FDI AND IMPACTS OF COUNTRY RISK –FACTORS AFFECTING THE INFLUX OF FDI IN EMERGING ECONOMIES

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Abstract: *The role of "Foreign Direct Investments"* **-** *(FDI)" is crucial for all the countries throughout the world but it is very important, specifically for the emerging Markets of Balkans and Black sea countries.*
FDI was an essential and critical factor of the overall economic growth for the countries of this region from the 1990s and onwards.
It is generally acceptable that the «foreign flows of capital» and the involving investment enterprises actions in foreign countries play today an essential and accelerative role in the industrial and economic growth of these states, which are also called as «Transition economies».
So, for all countries of South-Eastern Europe and Black sea, it is underlined thus the vital importance of contribution of foreign investors in the area of finance, innovation and innovative action, that are crucial for the transformation of their economies into a viable and sustainable market economy.
In these countries with economies in transition, it seems that the development rate has negative impacts due to a number of adverse factors derived from political and economic environment.
These adverse factors are namely the state bureaucracy and political and social corruption, as phenomena of structural weaknesses of the society and economy that have as an impact a hostile environment encountering innovation and competitiveness process of any economy.

Keywords: foreign capital flows, foreign direct investments, Country Risk, Political Risk, Economic Effects

JEL Classification Codes: F21, G32

1. THE INFLUX OF *FOREIGN CAPITAL FLOWS*

On the other side of the economy, there is a very important and crucial factor that refers to the ***influx of foreign capital flows*****,** for the implementation and diffusion of the proper manner in order to organize the whole environment with the positive factors of growth and competitiveness in emerging economies.

This constitutes a very important factor for the configuration of those conditions and contributes to the developmental dynamics so as to withdraw the negative factors and

reinforce the development of the regions of *transition countries* through transregional collaborations in a more interdependent way.
However, this transregional collaboration could be developed in the wider area of Balkans, and this fact shall lead to a continuing and constant surge of Direct Foreign Investments.
For this target we need the perpetual existence of the proper political and economic conditions of stability and growth, which may continuously prevail and apply all the actions of governments and societies.
So, the proper conditions must be created, forming the political and economic frame for the proper application of rational operation of the relevant factors of the "market economy", in the countries whose economy is under *"transition",* which are the countries of S./.E. Europe.
Our objective is, therefore, to analyze and record a series of negative factors and conditions, institutional, structural and systematic character.
Negative factors, that are obstacles, affect the delay to establish the positive conditions for the growth of competitiveness and innovative action for the quick transformation of these countries.
These questions will be approached through the relevant and special economic and financial theory, by taking also into account the political or country risk factor and the features that affect the delay to establish the positive conditions for the growth through competitiveness and innovative action.

The analysis and the overview of impacts of political / country risk factors, that are reported after the applied policies of the governments in any country are very important, and concern the events and the way of application of the total economic policy, as it expressed in the various fields of decisions.
Such fields are for instance, the existence of "exchange controls" and restrictions in imports, as well as the application of such restrictions on money, and generally capital inflows and outflows.
At first, we have to mention and deal with the main crucial factors, that determine the positive/negative impacts on foreign investments – FDI.

Studying the **structural weaknesses** of N-E Europe countries, certain common features are detected among the different regions of these countries, and it is intended to observe and access the general environment of investments.

Those are mentioned as follows:

1. After the 1989 it is noticed the beginning of political and economic transformation of the countries and the participation and entrance of these Eastern Europe countries in NATO and E.U.; this fact improves and increases considerably the geopolitical stability in the area.
2. Also the prospect of their entrance in the European Union provided powerful motives to these countries so as to increase the "budgetary discipline" and try to put an order in their budgets and the financial situation in general.
3. Finally, beginning from "low" economic base (low level of GDP), the rates of growth of the economies were relatively higher than those of Western Europe.

Based on the combination of assessments with the prospects of growth, they create many activities to attract investments.
It is true that the gradual improvement of «corporate governance» application and *the reduction of country risk* increase the investment opportunities in every country.

During this period the countries of South -Eastern Europe presented important economic progress, as it presented in the openness to free market economies, and generally they achieved ascendant course of privatisations.

As a result, the ''Foreign Direct Investments''-FDI, in these countries increased considerably from 1994 and onwards.

This was also interpreted as an increase of per capita income.

Today, we have a very low percentage of growth in the Eurozone, which does not support particularly the growth of the S/E Euro region.

It is remarkable the existence of a large number of companies that emerged from these conditions based on capable management, powerful economic elements of the new market conditions and the prospects as well as improved corporate governance.

The sectors that occasionally offer opportunities in the region are mainly those of banks, which, after the first wave of mergers and acquisitions, constitute a good reason for expecting constant profits.

In the field of telecommunications, for instance, the improvement of per capita income is interpreted as an increase of consumption volume of these services.

From the beginning of *2003* until now, these markets presented satisfactory ascendant course, mainly because the expectations of world economy growth seriously affected Stock Exchanges, which noticed impressive progress particularly in the emerging markets.

2. FACTORS THAT DISENCOURAGE THE FOREIGN INVESTMENTS

Structural weaknesses to achieve innovation and competitiveness

At first the crucial factors that determine positive or negative impacts on the implementation of the foreign direct investments (FDI), are the following:

1. The size of market,
2. The existence of important and constant consuming expenses
3. The effects of bureaucracy, the corruptness and structural weaknesses of economy that affect the innovation and competitiveness of the countries.

Other important and decisive factors about attractiveness of foreigner direct investments are as following:

1. The internal and external macroeconomic imbalances,
2. the degree of disruption of old economic system structures and old fashioned activities that create at the same time new "functions" in the economic life.
3. The weak and low "depth" capital markets and also low investment grants, and the insufficiency of capital availability in Balkan and Black Sea countries for financing investment plans.
4. The insufficient knowledge of local markets and characteristics of population and consumption patterns.
5. The insufficient and weak commercial banking system and the low possibility of financing of enterprises.
6. The relatively insufficient legal infrastructure, that is reported for the economic functions and actions, and the business status,
7. The «dangerous» illegal activities of various "interest groups" incorporated in the process of privatisation that can cause damage in a foreign enterprise or business.

A study, for instance, based on the international enterprise's actual state and experience, taken place in Latin-American countries, provides the following list of governmental operations and actions that it is possible to have negative effects on foreign investors:

1. controls of imports
2. local requirements of conformity in local regulations
3. local regulations for the CAPITAL requirements
4. requirements about regulations with regard to personnel
5. restrictions of lending
6. prohibitions of re-export of profits and rights of using patents (royalty remittance)
7. tax discriminations
8. several obstacles to materialize the investment process
9. discrimination for the allocation on the investment grants and subsidies.
10. preventive obstacles for acquisitions of fortune in the foreign country.
11. expropriation and nationalization.

These phenomena appeared in the past years before the advanced process of globalization.
It should be underlined that these interventions and restrictions are not formal discriminations in any case, but the result of deliberated discrimination.
Monetary/financial and tax problems etc. can be derived from the deficits in «balance of payments» at several periods.
The foreign investors confront the need to develop sustainable strategies that take into consideration not only the evolutionary tendencies in economy and politics, but also the possibilities of radical change and the discontinuities in the environment caused by political fluctuations and disturbances.

Traditional determinants *of F.D.I. are namely market size, firm specific costs and relative factor endowments; one should also consider the main transition-specific determinants of F.D.I, such as the internal and external macroeconomic imbalances, the centralization of economic activities prior to 1989, the inexistent capitalist class, the inadequate market knowledge of the population, the low financial depth of Balkan stock-markets, the inefficient commercial banking system, the ambiguity over private ownership, the insufficient legal infrastructure, the different pattern of trade and investment integration within the CMEA and the activities of embedded interests at the detriment of privatisation process.
(Hazakis K., Pattern of F.D.I. flows in South-east European transition Countries: A Comparative Analysis of trends and Perspectives, Editions Department of Mediterranean Studies-University of Aegean-Greece).

3. THE EFFECTS OF FDI ON ECONOMIC GROWTH OF A HOST COUNTRY

When we talk about the significance of foreign direct investments (FDI), for the transition economies of Southeastern Europe, two important effects of FDI come to our mind:

1. effect on economic growth
2. effect on export performances

<u>The effects of FDI on economic growth of host country</u>
Economic theory has identified a few effects of foreign direct investment (FDI) which result in an increasing growth rate of host economy:

1. FDI are forms of import of capital

2. Import of foreign capital (through FDI or any other way) enables the financing of current account deficit
3. Opening of foreign companies' affiliation contributes to the level of competition enhancement.

Foreign direct investments represent the channel of international technology transfer in the host economy:

4. There are three different ways of international technology transfer:

- import of high-tech products
- learning through export, when domestic producers acquire new technology-based knowledge available, and
- Foreign Direct Investment

Factors of influx of FDI in Central and East Europe countries with economies in transition

- The availability of natural resources
- Development and achieved level of reforms in economy
- Privatization

Access to the EU market

4. THE EFFECT OF FDI ON ECONOMIC GROWTH OF SOUTH EASTERN EUROPEAN TRANSITION ECONOMIES

Generally the studies examine the relationship between FDI inflows and economic growth in the countries of Southeast Europe (Romania, Bulgaria, Serbia and Montenegro, Croatia, Bosnia and Herzegovina and Albania).
Branches of transnational companies (TNC) in transition economies contribute to the production, productivity and employment increase.
The Correlation between FDI /GDP and economic growth rates is the most proper solution for all the three aforementioned approaches.
FDI/GDP ratio represents the most appropriate measure of FDI inflow's significance for the economic activity of a host country.
But, in some cases, we did not find statistical correlation between these two variables. (These are mainly derived from scientists of the former Eastern countries, as it can be seen from their research and articles, which have an ideological orientation for global growth).
The affiliations of foreign companies contribute to the production and employment increase.
But on the other hand, due to structural reform in these countries, the production and employment decreased in domestic inefficient firms.
This can neutralize or even surpass the positive effect of FDI on economic growth.
So, that's the reason why they did not find any statistical correlation between the FDI influx and the economic growth in some or many cases.
They don't believe in the positive transitionality of these economies and the positive effects of FDI, because of a nationalistic approach about development, according the "dogma of the foreign exploiter".

So, some economists or researchers suggest that FDI does not have any significant relationship with economic growth. The cause can be found in transition process itself.
Due to structural reforms in these countries, there is production and employment decrease in domestic inefficient firms. This can neutralize or even surpasses the positive effect of FDI on economic growth.

5. FACTORS OF POLITICAL RISK AFFECTING THE FOREIGN INVESTMENTS PERFORMANCE

The effects of bureaucracy, the corruptness and the structural weaknesses

An essay according Bibliographical references.
With regard to the determination of political risk, this can be caused from the behaviour of state (government and public administration) or government owned enterprises in the market, or even from more extreme situations, as the war and the big political agitations.
Thus the determination of political risk, are the changes in the "functional terms” of actions and the growth of foreign enterprises, that are coming as a result from the political processes and activities in a country.
More analytically, such political processes are**:** a war, a revolt, phenomena of political violence, or important changes in governmental policies, as well as changes that have effects on property rights, on the assets of a company, or the restricting enterprising attitude of each company.
The political risk that becomes perceptible in national and international environments can affect assets, the firm’s staff and generally all their operations with a direct impact on the turnover and the profits of foreign companies in a host country.
But the risk of a country has a general significance, including a much wider spectrum of uncertainties like.

a) Claims of payments of more generally SEVERAL economic obligations, against a state/country, that includes the claims against the government and the companies of that country.

b) The attitude and the relative policies of a country and its government to the foreign investments.

Thus we have:

A) Government risk or sovereignty risk, as risk of international lending.
B) Risk with regard to the direct foreigner investment.
C) Risk with regard to the investment in participial portfolios.
D) Risk concerning the international interaction of money and capital markets,

In relevant literature the risk of international lending and the relevant obligations that arise from it, is also called as government risk or sovereignty risk, as typically reported in the risk that dominates in the country so as to violate the obligations of the international payments, as a result of crisis in the system of exterior payments (eg Eaton and Gersovitz, 1981 walter 1981 Eaton et Al 1986).
These crises can emanate from:
a) bad chance, b) bad faith, c) mismanagement, or from a combination of those three factors.
Respectively, in the literature of direct foreign investments, the political risk is typically addressed as a risk of discontinuities of various policies that practises subsequent losses or damages, because of expropriations or other obstacles, which lead to perturbations of the sales and profits level[1].
In the case of "investment in participial portfolios", the country risk is defined as the medium variability in the output of companies in a given country[2].

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1 Reasons of important political shifts and realignments, Kobrin 1979
2 p.h. Agmon 1973, Solnik 1973, Lessard 1976

Finally, concerning the international interaction of money and capital markets, the political risk is typically addressed as a risk of control enforcement in the distribution of capital and similar exchanges[3].

6. CONCLUSIONS

THE TYPE OF FDI EFFECTS ON A COUNTRY

It is widely recognized, that, the Foreign Direct Investments – FDI have the following effects:

- FDI helps the process of economic rebirth of states and companies. (Djankov and Murrell, 2002);
- it facilitates the increase of GNP;
- it creates the competitive conditions in the economies of these states;
- The foreign surges of capital are bringing technical/technological and managerial-organisational knowledge;
- They impose the commercial transparency and the opening of countries of reception (Hunya, 2002: 393);
- They increase the dexterities of work;
- They upgrade the productive structure, and provide (under certain macroeconomic terms), alleviation of balance of payments (E.B.R.D, 2002).

It is known that, without serious surges of foreign capital, there would not be the probable and successful "passage" in market economies for the central and Eastern Europe countries, as well as their further developmental dynamics.

Consequently, the process of the passage was sensitive in Political and Economic circles, as well as fluctuation that considerably influenced the state of capital flows through foreign investments.

It is know that though this, capital flows enabled most of the states in the area to enjoy favourable initial economic terms of growth and facilitated their passage to open market economies.

In this process some countries were looking more attractive to foreign companies, because of their appropriate initial conditions, while other were dealing with constant obstacles because of their political and economic disadvantages.

SECTORS OF POSSIBLE POLITICAL CONFLICT

The most likely sectors and factors of conflict cover a wide spectrum of possibilities that are:

- <u>NATIONALISM,</u> resulting from the fact that it is considered as a “foreign exploiter” by investors.
- <u>PHILOSOPHY AND OBJECTIVES of ECONOMIC POLICY</u>, where the environment of investments is hostile, because it is determined by national objectives of economic political plans, as opposed to the wider private economic actions of firms for ideological orientation reasons of the country.
- <u>CULTURAL</u>, where the introduction of innovative ideas was disruptive for the established ideas, customs and ethics provided by the local society and its interests.
- <u>ADMINISTRATIVE</u>, where the company should oddly face many barriers from contradictory applied rules and regulations.
- <u>SOVEREIGNTY</u>, where the presence of a foreign company becomes perceptible and the

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[3] eg Aliber 1973, 1978, Dooley and Isard 1980

rights of sovereignty of a country decrease, and thus its fortune is determined; it is considered as a leader or driver that is very likely to enforce obstacles from foreign governmental intervention, due to the interests of multinational maternal companies.

THE CONSTITUTION OF POLITICAL RISK AND THE APPLIED POLICIES OF THE GOVERNMENTS

The country risk is defined as the constitution or the peculiarity of particular national conditions, operations and practical conditions, reported in the economic and political constitution of the state (country), and from this, peculiar functionalism of some certain standards (in other countries) of attitudes and reactions.
These aspects of country risk are the following:

1. Political risk that is reported in applied policies by the government of a country and it concerns the way of event of total economic policy in various fields.
Such fields are the existing exchange controls and restrictions in the import and the strict application (of rules) on money and capital markets.
The existing restrictive measures and regulations that concern the protection of exchange available in a country and the protection of its domestic currency can be differentiated from the height of profits from enterprises activity that can be exported, as well as all kinds of investment capital introduced into the country.

2. Monetary restrictions and Credit policy

The existence of monetary restrictions, restrictive credit policy and lending policy, in connection with the structure and the level of growth of financial markets and banking system influence the convenience or the delay in money transfer.

3. Social Stability

The existence of social stability and social cohesion conditions within a country, among various social groups, combined with the quality and the degree of organisation of working unions (workforce), as well as the degree of adversity and its ruptures with the business owner sin constitute the base of working syndicalism. Generally the existence of dynamic social balance that gives possibility in the modern economic and enterprise action.

4. Economic Stability

The existence of economic stability, that is reported in the macroeconomic stability,

1. the inflation rate,
2. the exchange parities,
3. the deficits of public sector and budget,
4. the exchange rate stability, in combination with
5. the commercial balance of payments in a country,
6. the economic growth rate - GDP and
7. the quality of general economic institutions combined with
8. the enterprise climate and environment and the business dexterity can create SYNERGIES in the enterprises actions.

5. Operational planning and political risk analysis

Thus today the estimate of the degree of economic, political and financing risk is a priority in the management action of planning and forecasts of results of every multinational enterprise operating in a foreign country.
By definition, the degree of risk depends on each prevailing economic and political general climate and the above referred special factors and thus shapes the degree of investment risk.

This climate influences therefore the relation between the growth rate of an economy and the rate of foreign investments, and thus the situation or the existing conditions of South-eastern Europe and Black Sea countries.

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