UDC 339.564:339.727.22(497.7)
330.55:339.727.22(497.7)
Original scientific paper

TOME NENOVSKI*
NINKO KOSTOVSKI**
DOBRILA DEJANOSKA***

INFLUENCE OF FOREIGN DIRECT INVESTMENTS TO EXPORT AND GROSS DOMESTIC PRODUCT OF DEVELOPING COUNTRIES – SPECIFICS OF REPUBLIC OF MACEDONIA

Abstract

It is widely accepted that the foreign direct investments play important role in the economic growth of the developing countries. They provide capital and positively affect these countries by transferring new technologies, establishing quality human capital, promoting integration into the global markets and the international community. In these terms, it is to expect that the foreign direct investments would also largely contribute to the host countries gross domestic product and their exports. While our research of the Republic of Macedonia time series proves significant correlation between the foreign direct investments and the gross domestic product growth, the association between the foreign direct investments and the growth of the exports is weak. We indicate on several topics for further research that would help better understanding of these results and conclude that the country specifics require detailed research in a wider social context if we want to learn more about the role of the foreign direct investments and before suitable recommendations to the policy makers can be made.

Key words: Foreign Direct Investments, Exports, Gross Domestic Product, Economic Development, Developing Countries

JEL Classification: E22, E44, F21

---

* Prof., Ph.D, University American College Skopje, e-mail: nenovski@uacs.edu.mk
** Prof., Ph.D, University American College Skopje, e-mail: kostovski@uacs.edu.mk
*** MBA, Head of Finance and Accounting, Ciklama Engineering, Skopje E-mail: contact@ciklama.com.mk

Introduction

The international capital flows, in general, gained significant momentum with the globalization. The same is true for their major subset, that of the foreign direct investments, that include mergers and acquisitions, building new facilities, reinvested profits, intra company loans and more than 10 percent voting stock in an enterprise operating in economy other than that of the investor. Financially speaking, the foreign direct investment is the sum of all capital transactions in the balance of payment of a given country. In more confined definition, the stock of the foreign direct investments refers to the difference between the total inward and the total outward direct investments of a country at a given date, (end of the year), excluding the portfolio investments. Foreign direct investments are all net inflows made by non-resident investors in the reporting economy. In these terms, strictly speaking, even the investments done by economic emigrants in their home country meet the criteria, at least before they return at home, if ever (WB, 2016).

The achievements of some of the fast developing countries during 1990s in the successful utilization of the foreign direct investments for the economic growth, put them into the lime light of many economists and policy makers around the world. There was even substantial jockeying of the countries in inviting the multinationals. With the domestic investment limited by lack of local demand, technology requirements, limited access to capital, the external stimuli to the investment process provided by foreign investors are critical for capital formation in many developing economies, typically plagued with low productivity, wages and saving. The foreign direct investments break this vicious circle. Moreover, the foreign direct investments also facilitate the access to the new technologies, knowhow and managerial practices. This raises not only the industrial output, but the competitiveness of the host countries. Globalization of the markets promoted further the growth of the emerging international investment sector. The developing, emerging and transitional economies all liberalized their legislations and employed various economic measures to attract more foreign investors. However, there are still various theoretical approaches to the effects of the relationship between the foreign direct investments and the gross domestic product and the exports. This paper explores these relationships in more detail in case of the economy of the Republic of Macedonia.

1. ROLE OF FOREIGN DIRECT INVESTMENTS IN DEVELOPING COUNTRIES

Many developing countries invite the foreign or multinational companies and provide various concessions expecting that the foreign investments will serve as substitutes for the missing local capital, lack of business initiative and shortage of knowledge. During the 1990s, many economists and policy makers praised the foreign investments as panaceas for virtually all development problems. Moreover, the entire concept of economic globalization was often equalled with the foreign direct investments. However, there are many who disagree stressing that the foreign investments are much more snake oil since they work only in the countries with already large local markets. Moreover, even then, when they leave, in the country nobody is better off, but actually poorer than before (Haynes, 2003).

2. MOTIVES FOR FOREIGN DIRECT INVESTMENTS

The literature on the foreign direct investments indicates on three most frequent motives for a company to invest abroad and hence on three main types of foreign investments: resource seeking, market seeking and efficiency seeking. According to Kudina and Jakubiag (2008) the availability of natural resources, raw materials and crops, together with the abundance of cheap labor attract the resource-seeking investors. The only requirement is reliable business infrastructure. Market-seeking investors are attracted by the size of the host country market and its potential for growth. For these investors, the market of the host country, if big enough, provides them chances to expand their sales and profits. This will allow them to stay competitive and grow internationally and at their native countries. Expanding the total markets where they sale these companies achieve extra economies of scale of their operations with yet focused scope. The countries with large market size and fast economic growth are particularly interested for these companies. The efficiency seeking investors look for ways to improve their cost effectiveness and thus their competitiveness. The efficiency seeking multinational companies prefer low wages countries with sufficiently skilled local labor. These companies are ready to trade off the lower labor productivity with the lower wages, achieving targeted productivity-adjusted labor costs that will allow them to pursue international cost leading strategy. However, they require availability of significant local

business services and friendly trade policy reflecting high degree of openness, as well as favorable currency rates. These factors are among the key location criteria for this type of investors. The degree of the development of the host country is instrumental for the location decision since it indicates on existence of the entrepreneurship attitude, quality education and reliable infrastructure, conclude Kudina and Jakubiag (2008).

3. FOREIGN DIRECT INVESTMENTS AND THE EXPORT

There is a lack of consensus among the scholars about the influence of the foreign direct investments and the host country exports, or more generally, on the relationship between the international factor movements and the international trade in goods. Although some recent research show that the foreign direct investments can stimulate the export growth, some other point out that the foreign investments can actually inversely affect the export, or at least the trade balance. Authors, like Kutan and Vuksic (2007a), highlight the positive effect of the foreign direct investments for the host country exports. Other, like Radulescu and Serbanescu (2012) argue that the foreign direct investments do not contribute, or at least, not significantly contribute to the growth of the exports, with some cases, when these investments can even worsen the trade balance, boosting the import and the consumerism in the host country.

Nevertheless, the positive effect of the foreign direct investments in promotion of the exports of a given host country may be summarized as direct and indirect. The direct effects refer to the actual export made by these foreign investments from the host country to the international market. The indirect effect stems from the influence on the performance of the domestic companies. The local companies have to meet high quality standards if they want to be part of the supply chain. However, the positive impact on the host country exports might not be present in all cases. For example, in case of the foreign direct investments in the non-tradable sectors of the host economy. Moreover, in the sectors in which the domestic companies already are exporting this additional offering might even move the local companies out from the market. According to Kurtishi (2013) the impact of foreign direct investments on the host country trade with the world, differs depending on the prevailing motive of the foreign investors. She claims that the output from the efficiency-seeking foreign direct investments is typically intended for export. Therefore, the impact of these

investments is likely to increase the overall exports from the host country. If the local firms can provide significant input to these investments, the value added of such exports could be much greater. In the cases where the intermediate goods are imported, the efficiency seeking foreign direct investments will simultaneously increase the imports. Nevertheless, since a good portion of the value-adding business processes is located within the host country, the impact on the trade balance and country value creation is positive. Regarding the market seeking investors, Radulescu and Serbanescu, (2012) stress that they expand the imports, but have no effect of the exports from the host economy unless the informal or other alternative channels of indirect export are not present.

Kutan and Vuksic (2007) surveyed the impact of the inward foreign direct investments in 14 transitional economies of Central and Eastern Europe, between 1993 and 2001, and found that they all improved their export performance. Their results indicated that the foreign direct investments had unambiguously positive and significant impact on the exports of the countries of the sample, as well as in the case of the two subsamples: the more advanced transitional economies and the new EU member states, and (2) for the group of transitional countries, Russia and Ukraine. However, they also found that the positive impact on the exports was much stronger in the case of the first subsample, possibly reflecting the fact that these countries have managed to attract more export oriented foreign direct investments. Surveying the potential for improvement of the export performance of the Croatian manufacturing by attracting more foreign direct investments, Vuksic (2005) using panel data for 21 manufacturing sectors between 1996 and 2002, found that the foreign direct investments in Croatia positively affected exports, but the extent of that impact is relatively low.

Radulescu and Serbanescu (2012) surveyed the relation between the foreign direct investments and the exports from the Central and Eastern European countries between 1990 and 2010 using statistical data and literature review and underlined the factors that determined the increase of exports from these countries. According to them, the foreign direct investments can contribute to higher exports by increasing the supply capacity and/or through foreign direct investments specific effects as multinational enterprises may have better knowledge about foreign markets, superior technology, lower production costs, and better ties to the supply chain of the parent firm than do local firms. They found that, the inflows of for-

eign direct investments contributed to the higher supply capacity of those countries, leading to more exports. On the other hand, the evidence for the foreign direct investments specific effects is mixed. The results suggest that this effect has been present mainly in the case of the new EU member states, reflecting, among other things, the higher amount of foreign direct investments that this countries received relative to the other countries of the Southeast Europe, but also the higher productivity of the local companies acquired by multinational companies.

Analyzing the foreign direct investment and its impact on economic growth in the Central and Eastern European countries between 2000 and 2012 , Hlavacek and Bal-Domanska (2016) found statistically significant link between the foreign investment and the gross domestic product. They also found spatial disproportion with in the inflow of foreign investment and in economic growth. Estonia, Hungary, the Czech Republic and Slovakia report high influence of the foreign direct investments to the gross domestic product while Lithuania, Poland, Latvia, and Slovenia report lower influence. That the foreign big companies present can also harm the local partners was originally noticed by Hamlett at al. (2008). During the 1970s, in case of UK they practically eliminated from the market the vibrant sector of small businesses set by the layoff workers. Similar effect is noticed by the US and Canada, too. The foreign big company first approach the local manufacturers, farmers and providers of various business services driving them from their local business partners. Once when they with low prices eliminate the competition, start growing the prices and offering unfavorable deals to the local suppliers. The buyers are left without alternative, as well as the suppliers. Since their former customers are out of the business, the local suppliers have no other option but to accept these detrimental new terms of cooperation. The Canadian National Bureau of Competition issued a special guide for the local communities how to trace and prevent such damaging practices (Predatory Pricing Enforcement Guidelines, 2009). Similar happened in the case of two big foreign direct investment in Republic of Macedonia in 2015 and 2016, when two big market seeking investors, McDonald's and Carrefour forced their local subsidiaries into bankruptcy leaving many people jobless in a short notice and many suppliers not compensated. No matter this, Krstevska and Petrovska (2012) using panel regression to assess the foreign direct investments impact on the export, employment and GDP in the case of the Republic of Macedonia, found that the foreign direct

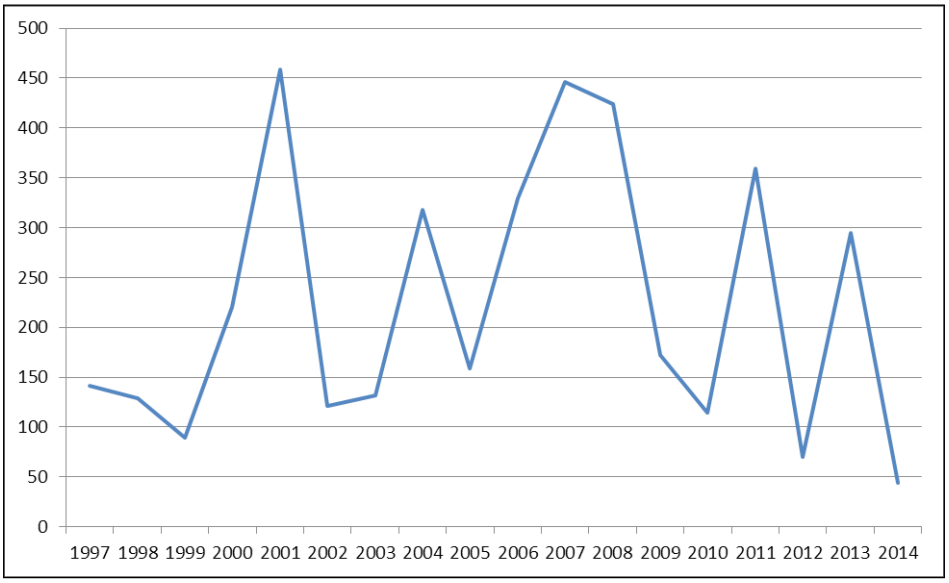
investments inflows, between 2002 and 2007, were important factors of the growth of the exports from the country.

4. FOREIGN DIRECT INVESTMENTS IN REPUBLIC OF MACEDONIA

Republic of Macedonia is a relatively new destination for foreign direct investments. In the past, numerous government strategies failed to bring tangible effects in terms of more foreign investments. The foreign investors were much more factor seeking and targeted the mining and steel, minerals, fresh fruits and vegetables or were market seeking and targeted the telecommunications, cable operations, utilities, financial services and health, the sectors with small but steady customer base. Only the radical and for some analysts and practitioners, controversial decision to set up a nationwide network of free industrial parks of high technologies, started to attract more significant numbers of efficiency driven investors. The country output and the GDP started to grow, the export also, even during the years plagued with recession or post- recession recovery in rest of the Europe. Currently, the foreign direct investments contribute to the increase of the country export and to the change of its structure towards more value added goods. Being a small transitional economy and lacking domestic capital, Republic of Macedonia had very high unemployment rate and low international competitiveness. The decisive commitment towards improvement of the business ambient, investments in the infrastructure and in education, only recently created the fundamental basis for moving forward from the previous vicious circle of low GDP, low employment, low saving and thus insufficient investments. In other words, the country promotes the foreign direct investments a main factor of its growth. Thus, one of the basic aims of the macroeconomic policy of the Republic of Macedonia today is to create environment in which the major investors will be the companies from abroad. Consequently, the authorities now are concentrated on maintaining a stable macroeconomic environment conducive for their business. This was significant change in the strategy and policies regarding the foreign direct investments. The country finally moved from the previous passive approach towards an aggressive quest for investors, radically removing any unnecessary administrative obstacles, introducing a flat corporate tax and fading the import duties. All of that was accompanied with large promotional campaign of these measures in some leading newspapers, magazines

and TV channels worldwide, stressing the suitable location close to the EU, reliable infrastructure and good educated workforce. Moreover, the free trade agreements that the country has with Turkey, Ukraine, CEFTA, EFTA and EU are additional incentives for location decisions of the efficiency driven investors. For the opponents of these policies, the results are maybe there but the actual figures are lukewarm. The Chart 1 shows the inflows of the foreign direct investments in the country. The peaks are results of the large major privatizations in the telecom, utility sector and banks; they claim (Kurtishi-Kastrati at al., 2016).

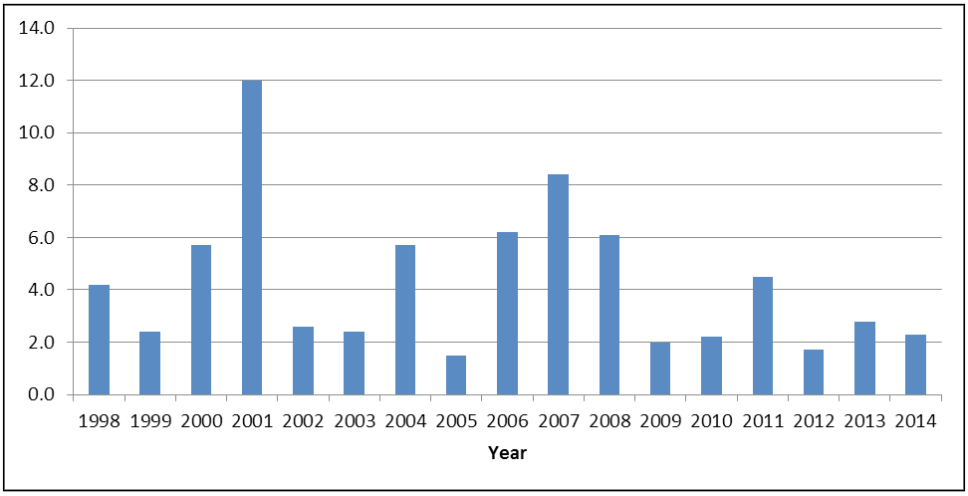
Chart 1 - Foreign Direct Investments in Republic of Macedonia, 1997 and 2014 (mil EUR)



Source data: National Bank of Republic of Macedonia

Between 2001 and 2014, the average annual growth rate of the foreign direct investments was 11.1%. The average annual foreign direct investments net inflows relative to the GDP, between 1998 and 2014 is app. 4%, much less than in the case of the other economies in the region (Bulgaria, Serbia, Montenegro, Albania), not to mention countries like Hungary, Slovakia, or the Baltic states.

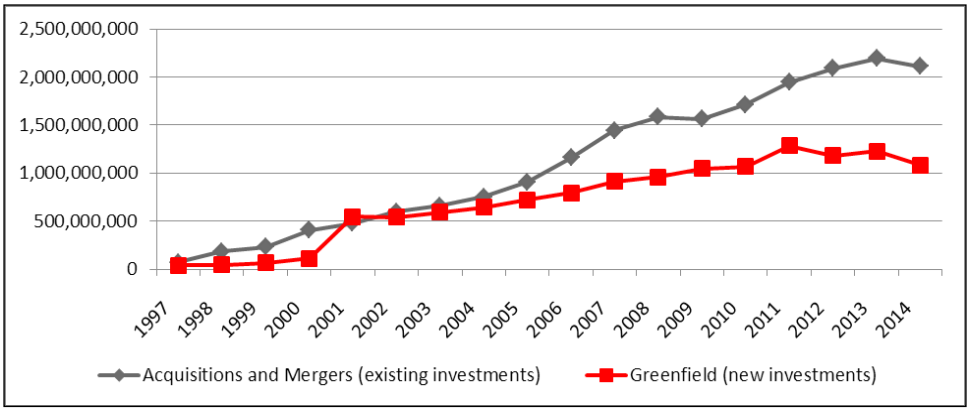
Chart 2 - Foreign Direct Investments in Republic of Macedonia as percentage of GDP



Source data: National Bank of Republic of Macedonia

Chart 3 depicts the overall structure of the foreign direct investments in terms of their two main forms, the acquisitions and the green-field investments, cumulative, from 1997 to 2014.

Chart 3 - Foreign Direct investments in Republic of Macedonia by type of the venture

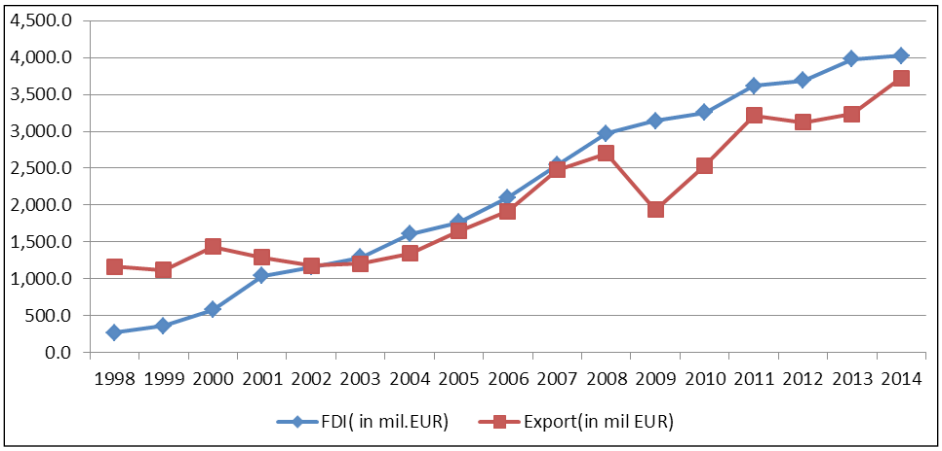


Source data: National Bank of Republic of Macedonia

Regarding the sector dispersion of the foreign direct investments, the services account for app. 51% of the total foreign direct investments stock, during the entire surveyed period. Regarding the countries of the origin, the majority of the foreign direct investments in the Republic of Macedonia currently are from Netherlands (22%), Austria (13%), Greece (11%), Slovenia (10%), Cyprus (9%) and Hungary (6%).

Since the local market is small, it is easy to predict that the growth of the foreign direct investments in case of the Republic of Macedonia will lead in a similar growth of the country exports. The foreign direct investments generate 60% of the country export (UNCTAD, 2012).

Chart 4 - Foreign Direct Investments and Export in Republic of Macedonia from 1998 to 2014



Source data: National Bank of Republic of Macedonia

As it can be seen from the Chart 4, the growth rate of the total stock of the foreign direct investments almost entirely matches that of the export from the country. Moreover, while the detrimental impact of the global economic crisis 2008 - 2009 and the aftershock in 2012 - 2013 is well depicted in the case of the exports, the foreign direct investments were practically not affected and kept almost straight-line trend. Table 1 shows the total stock of foreign direct investment, annual export and GDP from 2002 to 2012, and their increments. Chart 5 presents the increments of these three variables.

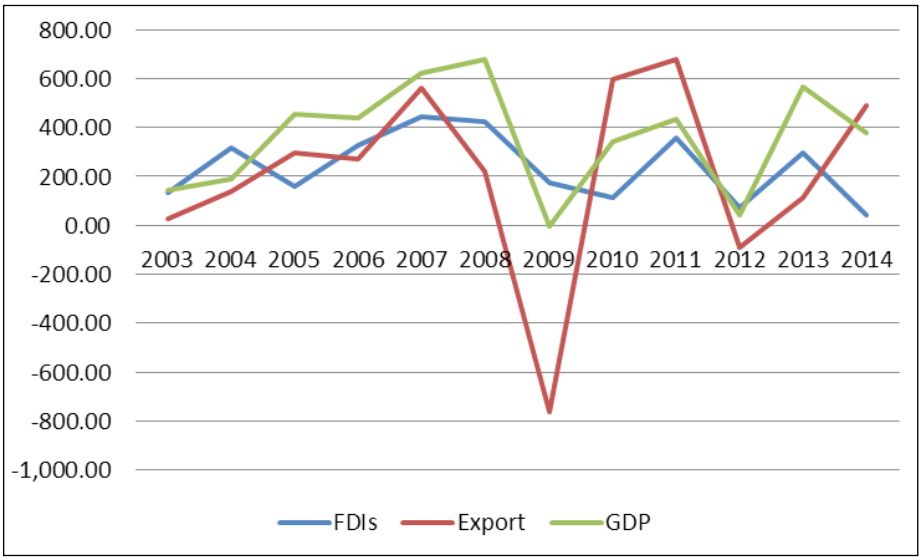
Table 1 Foreign Direct Investment, Export, GDP, and their increments

Year	FDIs	Export	GDP	Change in FDI	Change in Export	Change in GDP
2002	1,160.70	1,178.30	4,240.53			
2003	1,292.13	1,207.10	4,385.85	131.43	28.80	145.32
2004	1,610.22	1,345.90	4,577.71	318.09	138.80	191.86
2005	1,768.97	1,644.40	5,031.87	158.75	298.50	454.16
2006	2,098.57	1,917.50	5,472.27	329.60	273.10	440.40
2007	2,545.16	2,477.10	6,094.57	446.59	559.60	622.30
2008	2,968.75	2,697.60	6,772.02	423.59	220.50	677.45
2009	3,141.37	1,937.00	6,766.81	172.62	-760.60	-5.21
2010	3,255.97	2,534.90	7,108.76	114.60	597.90	341.95
2011	3,615.08	3,214.90	7,544.20	359.11	680.00	435.44
2012	3,685.54	3,124.00	7,584.92	70.46	-90.90	40.72
2013	3,979.96	3,235.20	8,150.00	294.42	111.20	565.08
2014	4,023.63	3,723.00	8,530.00	43.67	487.80	380.00

Source data: National Bank of Republic of Macedonia

The average foreign direct investment increment in this period is 238 million Euro with standard deviation of 133.41. The average export growth is 212 with standard deviation of 372 and the average growth of GDP is 357 with standard deviation of 213 million Euro. In other words, the figures are quite volatile and difficult to predict. This can be seen also from the Chart 5 that depicts the increments of these three variables in case of the Republic of Macedonia, between 2003 and 2014.

Chart 5 Table 1 Increments in Foreign Direct Investment, Export and GDP



Source data: National Bank of Republic of Macedonia

Due to this high volatility, the attempt to prove the presumed high correlation between the foreign direct investments and the exports, at least in the case of the Republic of Macedonia, turns correlation ratio of 0.25 and thus fails, since it is very weak to be statistically significant. The correlation between the foreign direct investments and the GDP is stronger, 0.64, and more than moderately significant. Only if three years moving averages are used, the correlation between the foreign direct investments and the exports, between 2004 and 2013, grows to 0.35, but being still below the presumed. The correlation between the foreign direct investments and the GDP in that case reaches 0.72.

Conclusions and Recommendations

High correlation does not imply actual cause-effect between two variables. Inversely, a failure of statistical attempts to show such association does not imply that relationship does not exist. Serious economists

would never argue the influence of the foreign investments on the growth in case of developing countries. However, researchers eager to deep probe the issue argue that the growth of the exports based on factor driven foreign investments is not necessarily prudent for the host economy and could lead to depletion of natural resources and over-exploration of local labor. In case of market driven investments, the conclusion that they not contribute to the export, while significantly drive up the import, might not hold always. Buyers in the big shopping malls in Skopje or Thessalonica are often from Macedonia and Kosovo, respectively. Politicians welcome the efficiency driven investments since they boost the industrial output, value added and GDP. However, these investors transfer their profits and leave only the payroll checks in the host country. On the other hand, when the expatriates invest in their homeland, their ventures are accounted as domestic.

No matter that data we collected failed to reveal stronger links between the foreign direct investments and the export in case of the Republic of Macedonia, this does not imply that the policy makers should stop considering the foreign investment important contributor for the export. This particularly having in mind that the recent foreign direct investments, at least in the case of the Republic of Macedonia, significantly changed the structure of the exports, introducing more value added products such as automotive parts, processed food, special steel, quality textiles and high valued business services and software.

References:

1. Canadian National Bureau of Competition (2009) "Predatory Pricing Enforcement Guidelines" available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02713.html viewed 28.03.2016
2. Hamlett, J., Alexander, A., Bailey, A, and Shaw, G. (2008)."Regulating UK supermarkets: An Oral-history Perspective". Available at http://www.historyandpolicy.org/policy-papers/papers/regulating-uk-supermarkets-an-oral-history-perspective viewed 20.03.2016
3. Haynes, J. (2003). 'Tracing connections between comparative politics and globalization'. *Third World Quarterly*. 24 (6). pp. 1029-1047.

4. Hlavacek, P, & Bal-Domanska, B 2016, 'Impact of Foreign Direct Investment on Economic Growth in Central and Eastern European Countries', *Engineering Economics*, 27, 3, pp. 294-303
5. Krstevska, A. and Petrovska, M. (2012) The economic impacts of foreign direct investments: panel estimation by sectors on the case of Macedonian economy, *Journal of Central Banking Theory and Practice*, 1(2), pp. 55-73.
6. Kudina, A. and Jakubiak, M. (2008) The Motives And Impediments To foreign direct investments In The CIS, OECD Global Forum on International Investment.
7. Kurtishi, S. (2013) The Effects of Foreign Direct Investments for Host Country's Economy, *European Journal of Interdisciplinary Studies*, 5(1), p.26-38.
8. Kurtishi-Kastrati, S., Ramadani, V., Léo-Paul, D., Ratten,V (2016) "Do foreign direct investments accelerate economic growth? The case of the Republic of Macedonia", *International Journal of Competitiveness*
9. Kutan, Ali M. and Vukšić, G. (2007) Foreign Direct Investment and Export Performance: Empirical Evidence," *Comparative Economic Studies*, 49(3), p.430-445.
10. Radulescu, M. and Serbanescu, L. (2012) The Impact of Foreign direct investments on Exports, and Export Competitiveness in Central and Eastern European Countries, *Journal of Knowledge Management, Economics and Information Technology,* 1(8), p.1-37.
11. Vukšić, G. (2005) Impact of Foreign Direct Investment on Croatian Manufacturing Exports, *Financial theory and practice*, 29, p. 131-158.
12. Vukšić, G. (2007) *Foreign Direct Investment and Export Performance of the Transition Countries in Central and Eastern Europe*. Available at www.ijf.hr/eng/employees/vuksic.pdf, [Accessed Date 01/07/2015]
13. World Bank (2016) "What is the difference between Foreign Direct Investment (FDI) net inflows and net outflows?", available at https://datahelpdesk.worldbank.org/knowledgebase/articles/114954-what-is-the-difference-between-foreign-direct-inve, accessed may 30, 2016