THE COMPETITIVENESS ENVIRONMENT IN ALBANIA

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INTRODUCTION

The world economy has recorded a high pace of growth over the recent decades, preceded by an even higher pace of world trade growth. Along with technological developments, the reduction of trade barriers and liberalization trends, triggered also by the globalization and integration developments have had a strong impact on the high pace of world trade. During the past 20 years, the average annual growth rate of world trade has been 6%, i.e. twice as high as the world output growth rate. Developing countries have been experiencing high growth rates of international trade as well. Their volume in world trade has reached to 1/3, starting from ¼ in the early 70-s. Processed products export from these countries has grown significantly, taking up 80% of their overall export volume.

Where does Albania stand against this general development background?

Albania is intensively involved in the regional and European integration processes. In the context of fulfilling its commitments as a member of WTO and Free Trade Agreements with regional countries, foreign trade is moving quickly towards liberalization. Though, foreign trade indicators are not really encouraging.

Over the past ten years, while the GDP annual growth rate has averaged 6.8%, the trade volume has grown by approximately 13%. The situation concerning exports is even more discouraging. The export/import ratio has averaged 25.5%, causing a strong trade deficit. Exports also suffer the domination of actively processed products, which provide a relatively low added value (chiefly clothes and shoes) as well as a low diversity degree, concerning the class of exported products and target countries.

The Free Trade Agreement with EU, which is actually undergoing a negotiation process, seems to bring about new challenges concerning not simply and only foreign trade, but the Albanian economy in general. The EU countries are Albania's main trade partners and liberalization with these countries is expected to be accompanied by increasing competition on their side. In what degree and how will the Albanian economy be able to withstand this competition? What are the possible ways to stop further deterioration of foreign trade indicators and even improve them?

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A number of factors and political actions may be mentioned, but we think that all of them can be summarized in a single notion: the growth of competitiveness of the Albanian economy.

1. COMPETITIVENESS INDICATORS IN THE ALBANIAN ECONOMY

What is competitiveness?

According to the OECD definition: "The extent in which a country, in the conditions of a free and fair market, produces goods and services that meet international markets' standards, while preserving and increasing its citizens' real income in the long run."

According to the World Bank definition: Competitiveness should be equaled to productivity: it is linked to the actions which the firm, the branch, the region and governments should carry out discretely, in order to stimulate sustainable productivity growth. It depends on:

- Continuous upgrading of human resources, capital and natural resources;
- Changes in technology and innovation stimulation;
- Modification of the organizational structure and of firm, branch and government behavior;
- Creation/encouragement of intra-sectoral, inter-sectoral and international relations.

As the above definitions suggest, being similar to each other, competitiveness is the result of a number of factors and can be specified through several indicators. However, considering the whole indicators and factors, we can mention:

- The relative exports level, which also indicates the level of economic opening towards international markets;
- Productivity;
- Qualitative characteristics of goods and services;
- Human, capital and natural resources status; the condition of technology and innovative capabilities;
- The overall business and investment environment, strategic behaviors of firms and governmental policies;
- Market structure and intra-sectoral, inter-sectoral and international relations status;
- Real income per capita;

In a synthetic approach, competitiveness could be measured by the relative exports level and economic productivity, or even by only one of these indicators. In a more analytical approach, concerning products and services, quality and individual distinction of goods and services, their differentiation degree vis-à-vis similar products and services are becoming increasingly important. The resources conditions, especially the condition of technology and innovative capabilities, business environment and market structure,

business strategies and supportive governmental policies, affect exactly the three indicators mentioned above.

Citizen's real income sustainability and growth is a prerequisite for economic competitiveness. According to this definition, sustainable growth of economic competitiveness cannot be achieved if this is effort rests upon low wages or devaluation policies vis-à-vis citizen's income.

Let's have a look at the synthetic indicators of competitiveness in the Albanian economy. The relative trade volume indicator (trade volume/GDP) would be a more suitable indicator of openness for transition countries, which are undergoing substantial structural change. The level of economic opening, even in the case of imports exceeding exports by a healthy margin, while the trade deficit is still sustainable, may serve as a competitiveness indicator. Considering the fact that economic opening is related to exports, it is a direct indicator of the economy's competitiveness in international markets. Given that it is related to imports and since imports support economic restructuring and technological modernization, economic opening can be once again considered as an indicator of competitiveness under development. Finally, since it's related to a sustainable trade deficit, economic opening can be considered as a competitiveness indicator of the economy in the context of providing sustainable financing sources for the deficit. However, it should be stressed that exports or their relative indicators remain direct competitiveness indicators of the economy in international markets.

The economic opening level in Albania has increased progressively during the transition years, but still remains in rather low levels (2-3 times lower), compared to other countries in the region, as shown in Table 1. The picture is even more dubious, if we refer to the exports indicator, which stands at 7% of the GDP, being three times lower than the next country in the region. It should be noticed, that for countries featuring small domestic economies, economic opening reaches very high levels, exceeding even the GDP level, indicating the dominant importance of foreign trade vis-à-vis the small domestic market.

Table 1: Some foreign sector relative indicators of competitiveness, 2002

	Level of economic opening, (X+M)/GDP, %	Exports/GDP, %
Albania	**39.1**	**7.0**
Bulgaria	80.5	32.5
Croatia	72.5	22.4
Macedonia	83.3	30.0
Bosnia-Herzegovina	110.9	21.9

Source: Calculated according to statistical data issued from the respective central banks' web sites. The opening level is calculated only in relation to exports and imports of physical goods, excluding services.

The productivity level (efficiency) encompasses another important dimension of economic competitiveness. As a result of the availability and quality[2] of data, for the purpose of this paper we have referred to the productivity indicator calculated as a ratio of gross domestic production against total employment, though it would have been more preferable to refer to branch indicators or focus more closely on products.

Table 2: Productivity in a number of countries in the region:

	Thousands of USD/employees
Albania	4,416
Bulgaria	8,848
Croatia	16,545
Macedonia	13,270
Bosnia-Herzegovina	8,049

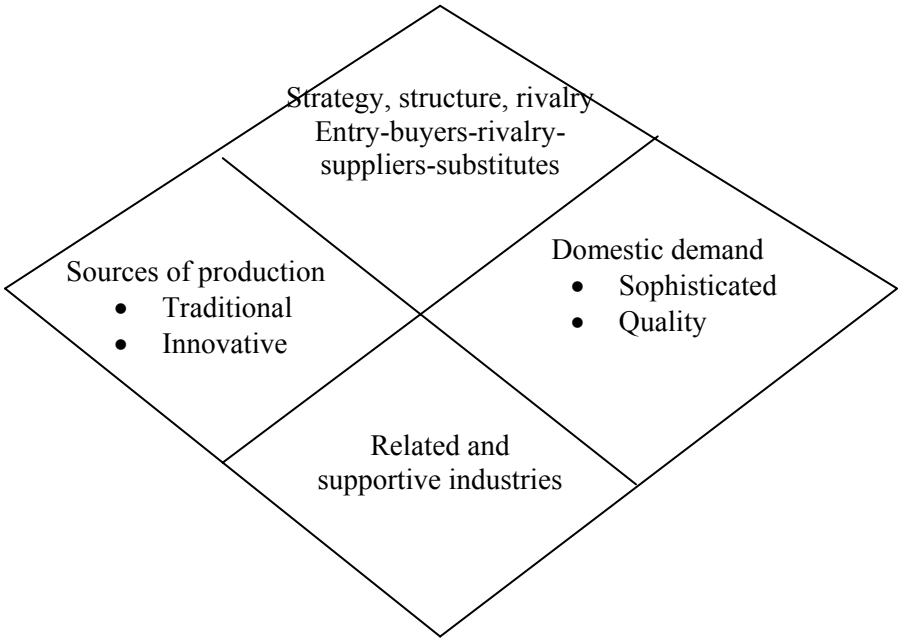
[2] Our statistical data about employment are not thoroughly correct. For instance, official figures on employment in agriculture have been almost invariable since 1993, while demographic developments should offer a reduction of the employees' number in this sector. The vast informal economy also has a negative impact, lessening the reliability of employment statistics. In this context, we refer to lower figures not simply as a result of the poor quality of records, but as a result of the restraining pressure that informal economy puts on the investment activity of businesses as well. (For more information, check with Olters…)

Source: Calculated according to statistical data issued from the respective web sites of national central banks

As the indicator shows, the competitiveness status of the country in relation to regional economies appears poor. The workforce in Bulgaria and Bosnia is nearly twice as productive, while Croatian and Macedonian workforces are respectively four and three times more productive than ours. Without analyzing the factors influencing low productivity, we think it is reasonable mentioning the impact of informal economy, the vast dimensions of which, not only hinder precise calculation of productivity, but in the same time put pressure on the productivity level, keeping it low.[3]

In order to analyze competitiveness in the Albanian economy, involving the factors mentioned above, we have referred to the Porter scheme[4], known as "Porter's diamond" (Figure 1).

Figure 1: "Porter's diamond"



2. FACTORS CONDITION

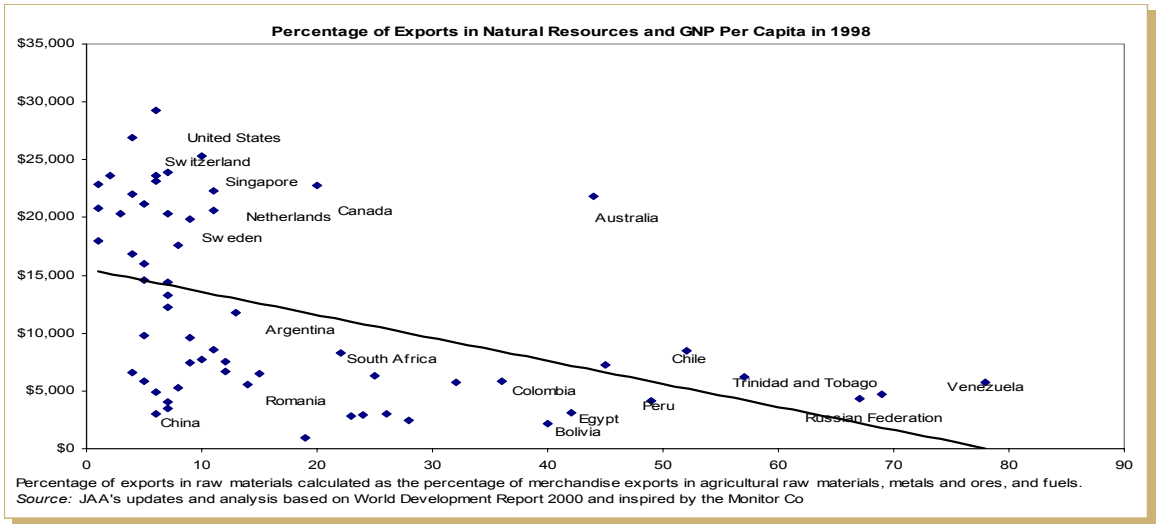
The abundance of production inputs plays an important role in the competitiveness of the country's economy. But, their role in economic development is different and much more complex than the traditional meaning. In essence, the most important factors concerning

[3] For more, consult Olters

[4] Michael Porter, 1998: "The competitive advantage of nations"; The Free Press, 1998.

competitive advantages of the country are those created in the country, not the inheritable ones. Actually, according to history, in several cases, the abundance of inputs has held back the process of extending competitive advantages; just like a disadvantage in the availability of specific inputs has often contributed to preserve competitiveness by stimulating strategies and innovations for the industries. (Figure 2)

Figure 2: Raw materials export volume and economic development in several countries



Anyway, let's have a look on the condition of resources, or production factors.

Natural resources represent a broad category of national resources, including the soil, mineral resources, geographic position of the country and climate. These are included in the group of inheritable factors. As shown in Figure 2, countries whose economic development is based on extraction and marketing of natural resources are not competitive economies and have not succeeded in joining the family of developed nations.

According to history, over the past fifty years Albania's economic development has relied heavily on the exploitation of natural resources. Mineral, metal and energy exports have occupied more than 55 percent of total exports during the whole 1950-1990 period. Actually, soil products dominated the remainder of the exports portfolio**,** but these were manipulated only to a modest degree, being mainly raw materials of plant or animal origin. In this context, raw materials extraction from both the soil and the underground has not succeeded in increasing the population's income and upgrading the economy. After the 90s, significant exploitation of natural resources over the past decades, environmental degradation, as well as the critical need for investments required to upgrade this part of the economy have had an impact on the significant contraction of these sectors. Soil and especially forestland exploitation also face serious problems. A more detailed analysis of the position and role of our country's natural resources' impact on economic competitiveness is given in annex 1.

Capital resources, as opposed to the previous group of factors, are factors that can be created. The concept of capital in economics is related to the idea of generating money. Evaluation of capital resources can be performed in two ways: the first one focuses on physical capital, i.e. regarding account balance assets, while the second refers to financial capital which makes possible the production process and is represented in the passive side of the account balance. In this analysis we are going to deal with the second way.

Domestic savings against GDP in the Albanian case stand at approximately 9 percent for the 1994-2004 period (Table 3), though the trend has moved upwards recently. Anyway, the domestic savings relative level is rather low compared to the 30 percent level encountered in fast growing economies.

Table 3: Savings and investments during 1993-2001

Balance of Savings/Investments, % of GDP	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Foreign savings	28.7	14.3	9.7	9.1	12.1	6.1	7.2	7	6.3
Domestic savings	-15.5	3.6	8.3	6.4	3.9	9.9	9.6	12	13.1
Public	-14.1	-10.6	-8.7	-9	-8.6	-5.2	-5.8	-2.6	-1.2
Private	-1.5	14.2	15	15.4	12.5	15.1	15.4	14.6	14.3
Investments	13.2	17.9	18	15.5	16	16	16.8	19	19.4
Public	9.5	8.6	8.2	4.5	4	5.2	7.4	6.5	7.3
Private	3.7	9.3	9.8	11	12	10.8	9.4	12.5	12.1

Source: IMF: statistical report on selected issues; March 2003

Capital accumulation (capital investment) can be achieved in several ways: by capital sharing (equity), borrowing from banks and by issuing obligations. Financing businesses through capital sharing is not preferable for private entrepreneurs in the case of domestic firms. **Though some financial schemes offer this kind of financing for private businesses, anecdotal evidence confirms that the most preferable way is borrowing, including informal lending which is thought to be significant as well as credit extensions.** Our statistical system does not provide data on the capital structure of businesses, hence either on the debt/assets ratio of the private sector calculated on the respective account balances. However, data from the banking system (Table 4) are sufficient to conclude that **this ratio should be lower compared to those in** regional countries, since the **credit extension** level itself remains rather low.

Table 4: Banking system indicators for several countries; data of 1999

Country	Term Deposit /PBB	Banking Credit/PBB	Private Sector Credit/PBB	Credit/Deposit	GDP/per capita in USD*
Greece	32.1	75.1	36.5	113.7	11,650
Italy	47.2**	96.3	72.4	153.4	20,250
Malta	128.2	129.5	105.0	81.9	9,440
Turkey	49.3	45.3	21.4	43.4	3,160
Czech Republic	43.4	62.6	56.8	130.9	5,040
Hungary *	45.8***	62.9	23.7	51.7	4,510
Poland	26.9	36.3	19.5	72.6	3,900

Banking intermediation in SEE, 2000								
Country (GDP/ Per capita)	**MP3/GDP**	**Banking Assets / GDP**	**Primary Deposit/ GDP**	**Deposit Total /GDP**	**Banking Loan Total/GDP**	**Business Credit / GDP**	**Business Credit / Primary Deposit**	**Business Credit/ Total Loan**
Slovenia ($ 10,020)	52.6	79.1	32.0	62.9	49.0	22.9	71.7	46.8
Croatia ($ 4,467)	39.5*	71.6	30.3	46.2	32.1	15.8	52.0	49.1
Bulgaria ($ 1,513)	32.3	38.3	14.0	25.6	18.3	12.2	87.1	67.0
Romania ($ 1,517)	25.7	28.7	9.9	20.0	16.9**	10.2**	87.2**	60.4**
Albania (2002) ($ 1,332.7)	70.6	57.5	38.7	48.4	6.5	N.A.	16.9	N.A.

Source: Albania's data are calculated according to Statistical Reports of The Bank of Albania; other data are borrowed from John P. Bonin (2000) "Financial Intermediation in Southeast Europe: Banking On the Balkans".

Considering the fact that an effective capital market where firms could increase their capital is missing in Albania, borrowing remains the only financing alternative. Thus, the banking system plays a critical role in financing capital and promoting economic

development. The question is whether the banking system is able to meet the requirements of the economy.

Restrictions in credit extension for the private sector appear as a result of the impact of both demand and supply side. Credit demand has been increasing, but however, businesses are still not able to provide sufficient reliability concerning credit extensions (the story of "two page balances" illustrates this). As for the supply side, banks seem to be discreet. Along with high interest rates applied in domestic credit extension, they prefer to invest their money safely, including deposits in foreign banks and the simultaneous application of relatively high tariffs on banking services for domestic clients. Thus, the market system inefficiency brings about higher capital and transactions costs. Hence capital sources become insufficient to sustain the economy's requirements and high growth rates.

In a globalized economy, domestic capital shortage, be it literally or metaphorically, is not considered to be an obstacle to development, since the country can activate foreign savings, preferably in the form of foreign direct investment of capital. But, even in this context, our country's performance compared to Central and East European countries and especially compared to countries in the region has been unsuccessful. (Table 4)

Table 5: Foreign Direct Investment in some of the countries of the region

	FDI leftovers, 2002, milions of USD
Albania	988
Macedonia	907
Bulgaria	3 889
Croatia	6 029
Ex-Yugoslavia	1 959
Bosnia-Herzegovina	828

Source: UNCTAD, 2003 World Investment Report

Given that capital is a factor that can be generated, policies that encourage savings and consequently capital generation required to finance economic development are especially important. For instance, taxation of profits from bank interests can be revised in order to promote growth for the private sector savings, and for individuals close to the banking system. In particular, we think it's not reasonable to apply higher tax rates for foreign investors.

Infrastructure

Infrastructure is closely related to economic competitiveness. It is directly related to business operational costs, and consequently its status represents a factor that can stimulate or hinder domestic and foreign investment. Albania inherited a poor physical infrastructure: roads, railways, ports, airports, telecommunications, water supply and

electricity. Progress during the 90s is particularly evident in the telecommunication and transportation sectors (Table 5). Though it's not our goal to provide a detailed approach on the infrastructure status concerning each of the categories mentioned above, it is important to emphasize that there is already sufficient evidence showing the electricity supply status in particular, has a decisive impact on the low competitiveness of Albanian businesses, as a result of higher business operational costs.

The customs infrastructure plays a similarly important role. According to empirical estimates[5] a one-day delay caused by the customs administration during payload manipulation causes a cost equivalent to a one percent increase in customs tariffs. According to FIAS[6] report estimates (March 2003), the average custom clearance time in Albania is 5.3 days, while in Bulgaria it averages 1.2 days, 2 days in Romania and 4.3 days in Moldavia.

Infrastructure development status is also considered a key obstacle for trade development between countries in the region, and hence one of the variables explaining low paces of trade between regions. This is why regional integration policies have targeted the improvement of transportation systems and minimization **of other non-tariff trade bottlenecks** in addition to tariff bottlenecks elimination and creation of a free trade zone between countries in the region.

Table 6: Indicators of infrastructure transition for 2002

Country	Telecommunication	Electricity	Railway	Roadway
Albania	**3+**	**2+**	**2**	**2**
Bosnia and Herzegovina	3+	3	3	2
Bulgaria	3	3+	3	2+
Croatia	3+	3	2+	2+
Romania	3	3	4	3
Serbia & Montenegro	2	2	2+	2+
Macedonia	2	2+	2	2+
Hungary	4	4	3+	3+
Poland	4	3	4	3+
Czech Republic	4	3	2+	2+

[5] See: J. Wolfensohn, 2003 "A good 'pro-poor' Cancun could help rich as well", Financial Times, September 8, 2003. Literature concerning transport cost effects and the impact of geographic neighborhood on transaction costs and international trade growth, and thus on economic development has experienced a significant expansion recently. See: Jeffrey Frankel, "Integrating Transportation and Geography into Trade Analysis", The Brookings Institution, 2002. (hard copy paper). Although integration overlaps a significant number of barriers, consequently stimulating international trade and overshadowing the geographic concept, in general, studies come to the conclusion that boundaries still play an important role in terms of business costs and competitiveness.

[6] FIAS, 2003 "Albania: Removing administrative barriers to investment: a critical component of the national development strategy".

Source: EBRD Transition Report, 2002.

Human resources and knowledge development

If the cost of workforce were a determinant factor for competitiveness, Albania, having one of the lowest wage levels, would have been the most competitive economy in the region. But the truth is different. In today's economy workforce is not the only important factor. Its quality and efficiency are important as well. New technologies demand highly qualified employees, including general and specialized qualification. Workforce and knowledge today are thought to be determinant for economic development.

During the transition years, education indicators have deteriorated significantly (for more detailed information see GPRS, 2002; 2003). The brain drain process is still present as a result of different causes; the economic and financial status of universities, as well as the whole education system's status is still discouraging. While GPRS emphasizes the importance of basic education, intellectual workforce development demands higher rates of investment for universities, and research and scientific institutions. As Porter prescribes, "... knowledge rests upon universities, private and governmental research institutions"[7].

We think the current status of education inter alia suggests:

First, the requirement of a greater proportion of higher education among the population. According to official statistics, the portion of citizens who have completed higher education is significantly low, occupying only 4.8 percent of total population of which only 0.2 percent are postgraduates.

Second, higher education, at least in a number of faculties, preserves the line of academicism, remaining aloof from the real needs of various sectors of the economy or social life, and community. We think that diversifying higher education, supporting a system of higher education that does not rely exclusively on universities and addresses more directly the needs of various sectors of the economy and local community (introducing the model of American colleges), will serve as an important set of reforms that would also upgrade absorption capabilities of knowledge and adequate skills, consequently increasing competitiveness. According to feedback ACIT has received from the business community during seminars on competitiveness, almost all respondents have revealed the fact that "it is really hard to find adequately qualified workforce and professional managers". They also said they were "only partially" satisfied by the way universities, research centers and education institutions in general, responded to the adequate qualification requirements of workforce.

Third, the whole education system still employs a scholastic approach; efforts to arouse and develop creative skills and critical thinking in students are still insufficient. Improving the situation in this context should be another priority in the education reforms agenda and would directly and positively impact the upgrading of production resources.

[7] Michael Porter, op. cit. page 75

Fourth, research and development (R&D) for key sectors of the economy still remains a function of public institutions, while in developed countries and elsewhere, a great portion of R&D is carried out by the private sector. In the USA, for instance, two thirds of the total R&D expenditures are financed by NGO-s. Moreover, public expenditures allocated for R&D and especially the effectiveness of these expenditures are not really encouraging.

Fifth, though education is a SKZHES priority, the level of budgetary expenditures for education is lower than that of other countries in the region. Increasing budgetary expenditures (including local administration expenditures), along with the intensification of education reforms in the directions mentioned above, would contribute in sustaining high rates of economic development in the long run.

Conclusions

The generation of high quality and modern inputs requires significant and constant investment.

Important inputs including the soil, geography, climate and high quality underground resources are not being used efficiently.

The physical, institutional and human infrastructure of the country suffer an inferior status compared to competitive countries. Consequently, governmental policies should focus not only and simply on their priorities concerning budgetary expenditures, but on the intensification of structural reforms in these sectors as well. The completion of structural reforms will require more incentives for private investment in these activities, more importantly in the conditions of budgetary restrictions implied by the reality of our public finances. More coordination and incentives should be offered especially concerning research and development in the private sector.

3. DOMESTIC DEMAND AS A COMPETITIVENESS FACTOR

An increasing domestic demand affects positively the competitiveness of domestic businesses, first through facilitating the process of overcoming the "emerging" stage and through investing to extend technological capacity and improvement, and second, given the fact that domestic demand is complemented by imports, through the interaction of domestic businesses and foreign supply of goods and services. Import, especially that of quality products is not only an indicator of investment possibilities, but an indicator of required technological standards that firms should apply as well. Access in international markets for domestic businesses can be facilitated through efforts to substitute imports. These efforts, though insufficient, serve as a useful experience for Albanian businesses, enabling them to export.

The extent in which domestic demand affects economic restructuring and competitiveness for domestic businesses, depends both on its dynamics and structure.

What's the dynamics of domestic demand in Albania and how did its structure evolve? How did it evolve from a "simple" demand, focused on primary goods, to a "dynamic" demand focused on capital goods, and a "sophisticated" demand focused on differentiated products?

To answer the above questions it would probably be relevant to distinguish between individual or family demand for consumption, private firms demand for investment and governmental demand.

Individual consumption

Consumption is the main and most important component of aggregate demand and in the same time, a key factor of economic growth. In the National Account statistics, private consumption stands at approximately 98 percent, while governmental consumption averages 13 percent.

Even though there is some sort of positive dynamics, the majority of the country's population still belongs to the lower range of consumers that use cheap goods and services. According to LSMS (Table 7), about 68 percent of families report revenues that stand below the medium level, while the medium income level itself is rather low to stimulate a demand for quality products. The high market consumption range doesn't seem to exceed 20 percent of families. This consumption profile does not stimulate the development of high quality products.

Table 7		**Household Reported Income, 1998**
per month	*In USD*	*% of household*
Up to 4000 leks	up to 29 USD	10.5
2000-6000	14.5-43.6	10
6000-8300	43.6-60	10.2
8300-10000	60-72.6	9.8
10000-13000	72.6-94	11.5
13000-15000	94-109	8.6
15000-18000	*109-130.7*	*7.9*
18000-24000	130.7-174	12.6
24000-31000	174-225	9
over 31000	Over 225	9.9
Total		100
Mean Income	**120.5**	**16600**
Median	94	13000

Source: INSTAT

It is generally thought that the major part of the Albanian consumption market is very sensitive to price levels. The small size of the market, considering the consumers limited scope, purchasing power, and price-oriented rather than quality-oriented decisions don't

contribute in creating a stimulating environment for businesses to improve the quality of goods and services.

At this point, the presence of a number of positive trends that ought to be supported should be emphasized. Along with the trend of growing revenues, an increasing part of the market is becoming more sensitive to quality, and thus more discriminating towards products that don't meet the required quality standards. Such a phenomenon can be already noticed in the clothes or furniture industries as well as in daily consumption. Increasing consumer awareness towards quality in the consumption of milk products, for instance has made possible some new projects in the milk industry. A similar trend is evident in relation to the industries of potable water, soft drinks, and fruit juices as well. But, how has the consumption structure evolved? Food and similar products expenditures, still occupy a dominant part of consumption (Table 8), standing at a higher relative level compared to other countries in the region. For example, while in Albania the portion of this group of goods in the family budget was 68,9 % in 1996, in Bulgaria this indicator stood at 45 %. Even if we refer to structure, it is not likely that consumption will put significant pressure on the market to stimulate the production of sophisticated and quality products.

Though, even from the structure perspective, the consumption demand is changing positively. As shown in Table 8, expenditures for food and similar products have been decreasing: from 72,1 % in 1993 to 57,8 % in 2000 and the downward trend goes on. In the meantime the volume of the clothes group has been increasing along with dwelling, medical care, education and entertainment, transportation and communication expenditures. These structural changes reveal a "sophistication" trend of consumption. As demonstrated in literature, the more sophisticated consumption is, the more positive is its pressure on efficient economic restructuring and increasing competitiveness for businesses and for the overall economy.

Table 8: HOUSEHOLD EXPENDITURE PATTERNS ACCORDING TO MAIN GROUPS (in %)

no.	**Patterns of expenditures**	**1993**	**1994**	**2000**
1	Food, tobacco, beverages	72.1	68.9	57.8
2	Clothes, footwear	2.8	2.4	5.3
3	Rent, electricity, water, fuel	6	4.9	6.9
4	Equipment, furniture	7.6	10.5	6.3
5	Health care	0.9	0.9	2.6
6	Transport, communication	4.8	7.3	7.9
7	Education, entertainment	3.7	4.1	5.4
8	Personal care	0.4	1.0	2.3
9	Other	1.7	0.01	5.5
	Total	100	100	100.0

Source: http://www.instat.gov.al
*Household Budget Survey in Urban Area 1999-2000

Data on imports demonstrate positive changes in consumption too. Referring to selected data for a number of categories of clothes and footwear, their imports have doubled during the 1996-2002 period. Moreover, imports of these products from countries enjoying high quality standards have grown. So, suit imports (in volume terms) from Italy, class 6103 and 6104, have increased 3,5 times (in physical terms) during the 1996-2002 period. Similarly shirt, children's clothes and footwear imports predominantly come from Italy and Greece, which are well-known in the world fashion industry and maintain high production standards.

Private sector investment

The dynamics and structure of the private sector demand for capital goods can be seen as direct indicators of economic development and potential. The picture is complex in this context too: on one hand the relative volume of private investments compared to countries in the region, is still very low. Nevertheless it has increased progressively. As shown in table 3, private sector investments have grown from 3,7 percent of GDP in 1993, to 12,5 percent in 2002 (Bank of Albania, Annual Report, 2003).

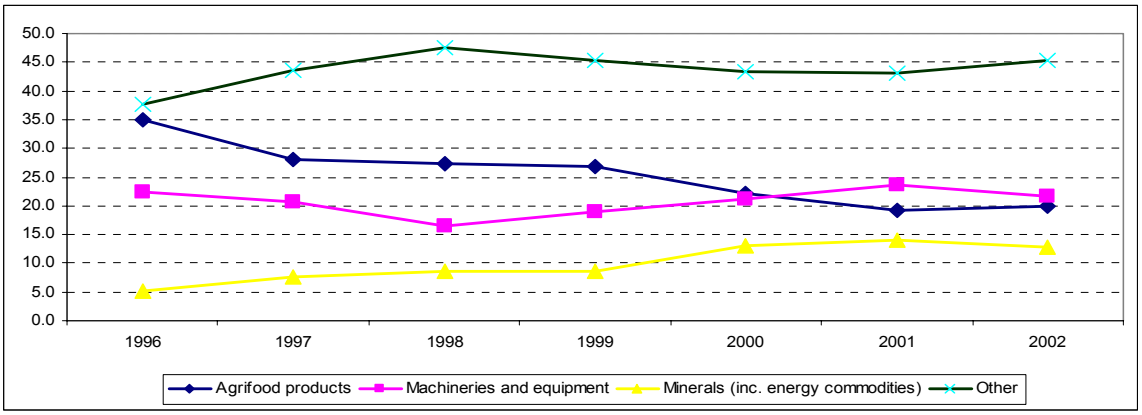
Demand structure and its provision sources as well, reveal serious problems concerning the output structure and technological level, thus in relation to the competitiveness of businesses. But on the other hand, we cannot ignore the positive trends of the private sector demand for capital goods, which is a positive trend of the structure and technological base of domestic output as well. Structural changes in imports illustrate this trend.

Machinery and equipment imports have contributed in increasing capital stock and renovating the economic technological base. Studies[8] have shown that information and communication technology (ICT) has been the most advanced sector in the context of technological renovation. In the 1995-2001 period an average of 35 percent of machinery and equipment imports belonged to this sector. The construction industry is next with 33 percent, followed by the textile and footwear industry with 12.8 percent, agriculture and agricultural processing accounting for 8.4 percent etc.

Raw materials for the domestic industry, especially for the export sector (textile and their products imports – standing at about 10 percent of total imports) have occupied a significant portion of import structure. Figure 3 shows the dynamics of various categories of import. The "others" group consists mainly of raw material imports used by the domestic industry.

Figure 3: Structure of group of commodities imports

[8] Mançellari, Xhepa (2002) "Trade and Economic development", paper, December 2002.



Source: ACIT Annual Report on Foreign Trade, 2003

Governmental demand

Though less important than the two components analyzed above, government expenditures have a significant impact on the aggregate demand. In order to effectively control public finances, the reduction of government expenditures during the whole 90s period has been necessary. The relatively low levels of budgetary income and the government's limited ability to borrow in the market, inflict low levels of government expenditures. However, we're not going to analyze all types of government expenditures. We will focus briefly on two points: public investment and public procurement. Public investment, which is an important component of government expenditures, went down to 4 percent of GDP in 1992, in contrast to very high levels during the pre-transitional period. This indicator has fluctuated over the 1993-2002 period: first it experienced a growth of more than 8 percent of GDP until the end of 1995, then in the 1996-1997 period it fell back to the 1992 level, and finally started to grow again. In the late 2002 public investment reached 6.5 percent of GDP.

Public fund procurement demands on the other hand, overestimating the importance of the price of goods and services to be procured from competitors, not to mention abusive tendering procedures, which are not difficult to spot, have not succeeded in stimulating businesses to raise quality standards.

Conclusions

Domestic consumption is still rather insensitive to sophisticated and quality products, despite the positive pressure on domestic production (mostly on imports). Consumers are very sensitive to price levels, and this reduces pressure on businesses to apply higher quality standards for products. On the other hand, insufficient quality control on the market, has encouraged the import of relatively low quality products. This also has a negative impact on the higher market segments and obstructs the perspective of increasing quality standards of domestic production.

Domestic demand can better stimulate competitiveness in those sectors and products that require little investment, such as agricultural and food products.

3. BUSINESS STRATEGY, STRUCTURE AND COMPETITION

Competition between firms is not simply about price: actually, other forms of competition not related to price bring sustainable competitive advantage for both firms and countries. Companies are able to attain and maintain relative advantage only through innovation, innovation that meets the consumers' needs and demands, one that not only serves, but also creates markets.

Business strategy

In order to achieve innovation, businesses should be placed under pressure; consumers must have enough power in order to compete with suppliers and force them to reduce prices demanding higher quality and a more effective service. In this context, consumer behavior takes over business strategy. As revealed in the analysis of the factors of consumption demand, the largest portion of the domestic market is essentially sensitive to price. This way, firms have tended to go for a *low quality – low price* strategy. On the other hand, there is still no evidence of marketing strategies of Albanian businesses toward foreign markets. This is because exports for the most part consist of clothes and footwear (manipulation of goods exported by foreign businesses), minerals and basic agricultural goods (generally medicinal herbs).

According to workshops with the business community, the predominant strategy they have chosen is *survival*. Survival can be explained as a reaction triggered by political and economic instability, lack of game rules, and equal competition in the market, other market distortions and poor management of transitional structural reforms.

Competition

The extent of rivalry between businesses in the domestic market is hard to measure by a relevant indicator. In a general view, the number of firms dealing with the production and marketing of products and their dynamics, in a certain way reveals the extent of rivalry while the increasing number of firms operating in the market can be seen as a proof of increasing competition.

Since the transition began, the number of private enterprises has increased significantly, peaking in the first 3-4 transitional years as shown in Table 9. The total number of active enterprises in the country was 56,490 until the end of 2002.

Table 9: Typology of SMEs

ACTIVE ENTERPRISES ACCORDING TO ECONOMIC ACTIVITY, SIZE AND LEGAL FRAME		
Economic Activity	**Year**	

	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Agriculture	245	187	119	42	18	34	35	36	19	**735**
Industry	1275	1082	572	684	365	505	462	632	496	**6073**
Construction	352	396	287	277	95	205	156	143	100	**2011**
Transport	1550	1663	875	674	207	741	1209	1634	941	**9494**
Trade	6037	5482	3085	2822	1319	2572	3418	3685	3527	**31947**
Services	2092	2048	895	1220	613	929	1137	1252	1413	**11599**
Total	**11551**	**10858**	**5833**	**5719**	**2617**	**4986**	**6417**	**7382**	**6496**	**61859**
Capacity	2									
1 employee	8386	8179	4598	4778	2191	4403	5985	6580	5940	**51040**
2-10 employees	2694	2307	1176	898	411	572	397	770	543	**9768**
More than 10 employees	471	372	59	43	15	11	35	32	13	**1051**

Source: INSTAT, the Enterprise Catalog, 2003.

Nevertheless, the number of firms per se is not enough to properly evaluate the competition status. The distribution of branch production according to business classes sorted by size, and thus the indicator of market structure, is important as well. The analysis of relative price levels of specific products reveals a meager rivalry in the market. Furthermore, the presence of monopolies and cartels can be spotted in specific products. There is a widespread conviction that domestic prices are higher compared to those in foreign markets, for products of comparable quality.

On the other hand, cooperation to create new business opportunities is still not an integral part of the country's entrepreneurship culture. Cases of the lack of cooperation have been reported in round tables with the business community, especially between olive oil producers and olive cultivators, between farmers and fruit & vegetable processing firms, or wine producers, etc.

5 RELATED AND SUPPORTIVE INDUSTRIES

The establishment of relations between firms involved in the added value chain has a positive impact on the country's competitive advantage. The presence of local input suppliers, technology, research and scientific institutions, as well as the presence of an efficient and supportive physical, institutional and legal infrastructure facilitate the reduction of business operational costs, thus increasing competitiveness.

Nevertheless, the presence of industries or related institutions as such, is of insignificant importance concerning business competitiveness in the existing global economy. Their effectiveness is more important than their availability. Business relations and cooperation between partners are even more important in relation to competitiveness. Suppliers help firms to perceive new production methods and technologies; the presence of research institutions facilitates research and development expansion and increases market intelligence etc.

A *Cluster* is the result of bringing together all related players involved in the production of identical commodities. Clustering is widespread in developed economies, but it is welcomed in developing and transition countries as well. In other papers, ACIT has presented clustering benefits, the way clusters are created and how they work, involved actors etc.

4. OUR GOAL

Integration with the EU, which has been officially launched already, is a widespread aspiration of Albanians. The pace of this process is heavily dependent on us. While Albania's prevalent ambition is to become a member of the family of advanced Western nations, time is a critical factor for the business community. Participation in the European free trade area puts additional pressure on entrepreneurs to upgrade their businesses by adopting standards analogous of their Western rivals, or otherwise face bankruptcy. As a result, competitiveness improvement for the overall economy and businesses should be a key priority for government policies, the business community and for all players involved.