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ANALYZING THE CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO THE FORMATION OF INVESTMENT POTENTIAL OF EUROPEAN COUNTRIES

ГОДИШНИК НА ВУАРР

ТОМ VIII

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UNIVERSITY OF AGRIBUSINESS AND RURAL DEVELOPMENT

YEARBOOK, VOLUME VIII, 2020

ANALYZING THE CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO THE FORMATION OF INVESTMENT POTENTIAL OF EUROPEAN COUNTRIES

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Abstract: The paper analyzes the importance of foreign direct investment in the formation of investment potential of European countries. It describes the changes in the volume of foreign direct investment in many European countries, such as Ireland, Switzerland, Germany, Spain, the Visegrad Group countries (Czech Republic, Hungary, Poland and Slovakia). The paper includes analysis of the inflow and outflow of intra-regional foreign direct investment within the EU during the period 2016-2018. The authors divided the inflow of European foreign direct investment during the period 2003-2015 into four main stages, which have their own characteristics and differ significantly due to the financial crisis of 2007-2009. The paper highlights a clear tendency for non-European FDI to flow to large and economically mature countries. The top five countries in terms of GDP (Germany, the United Kingdom, France, Italy and Spain) account for almost 60 percent of total extra-European FDI flows to Europe between 2003 and 2015 (51 percent of Greenfield and 61 percent of M&A).

The study shows that there are common factors increasing the attractiveness of European countries to foreign investors.

Keywords: foreign direct investment, EU, multinational corporations, mergers and acquisitions, UN Conference on Trade and Development, innovations.

Introduction. Investment is an important component of integration processes and a catalyst for globalization in the world economy, which creates additional challenges for cooperation between countries, while creating new opportunities for their partnership. The European Union is the largest economic bloc on the planet. It is an active global player in the international arena and one of the world's largest generators and donors of development processes. The economic potential of the EU is quite strong and in economic independence the European Union is second after the United States. The EU is one of the largest global players in the field of foreign direct investment, which draws increased attention to the peculiarities of the formation and implementation of the investment policy of the association. The investment policy of the European Union differs significantly from the investment policy of the national level, as it is international in nature. The mechanism for implementing the EU investment policy is based on the task of optimizing the distribution of capital within an integrated Europe and ensuring sustainable economic growth in the region. The investment policy of the European Union is based on the relevant founding treaties and the principles of the single internal market, which ensures the free movement of capital within the union and its effective development by member states.

The beginning of the century was a very difficult period in the movement of global flows of foreign direct investment. The main reason for the instability of FDI is related to the crisis in the world economy. The value peak reached in 2007, when the global inflow of FDI amounted to 1.8 trillion dollars, almost recovered by 2015 (1.76 trillion dollars), which was the highest level since 2008-2009, in 2016 amounted to 1.75 trillion dollars, in 2017 - 1.43 trillion dollars, in 2018 - 1.3 trillion dollars. Experts link the recovery and then the decline in global FDI with the instability of international mergers and acquisitions, as well as large-scale repatriation of American capital. These processes have led to the transformation of foreign direct investment mechanisms.

The aim of the study is to analyze the importance of foreign direct investment in the European economy.

Issues of modern investment processes in the context of globalization are studied by scientists in all countries of the world. Significant attention to investment in modern conditions was paid by Shayerah Ilias Akhtar, Marianne Schneider-Petsinger, Anabel Gonzalez, Rohach O.I., I.V. Prychepa, O.A. Smetaniuk, O.H. Ratushniak, Malskyi M.Z.

Materials and research methods. UNCTAD and IMF statistics were used. Research methods included analysis, synthesis, comparison, generalization, graphs, statistics.

Results of the research. The inflow of FDI to the developed economies of the world in 2019 increased by 5% to $ 800 billion from $ 761 billion in 2018, despite the uncertainty of the investment market caused by tensions with Brexit and weakening macroeconomic indicators (World investment report (2019)).

External FDI from developed economies to European countries in 2019 increased by 72 percent to 917 billion dollars. The increase was mainly due to a reduction in the effect of tax reform in the United States at the end of 2017, which led to a significant negative outflow in 2018 - overall external FDI remained relatively low, only about half of the 2007 peak.

The value of cross-border agreements on mergers and acquisitions in developed countries has actually fallen by 34 percent, mainly in manufacturing and services. Several countries, including the United States, the Netherlands, and Germany, have experienced high volatility in their outflows. Figures 1 and 2 show the inflow of intra-regional FDI within the EU during the period 2016-2018 (World investment report (2019)).

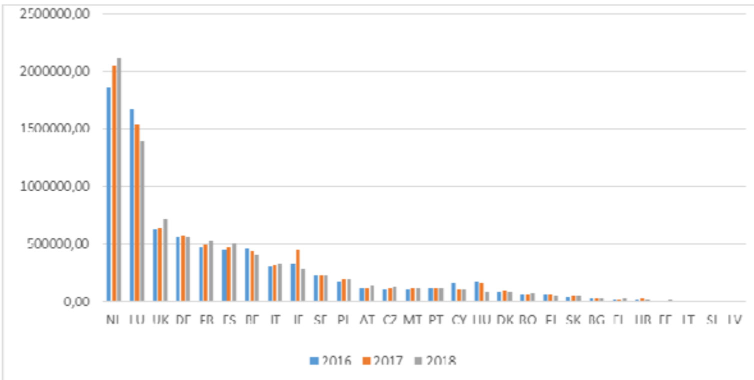

Fig. 1. Inflow of intra-regional FDI within the EU, 2016, 2017, 2018 (distribution by country), in thousand USD

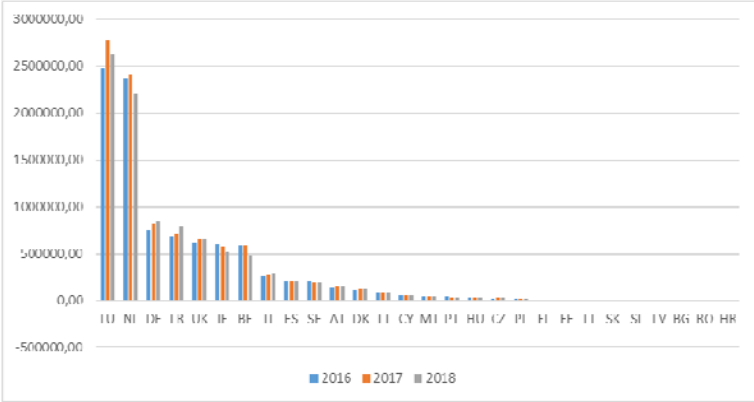

Fig. 2. Outflow of intra-regional FDI within the EU, 2016, 2017, 2018 (distribution by country), in thousand USD

FDI inflows can benefit regional host economies through various channels, as follows:

First, foreign firms can have a direct positive impact on production and job creation in the host region. Investments in greenfield stimulate economic activity in the region during the construction and expansion of the capital fund, and investments in greenfield thus have the potential to increase production and create new jobs in the host region. A change in ownership related to M&A can increase the growth productivity of the target firm (for example, by transferring new leadership principles, understanding foreign markets and advanced technologies). The contribution of additional capital to the firm can alleviate the situation with capital shortages, which will support long-term survival and growth prospects. Therefore, M & As also has the potential to positively contribute to the regional economy, supporting or even contributing to the growth of production and jobs within the firm. For both types of FDI, increased production can stimulate demand for local supplies of goods and services, which will have a positive impact on job creation in the host region.

Second, foreign firms can increase the competitiveness and growth of local firms through the so-called diffusion of productivity.

The average size of the transaction and the sectoral composition of domestic European FDI are similar to the BNP's European profile, but European investors are more likely to hold M&A, while non-European investments are more common in greenfield. In addition, FDI by public investors is less likely to be associated with intra-European markets than non-European FDI.

A conducted study of the dynamics of FDI inflows to the EU and the Eurozone made it possible to identify five main stages over the past twenty years: the total number of projects and the cost of FDI experienced a sharp increase and peak in the pre-crisis years (the first stage); during the financial crisis of 2007-2009, direct investment in Europe by European and non-European investors slowed down and returned almost to the level of 2004 (second stage); in the following years, the level of FDI inflows to Europe stagnated (third stage), until the beginning of the recovery phase in 2013 and continued until 2015 (fourth stage); The period 2015-2018 is characterized by a sharp decline in FDI inflows to EU and Eurozone countries, even to negative values in 2018 (fifth stage) (Fig. 3). The identified trends in the dynamics of FDI inflows reflect the global economic dynamics and trends in BNP investment activity.

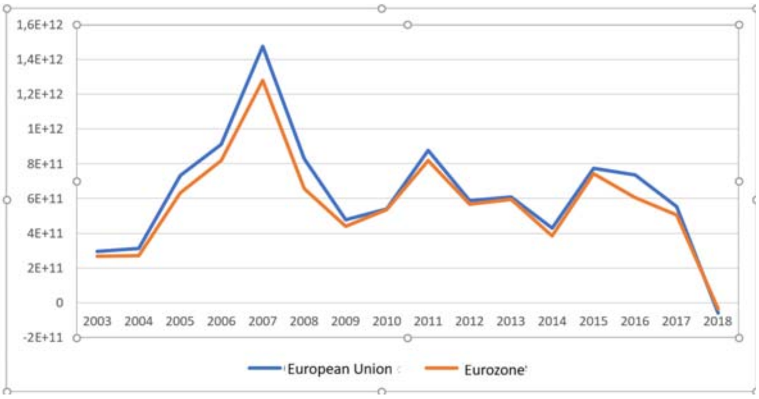

Fig. 3. Dynamics of FDI inflows to the EU and Eurozone countries, 2003-2018, in USD

Both intra-European and non-European FDI show a peak in the number of FDI projects in the pre-crisis years, followed by a slowdown, a period of stagnation and a recovery period. However, intra-European FDI has played a smaller role in recent years, with intra-European FDI projects accounting for 57 per cent in the recovery phase compared to 63 per cent in the slowdown phase.

The total value of intra-European FDI exceeds the total value of non-European FDI in most years during 2003-2015. The increase in FDI inflows to Europe was mainly due to intra-European FDI, while non-European FDI was relatively more important for post-crisis Europe due to the faster recovery of non-European FDI. Since 2010, intra-European FDI has accounted for about 50 percent of total FDI, up from 60 percent in 2003-2009.

The outflow of FDI to other European as well as non-European countries can also benefit the firm's home region. Investing abroad can help European firms enter new markets, benefit from a large-scale economy, gain access to key factors of production and other ways to increase their efficiency.

Thus, non-European FDI brings new capital to Europe, supporting job creation and increasing the productivity of local firms in the host region. Similarly, intra-European FDI can benefit both the host region and the home region. Intra-European FDI has the potential to increase European productivity in both host and domestic regions.

Although FDI has the potential to boost economic growth in Europe, the net positive impact will not be taken for granted. Local firms that are in direct competition with foreign firms may lose market share and reduce their production capacity, which means that new jobs in a foreign firm to some extent reflect the replacement of jobs in local branches. If a foreign firm also uses domestic suppliers to a lesser extent than a local substitute firm, the net impact on job creation may even be negative. Diffusion of knowledge may also be limited, for example, if local firms are limited to terulation with a foreign firm or have a low absorption capacity. This report provides new insights into how these productivity spills materialize and how employment in local firms is affected by the presence of foreign firms.

FDI also has the potential to support convergence in different regions of Europe. In general, FDI generally supports convergence if it enters disadvantaged regions with low levels of economic activity or if the impact of FDI in these regions is greater than for other regions.

Thus, FDI has the potential to increase productivity, boost economic growth and support economic convergence in Europe:

• Non-European firms account for about 4.3 million jobs, which is five percent of total employment in these countries. In addition, non-European firms account for 11 percent of production and nine percent of value added;

• European firms account for about 19.2 million jobs, which is 13 percent of total employment in these countries. In addition, European firms account for 21% of production and 19 percent of value added in these countries.

In general, foreign firms (both non-European and European) account for three percent of the total number of firms, but 18 percent of total employment, 32% of production, 28% of value added, and thus have a disproportionately large impact on European economy.

The potential for productivity diffusion arises because foreign firms consist of large amounts of technical, operational, and managerial knowledge that can spill over between local firms and improve their productivity and growth. Foreign firms may influence local firms in one industry differently than local firms in other industries. Foreign and local firms within the same industry often share the same pool of labor and customers, which means that they are more competitive, but the knowledge of foreign firms can also be transferred directly to local firms within the same pools.

Local firms benefit from diffusions arising from FDI in their own industry and region (intra-industry), as well as from FDI in other industries within their own regions (broader regional diffusions of productivity).

Previous research has also shown that productivity gains from non-European FDI tend to be higher than from intra-European FDI. There are a number of possible explanations for this. First, investment barriers may be higher for non-European FDI than for intra-European FDI, which means that non-European firms that have managed to enter the European market will be closer to the frontiers of knowledge and thus have greater potential for diffusion of knowledge. Second, knowledge can flow more smoothly between European countries than between European and non-European countries, which again suggests that the potential for learning from non-European firms will be greater. Third, the differences may be related to the underlying differences in investment patterns for European and non-European investors across different types of investments, origins and directions.

Figure 4 illustrates the spread of productivity from FDI in companies of different volumes The World in Europe, global FDI flows towards Europe Intra-European FDI Applied Research (2018) ..

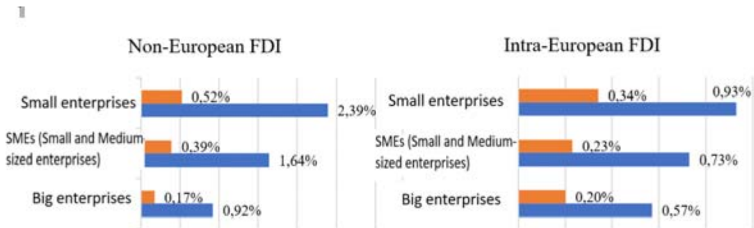

Fig. 4. Expansion of productivity from FDI

There is a clear tendency for non-European FDI to flow to large and economically strong countries. The top five countries in terms of GDP (Germany, the United Kingdom, France, Italy and Spain) account for almost 60 percent of total extra-European FDI flows to Europe between 2003 and 2015 (51 percent of Greenfield and 61 percent of M&A). Luxembourg and Cyprus are also large recipients, mainly due to their competitive tax regimes. Given the size of economies (measured by GDP), the Netherlands and Ireland are the most successful countries in terms of FDI attraction.

The UK alone attracted 30 percent of the total value of non-European FDI to Europe (49 percent of which came from the United States). Brexit has certainly affected FDI flows to both the UK and other EU member states.

Old EU Member States (e.g. France, the Netherlands and Germany) and EFTA countries (e.g. Switzerland and Iceland) tend to be net investors, while new Member States (e.g. Hungary and Romania) and candidate countries (for example, Turkey) are net recipients of intra-European FDI. Some of the net investment can be explained by the outflow of production from high-paying countries to low-wage countries. Also, large external FDI flows from the Netherlands reflect extra-European FDI invested in other European countries through Dutch holding companies.

The direct impact of additional European FDI is smaller in rural, non-metropolitan and less developed regions (less profitable regions) than in other regions, and therefore the contribution to convergence from the direct impact of non-European FDI is likely to be limited. These regions receive fewer additional European FDI, and non-European affiliates located in these regions tend to have a smaller average number of employees than in more developed regions. However, extra-European FDI inflows into transition regions have a large direct impact on jobs and economic growth, fostering convergence between transition and more developed regions.

According to the empirical analysis, we see that non-European FDI is associated with positive productivity spills for local firms within one industry and region (intra-industrial diffusion of productivity) and within a particular region in a broader sense (wider regional diffusion of productivity) in urban, metropolitan areas and more developed regions (preferences of regions). These results suggest that productivity diffusion should not be expected to stimulate convergence across regions.

There is every reason to believe that intra-European FDI stimulates the convergence of different regions more than non-European FDI. First, intra-European FDI is more evenly distributed across regions than non-European FDI. While capitals, urban regions and more developed regions still receive the majority of non-European FDI, less profitable regions receive a larger share of intra-European FDI. Secondly, rural, non-metropolitan and less developed regions receive a larger share of intra-European greenfield. This type of FDI is more likely to create new jobs directly in the region than M&A (at least in the short term). Third, while less profitable regions receive the least investment both inside and outside Europe, European firms are more likely to support more jobs in less profitable regions than non-European firms. Finally, intra-European FDI is associated with increased productivity for local firms in all groups of regions, as well as in less developed regions, where there are no diffusions of productivity from non-European FDI.

Results and discussion. The study showed the presence of common factors that increase the attractiveness of European countries - the strength of regional industry clusters; availability of labor supply and a high share of the population with higher education; regional accessibility (physical and digital); high level of innovation; high concentration of FDI; market size; population density; introduced regimes of special economic zones in some countries of South-Eastern Europe.

Strong industry clusters, associated with a number of positive externalities that arise when such firms interact closely, make individual firms more productive. Specialized labor pools will be available in industries with strong industry clusters, and new ideas and innovations will be more easily disseminated to firms. Thus, the construction of strong clusters can launch a positive spiral, attracting foreign firms, which will further increase their strength.

The supply of labor and a high proportion of the population with higher education are also important drivers of FDI. These factors are important mainly for firms working abroad to provide a highly skilled workforce at a competitive price, as well as for firms in sectors with an interest in key expertise.

Regional accessibility (physical and digital) is also an indicator of the attractiveness of FDI, as it is highly correlated with the cost of transportation and ease of travel to and from the region. Good communication can also increase the size of the local market by improving market access (especially to more developed regions).

The high level of innovation also makes European regions more attractive to foreign investors, as the scope for acquiring new knowledge and hiring R&D workers will be larger. The impact is quite small, and we believe that further research into the importance of innovation as a driver of FDI for Europe may be useful.

High concentrations of FDI send a signal of low risk and high returns for other potential investors, and regions with a large stock of foreign firms will find it easier to brand themselves internationally and attract even more FDI. Thus, a higher concentration of FDI can also cause a positive spiral of constant FDI inflows.

The regional size of the market attracts foreign investors who are abroad to sell their products locally. In such cases, the relevant market is not limited to the regional market, but also to adjacent markets in other regions and some neighboring countries. A region with a small market size but with good accessibility to other markets can thus still be an attractive place to invest.

Population density in regions also attracts foreign investors looking for new business opportunities abroad, as a dense regional market means that firms can reach a large number of potential customers over a limited geographical distance.

Border regions, on average, are disadvantaged, as barriers to doing business across borders can limit the size of the local market and increase the cost of doing business across borders.

Regions with a high dominance of existing firms are less likely to attract foreign firms, as the local market will be perceived as a less attractive and riskier competitive environment.

Thus, one of the specific characteristics of international economic relations in the European Union is the interaction of global internationalization of economic life and regional economic integration - has become particularly clear. The institutional transformations taking place in the EU have changed the investment climate and put the BNC in need of adapting cross-border operations to the new conditions for FDI placement. The international corporate integration conducted by the BNC is important for strengthening the convergence of national economies in the EU.

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