been undertaken, where prevails the fiscal one in 2008 with the 10% flat tax, that intended to positively affect foreign investors attraction<sup>21</sup>. In fact after 2008, it is noted a significant increase of investments which had as primary objective the increase of production, employment and export growth. Indeed, if we take a look at the following table the figures don't support the mentioned objective. Thus, the growth of FDI has not significantly impacted neither employment nor the increase of exports. With almost 3 billion Euros that have been invested during the last 5 years, the change in employment was only 53,484 persons<sup>22</sup>.

**Table 2:** FDI, export and employment, 2008-2013

Year	2008	2009	2010	2011	2012	2013	2008-2013
FDI in billion euros	610	689	789	716	727	730	3041
Export in billion ALL	112	104	161	197	213	246	921
Employment	901708	905088	904210	925242	958474	955192	53484

*Source:* E. Meksi: "The economy, a difficult equation. How to stimulate the economic growth in the crises vortex. The development and perspectives of Albanian economy, Pavia University, 2014. INSTAT Albania 2014.

<sup>19</sup> Bank of Albania, Annual Report 2011, pg 56

<sup>20</sup> Bank of Albania, External Trade Statistics, 2014

<sup>21</sup> See G.Fehlinger in: At least 7 reasons for saving Flat tax in Albania, [www.ekon.al](http://www.ekon.al), 2013

<sup>22</sup> INSTAT Albania, Total employees according sectors, 2014

The employment growth in these five years was not only impacted by investments, which have been mainly in the form of public enterprises privatizations. It is important to mention here the privatization of ARMO in 2009 by an Albanian businessman while initially was proclaimed as an enterprise from Texas. Moreover the contract planned 240 million euro of investment in the coming years while no investment was made and the Albanian investor went bankrupt<sup>23</sup>. Another similar case was that of four hydropower plants purchased by KURUM with 110 million euro while it owed to the government a great part of this amount as unpaid VAT, without forgetting that these hydro plants had an annual profit of about 30 million dollars per year<sup>24</sup>. So the two aforementioned privatizations although were accounted as foreign investments they didn't produced any growth or employment, or increased production, therefore they resulted FDI with zero result.

## **2.1. The economic policy interventions**

In the mentioned period the main objective of the economic policy was to increase foreign direct investments in the belief that this will automatically generate positive effects such as market competitiveness increase and exports increase. The model of Albanian economic development is based on: the development of labor intensive sectors, the production of goods relatively standardized by price competitiveness (Muco, 2013; Kota, 2009) and concessions granted in mining, oil or hydropower construction. Albania is a country with a very low cost of labor force and with a high unemployment level. This positively affects output growth without the possibility of salary's increase. Here the question is about the fasson sector. It is actually a very important sector for the Albanian economy that generates about 40% of Albanian exports in 2013 while in 2010 this sector accounted for about 50% of Albanian exports<sup>25</sup> by about 110,000 employees. The new government has taken recently a series of measures for the promotion of this sector which will revitalize the economic activity of the country and will certainly have positive effects on the entire economy. But if we consider the salaries in the sector which are about 130 dollars per month, for sure this sector employees poor strata of the population, those who have no other opportunities in the labor market. The wages are under the legal minimum and they do not stimulate consumption and above nothing is left or nothing goes for the Albanian economy because only one production process is conducted and product goes back outside, i.e. is re-exported. The effects are very limited. Moreover, Albania is a country that does not produce raw materials for this sector and the prospects for development in the future are comparatively low especially if the country won't specialize in other processes of this sector and if Albanian brands will not be promoted.

The economic policies both of the previous and current government have always been oriented by those policies that support employment and public acts, as long as in Albania dominates Keynesian thought. In Albania these policies have often generated expansive effects with consequences for the country. Here the question is for Albania's economic policies after the beginning of the global crisis in 2007 where the government began to stimulate the economy through public investments, through public debt (Meksi, 2013).

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<sup>23</sup> ME'TE. 2013

<sup>24</sup> Ministry Of Finance, 2013

<sup>25</sup> <http://acit.al/attachments/article/88/ACIT%20Trade%20Report%202010.pdf>



In the report of the third quarter of 2013, published by the Ministry of Finance, it is noted that Albania's public debt has increased by 435 million Euros, reaching 62.6 %, while currently with the new government arrival and the accounting of the "hidden debt" that the government owed to private businesses, the debt reached 70.4% of GDP<sup>26</sup>. On one side this has stimulated the employment of individuals and improved infrastructure, but on the other side, it is surprisingly increasing the cost of public debt and has led, to a non affordable risk for the government. To summarize, another case of the economic policy failure are the concessions granted, with the idea that these concessions would increase investments, employment and the technology used, but in fact they only have served to use in a macabre way the underground without any vision for the future.

## Conclusions

In conclusion we can say that the reforms undertaken in the 90s did not give the expected effects. Albania's economic transformation proved to be more difficult than was previously thought. As a result Albania is experiencing an utopian transition without knowing where the end is. The reforms undertaken during 2003-2007 gave some effects and increased the flow of FDI, although they mostly were not like Greenfield investments and had no impact on employment growth. Even though in this paper there is no detailed analysis, we can say that the implementation of the *flat tax*, in addition to the other positive effects of FDI contributed positively to the reduction of informality. Public debt has positively contributed to GDP growth in Albania even though this debt was often used for infrastructure investments that fail in some way to recovery immediately their cost.

The economic development model applied in Albania, the Harrod – Domar model, was a model that functioned for short economic cycles and rich countries and not for a poor country that requires a balanced economic development. Currently like Hirschman says, the development is entirely an institutional issue, i.e. a change of development strategies is needed, the orientation of the economy towards exports and a reorganization of the current economic structure, focused on new sectors which generate sustainable employment, like the fasson sector which generates employment although it has an insignificant impact on the country's economy.

It is assumed that in Albania domestic brands will be developed in the future and this production will be oriented for domestic consumption. Today another problem of our country is the level of remittances. They have positively stimulated the country's economy and reduced poverty. Currently, remittances are falling year by year; therefore it is necessary to find out the proper way to substitute them and their effect. To conclude, it can be said that recently the main objective of the economic policy has been the increase of foreign investments believing that they will automatically generate positive effects in market competitiveness increase and exports growth. The model of economic development of Albania is based on Labor intensive sectors development, in the production of relatively standardized goods and price competitiveness. Albania's economic development and its challenges in the future will be the increase of production that will generate employment, reduce imports and attempt to improve the trade balance.

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<sup>26</sup> Ministry of Finances, 2014

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