FOREIGN DIRECT INVESTMENT AS A KEY ELEMENT OF ECONOMIC GROWTH

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ABSTRACT

Foreign direct investment (FDI) is crucial for faster development of the countries that are still developing their economies and trying to reach the developed countries. This flow of new capital strengthens the structural basis of an economy because of long term investments. This implies the investor brings new knowledge in managing the company and investment means a great improvement in abilities of local workforce. Furthermore, there are also great advantages in obtaining new technologies, production processes and opening new markets. Since FDI is divided into greenfield (investing in new capacities) and brownfield (investing in existing capacities) investments, the importance of the first one is much greater since brings greater 'blood flow' to the economy. Many countries give investors a lot of benefits trying to lure them in an investment that will greatly benefit the countries' economy starting from new employment. Smaller costs of production, political stability, market growth, good infrastructure, educated workforce are the conditions that increase FDI.

The FDI in Croatia as in other countries slowed down and created great problems in boosting the economy. In the paper figures will compare investment and growth in different countries trying to find the reasons why there is difference between them. We will look for the determinants that are slowing the flow of FDI. With the recession, stagnation of GDP and a big unemployment figure FDI would greatly help in restoring economic growth. According to the findings and obtained results, this paper will propose measures that can help the growth of FDI in Croatia and similar counries.

JEL Classification: O47, R11

Keywords: development, economics growth, Foreign direct investment

1. INTRODUCTION

The Gross Domestic Product (GDP) is one of the most important indicators for the economic health of a country. It has four components: private consumption (C), gross investment (I), government spending (G) and net exports (export (X) – imports (M)). Investments are very important because they enable the economy to grow faster. Foreign investments are even more important because they are new capital coming in a country's economy. Countries with a great need for economy growth have to invest in business capacities and strengthening the basic production of their economy. Since the countries in development are usually the one that need more investment, they get the money either from loans or trying to lure foreign investors to invest in the country's economy, which is for sure better than a loan. When we say foreign direct investment (FDI) we mean the investing assets in structures, equipment or organization in a subject that is located in another national economy with the goal of achieving a long term interest, with the exclusion of investing in equities.

The main target for foreign investors is to accomplish a long term relationship with an entrepreneur in another country, that way the FDI includes all transactions from the first investment to the next following transactions, taking into consideration that there is a long term motive when at least 10 % is invested in the capital of the foreign company. The definition of FDI implicates that the foreign investor has a big influence on the management and managing of the company in which he invested. A foreign investor can be an individual person, a company or an investment group (fund) and the investment can be in the form of an investment in the capital, reinvested earnings or loans between companies. Because of the long term character of the relationship, this type of investment is better than an investment in shares. Furthermore, when a crisis arrives, the money invested in shares and other equities tend to escape out of the country, unlike the investments in the business structure that tends to evolve and continue in spite of a crisis (Škuflić & Botrić; 2009., 9-28). This active participation of the foreign investor and his long term interest to cultivate his capital form the main difference from short term portfolio investments that are motivated by short term earnings.

FDI are just a part of the total capital motion which is usually divided in three categories (Kumar; 2007., Vol. 2, No. 1): FDI, equities and debt. The International Monetary Fund divides the net flow of capital in five categories (IMF; 2000., Part1, p.XI.): FDI, portfolio investments, other investments (commercial loans and deposits), use of a MMF's loan and extraordinary financing (accumulation of unpaid liabilities and condonation of debt).

FDI are divided into greenfield and brownfield investments. Greenfield investments create new production assets. Brownfield investments include buying existing production units and companies as well as taking control over them. In economic theory mergers/acquisitions or take-overs are widely spread. From the acquisitor or new owner it is usually expected to bring new knowledge, technology, production process, management as well as opening new markets. These investments give benefits to the company in which it is invested as well as to the surrounding region and sometimes even to entire countries. It has to be said that there are also some negative results from FDI, for example, when new competition enters a country's market home companies can be thrown into problems or even closure. But usually the benefits from FDI greatly outcome the negative sides e.g. the benefits being transfers of new technology, knowledge, new employment, strengthening of an economy, better trade balance with other countries, and so on.

Since FDI open new work places they have a direct impact on employment, rising of wages as well as transferring of skills and knowledge. FDI also improve management skills and techniques, which combined with new skills of workers working with new and sophisticated technology rises productivity and competitiveness. The results of new FDI are better if the income country has educated human capital that can or is able to cope with new technologies. Infrastructures as telecommunication, transport, as well as a good banking and insurance system have also great importance. If a country wants to lure foreign investments usually it uses persuasions as tax and duty benefits, cheaper work force, etc.

2. DETERMINANTS THAT ATTRACT DIRECT FOREIGN INVESTMENTS

FDI is usually attracted by owners' private interest, e.g. lower labor, production or business costs, big market can be a good reason for investing. There are some criteria that must be fulfilled for FDI. The first is political stability – for a long term investment stability is an imperative. Unstable political situations usually attract high risk investments that usually have a short term character. The second criterion is a favorable business environment – companies should have the possibility to function freely on the market without any excessive cost or administration. The third is economy stability – stable fiscal and monetary policies are key components for a foreign investor. The forth is infrastructure – traffic, communication, institution and other infrastructures can be of great help for the development and growth of FDI.

There are two main preconditions that have to be fulfilled for a country to become a target for foreign investors, and those are profitability and stability. If a country can assure conditions for a profitable and steady business with its policy, FDI comes almost automatically.The credit rating is one of the indicators of risk and attractiveness for investing in a country, ratings that are given by well known agencies. Some of the ratings are shown in the table below (cf. table 1).

Table 1: Credit rating of chosen countries

Country	S&P Rating	Moody's rating	Fitch Rating
Brazil	BBB	Baa2	BBB
Russia	BBB	Baa1	BBB
United States of America	AA+	Aaa	
China	AA-	Aa3	A+
Germany	AAA	Aaa	AAA
Italy	BBB+	Baa2	A-
France	AA+	Aa1	AAA
Austria	AA+	Aaa	AAA
Slovenia	A	Baa2	A-
Bulgaria	BBB	Baa2	BBB-
Poland	A-	A2	A-
Czech Republic	AA-	A1	A+
Greece	B-	C	CCC
Croatia	BB+	Baa3	BBB-

Source: www.guardian.co.uk, January 2013

Countris with A have the highest rating and the lowest risk when investing, C is the lowest rating with the highest risk when investing in those countries. As the table shows, well developed countries like Germany and USA usually have a high rating, unlike them developing countries usually with structural, coruption, slow administration and other problems, like Bulgaria, Greece, Croatia, have lower ratings.

3. INCENTIVES MEASURES FOR FDI

Since direct foreign investments have positive effects on the economic growth many countries try to boost FDI by giving incentives for investors. Investors have a great number of choices where to invest their money, knowledge and technology so the country with the best conditions is the most probable to get the investment. Incentive measures can be used not only to drive investments but also to drive them in the right activities, sectors and regions. The choice of which measures to use depends on the goals that a country has. Sometimes countries add conditions for investors that want incentives, such as the minimum amount of investment, employment conditions, the cooperation of local companies, the transfer of technologies, etc. One of the most used measures is to exempt the investor from some taxes and/or duty for a certain amount of time. There can be also other financial measures like giving free fields to use, free infrastructure, etc. Fiscal measures are usually used by developing countries that do not have a lot of financial capital. Developed countries are most likely to use financial measures to attract investments giving loan or other financial help with good conditions to investors.

The financial sum of the incentive measures for FDI should be equal to the difference between the society benefits of the receiving country and the private benefits of the investor.

4. FOREIGN DIRECT INVESTMENT PER CAPITA

The FDI per capita is the value of a country's final net inflow FDI in one year divided by the country population. So it's the average net inflows FDI of the citizens of a country. Below are the FDI per capita for selected countries (cf. table 2).

Table 2: FDI per capita in selected countries

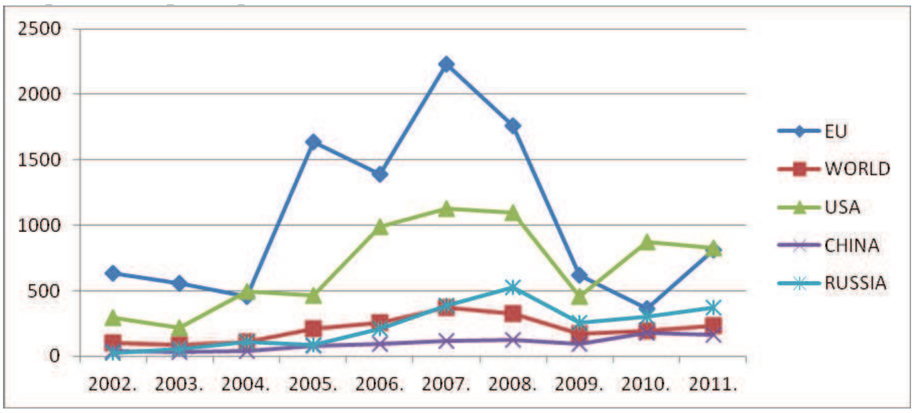
	2002.	2003.	2004.	2005.	2006.	2007.	2008.	2009.	2010.	2011.
EU	637,742	554,325	456,501	1640,28	1390,02	2227,25	1760,86	619,978	364,009	809,559
WORLD	100,289	89,8227	111,349	211,906	257,125	370,166	326,193	169,331	192,072	233,096
USA	293,333	219,746	498,509	468,085	986,286	1128,92	1094,18	454,922	875,986	826,491
CHINA	38,5098	36,5389	42,3868	79,8551	94,6454	118,561	129,494	98,437	182,164	163,781
RUSSIA	23,8206	55,0356	107,365	90,0161	208,431	387,566	528,372	257,203	305,015	372,567
BRASIL	92,5332	55,8462	98,7946	83,124	103,098	234,879	264,778	162,905	273,637	363,777
GERMANY	649,8515	374,802	-118,8	507,4766	674,2814	350,8083	201,3296	504,8895	250,1508	478,0213
FRANCE	802,0429	691,8441	523,5717	1405,352	1393,538	1453,965	995,8873	415,2512	581,2534	690,8812
ITALY	257,1698	287,0912	288,6298	335,059	661,7919	674,4033	-416,326	670,4293	-87,4479	460,7952
SLOVENIA	832,0256	151,0723	416,322	485,285	343,6163	934,0034	901,6755	-171,233	309,1644	398,6306
CZECH REPUBLIC	832,6047	198,0214	487,2541	1133,468	537,7047	1026,311	630,4973	273,5559	581,6707	510,1855
CROATIA	247,74	461,443	242,975	400,073	778,705	1130,81	1366,07	773,932	192,006	286,906
EURO AREA	782,05	697,913	405,471	1470,92	1161,01	2055,32	1363,91	817,258	381,931	961,179

Source: calculated and prepared by the authors

While in the laste twenty years the FDI per capita grew sedily in developing and developed countries, in the last ten years things changed. In developing countries continued to grow stadily while in developed slowed down.

The FDI per capita for some selected countries, the world and the EU is shown below (cf. grapf 1).

Graph 1: FDI per capita for selected countries



Source: calculated and prepared by the authors

In the grapf is clearly visible the impact of the world economic downturn started in 2008., after that happened the FDI per capita fall down, slowly recovering after that. The crisis had obviously a great negative impact on direct investment and has to be taken into account when analyzing the FDI. The natural course and growth of the FDI changed because of such an event.

5. GROSS NATIONAL INCOME PER CAPITA

The gross national income (GNI) is the sum of all the incomes of a country's residents in a given period. GNI=GDP+(FL-DL)+NCI, where FL and DL are foreign and domestic income from labour, and NCI is the net capital inflow. The GNI per capita is the value of a country's final income in one year divided by the country population. So it's the average income of the citizens of a country. It's one of the most important indicators that measures the well being of a country and of course it's citizens. This is the main reason why it's used in this paper as a clear indicator af a country's growth. Below are the GNI per capita of selected countries as well as the average GNI per capita for the world, EU and the Euro zone (cf. table 3).

Table 3: GNI per capita of selected countries

	2002.	2003.	2004.	2005.	2006.	2007.	2008.	2009.	2010.	2011.
EU	18043,6	20357,5	24669,5	28279,1	30227,9	32350	34724,3	34157,1	33912,9	34033,1
WORLD	5210,83	5609,84	6408,85	7109,93	7583,1	8088,31	8687,61	8674,44	9076,38	9511,19
USA	35970	38360	42020	44670	46280	46910	47890	45950	47360	48620
CHINA	1100	1270	1500	1740	2040	2480	3040	3620	4240	4940
RUSSIA	2100	2590	3410	4460	5820	7590	9710	9290	9930	10730
BRASIL	3050	2950	3310	3960	4800	6110	7490	8150	9540	10720
GERMANY	22850	25400	30750	34780	37210	39440	42470	42540	43280	44270
FRANCE	22330	25130	30420	34850	36760	38900	41940	42380	42190	42420
ITALY	19910	22310	26980	30880	32560	34030	35760	35570	35550	35290
SLOVENIA	10790	12470	15400	18070	19570	21520	24210	23750	23910	23610
CZECH REPUBLIC	6340	7720	9750	11890	13440	14910	17840	17920	18390	18620
CROATIA	5390	6390	8150	9690	10800	12140	13700	13590	13570	13530
EURO AREA	20234,9	22806,8	27723,6	31728,6	33812,7	35869,6	38477,3	38472,7	38502	38654,2

Source: data.worldbank.org

From the table is visible the rise of the GNI per capta in all the chosen countries. Also, we can see that GNI per capita in developing countries grows faster, sometimes a lot faster than in developing countries. In the last ten yers GNI per capita in China grew 4,49 times, in Croatia 2,51 times, in Brasil 3,51 times, in Russia 5,11 times. While the USA had a growth of 1,35 times, Germany 1,94 times, France 1,9 times.

6. THE IMPACT OF FDI ON THE COUNTRIES ECONOMY GROWTH

To find out what's the impact of foreign direct investment on the countries growth we calculated the correlation between FDI per capita and GNI per capita. The results are shown int he table below (cf. table 4).

Table 4: Corelation between FDI per capita and GNI per capita of selected countries

Coefficient	Pearson	Spearman
EU	0,58202667	0,619549
WORLD	0,76639428	0,783459
USA	0,62256813	0,675188
CHINA	0,95317143	0,956391
RUSSIA	0,92891719	0,674436
BRASIL	0,85328416	0,813534
GERMANY	-0,090155	0,051128
FRANCE	0,43611064	0,275188
ITALY	0,29800262	0,249624
SLOVENIA	0,46373433	0,494737
CZECH REPUBLIC	-0,0860509	0,249624
CROATIA	0,58716629	0,466917
EURO AREA	0,54783887	0,482707

Source: calculated and prepared by the authors

As we can see in the table developed countries there is no or low correlation between DFI per capita and GNI per capita. Countries in developement have a good or high correlation between FDI per capita and GNI per capita. The results has shown that there is a much bigger impact of FDI on the economy growth of developing countries than on developed ones. Which is understandable because those countries have a lot less investment capital of their own so they need FDI if they want to grow with faster rates.

CONCLUSION

The economic growth is the primary concern of modern governments. FDI is one of the elements that contribute to the economic growth of a country. Benefits from FDI greatly can be seen in transfers of new technology, knowledge, new employment, strenghtening of an economy, better trade balance with other countries, and so on.Since FDI open new work places they have a direct impact on employment, rising of wages as well as transfering of skills and knowledge. FDI also improve management skills and techniques, combined with new skills of workers working with new and sofisticated technology rises productivity and competitivness. FDI is usually attracted by owners private interest, like lower labour, production or business costs, big market cac be a good reason for investing. There are some criteria that must be fulfilled for FDI. The first is political stability, for a long term investment is imperative stability and favourable business environment, unstable political situations usually attract high risk investments that usually have a short term character. The Gross National Income (GNI) is one of the most important indicators of a countries economic health, for more objectiveness int his paper was used GNI per capita. Investments are very important because they enable the economy to grow much faster. Foreign investments are even more important because it's new capital coming in a countries economy. While in the laste twenty years the FDI per capita grew sedily in developing and developed countries, in the last ten years things changed. In developing countries continued to grow stadily while in developed slowed down. The financial crisis of 2008. had obviously a great negative impact on direct investment and has to be taken into account when analyzing the FDI. The natural course and growth of the FDI changed because of such an event. The GNI per capita in developing countries grew faster, sometimes a lot faster than in developing countries. Since Croatia and other countries that still haven't arrive to the level of developement of leading countries in economy they have to improve in lowering administrative beriers s well as still some corruption issues, there is lot to be done in education to create work force that can cope with new technology, there can be done also a lot more in fiscal benefits for companies as well as in financing. The results has shown that there is a much bigger impact of FDI on the economy growth of developing countries than on developed ones. Which is understandable because those countries have a lot less investment capital of their own so they need

FDI if they want to grow with faster rates. Finaly, we found that FDI has a big impact on the economic growth, but as the countries develop they become less reliant on foreign investments.

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