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Professional paper

COMPARATIVE ANALYSIS OF FOREIGN DIRECT INVESTMENT FOR EURO AREA AND NORTH MACEDONIA

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Abstract

As a result of the globalization process, the level of foreign direct investment in the second half of the last century, in the world level took a big boost. Liberalization processes and the removal of various barriers, especially trade barriers and those of free capital movements, accelerated this process. Each country wanted to get as much as possible of this increase in the investment level to stimulate their local economies. In contemporary literature, investments are considered as an important stimulus factor of economic development, therefore it is very important to identify the factors that make a country attractive to foreign direct investments. It will be very interesting to analyze the impact of the euro, as a common currency, on the movement of capital, which then influences the decisions of international enterprises to invest in a certain market. Another important factor that affects the inflow of foreign investment is the uncertainty that international firms may feel, especially the type of uncertainty that has to do with exchange rate volatility. Coverage from this type of eventual risk increases the importance of membership in a monetary union, which has consequently the elimination of this exchange rate volatility risk that affects in turn positively the level of foreign direct investment. The comparison will be made for the period immediately after the adoption of the euro as the common currency, for certain member countries that will be divided into four groups. A detailed composition of the investment level of North Macedonia will be presented and will be provided an answer to the question of whether the foreign direct investment attracted by the euro area is higher than that of countries that are not members.

Keywords: North Macedonia, investment, comparative, euro area.

1. Introduction

In each country, there are two ways of measuring foreign direct investment, that of central banks and that of the national governments. Central banks calculate foreign direct investments as part of the capital account in the balance of payments, from there; they try to explain the relationships they have with for example the financial markets and the financial system in general. The national government's institutions analyze the foreign direct investments by calculating the impact and the effect they have on job creation and the side effects that the absorption of foreign investment may have in a country, such as the transfer of knowledge, management expertise, or access to international sales networks, etc. It should be noted also that different governments determine the effect of foreign direct investment by assessing their impact on the number of employees, as well as sales made by different enterprises.

To best analyze foreign direct investment, the measurements made by governments are more appropriate, but because they are based on data that in most cases are confidential, that makes it difficult to collect and analyze for most researchers. But on the other hand, the measurements of foreign investment through the capital account, from the balance of payments, provide data to which we can have much easier access, even though they are not directly related to the economic activity of a country. The balance of payments calculation method considers one investment as foreign if one enterprise controls another enterprise in a foreign country. In general, this takeover implies the movement of capital between these two countries that is recorded in the current account of the balance of payments.

However, even if the data from the balance of payments are considered, one must consider that the foreign company can take a loan from a bank or domestic financial institution to finance its new purchase and investment, these kinds of operations make it very difficult to define the investment as foreign direct investment. Same if the parent company wants to reinvest the benefits by buying another or starting a joint venture with another company, this form of investment is also difficult to measure. One must always be careful in assessing the real impact of these investments because the magnitude of these investments on the real economy cannot always be measured precisely. As a summary of what was said above, foreign direct investments can take different forms, and that each of them has its specific impact on the domestic economy.

2. Literature review

Taylor (2008), in his study, has shown that member countries have managed to attract a greater amount of investment than the ones that are not members. He did his study counting all OECD countries. In his results, he made it very clear that foreign direct investments by members who were part of the euro area towards other members of the same area increased more than the investments made by area members towards non-member countries. The estimate was that, not only for member countries but also foreign direct investments which were made in the euro area by non-member countries, were higher by 400%. According to his study, the increase in foreign investment was much greater from countries that were not members of the euro area than from those that were members. This made him conclude that the euro area has unquestionably become a monetary and economic area that attracts a lot of foreign direct investments, where the euro as a common currency had undoubtedly a significant effect.

Buch and Lipponer (2008) are the authors who have studied the effect of the euro on foreign direct investment by calculating them at the enterprise level. These types of data are more reliable. The authors used data from German enterprises at the firm level organized and based on a Bundes Bank study. The authors began their study by analyzing the impact of foreign direct investment that has left Germany for foreign countries. These investments of German companies abroad, according to the logic of attracting foreign direct investment, will have to be attracted by countries that are members of the euro area. Considering three study groups, the first group consists of 15 member states of the European Union that use the common market but do not have a common currency, the euro. The second group consists of other European countries such as Switzerland, Norway, and the new member states. While the third group consists of other countries of the world. The authors concluded that the effect is not what is expected for investments that have left the country. The study shows that German companies have invested outside the countries that are members of the Eurozone. Using different indicators to make investment calculations according to real factors, the results showed that the countries that were members of the euro area with a common currency and the group of 15 member states of the European Union have managed to pull a same approximate level of foreign direct investment from German enterprises, for the period 1989-2005. Meanwhile, when the analysis of the same indicators of the real economy was expanded, in terms of foreign direct investment that have been accepted by Germany, the results are different. According to the study, Germany is a more attractive place to invest, for euro area member states and those that are members of the European Union, i.e., EU 15, than for the other two groups which included countries that were not members of the European Union.

Giordano et al (2018), by analyzing the investment level for a group of EU countries and by using a different analytical tools and data sources, found that the assessment of the foreign direct investment level varies across benchmarks and countries. At the euro area level and for most countries, the level of investment complies with the overall activity. According to the authors credit constraints have penalized investments. Furthermore, during the debt crisis, government investment decreased as a share of GDP, particularly in countries that were hit hardest by the crisis.

Contrary to the findings of Taylor (2008), researchers Coeurdacier, De Santis and Aviat (2009) in their study pointed out that to see the effect of the common currency on foreign investment we will first need to distinguish investments in manufacturing sector and investments in the services sector. If an analysis is made of what is the share of productive investments in total investments, we can see that in terms of the euro area this share is much larger for the years after the countries have adopted the euro as a common currency, than the years before they adopted the euro as a common currency.

Giordano, Marinucci and Silvestrini (2016), studied the investment level in Italy from 1995 based on the data provided from the national accounts. According to the authors pre–2007 investments were very broad, across institutional sectors and asset categories. In the same manner, the decrease in investment after the crises affected all the sectors to a different extent. When they focused on the most recent period, the decline in general government and non-financial corporations' expenditure, decreased the investment level by about two thirds of total investment in Italy.

Dellis, Sondermann and Vansteenkiste (2017), by investigating the economic structure of advanced countries to attract foreign direct investments inflows concluded that there is a relationship between the quality of economic structure and dhe capability of that country to attract investments. They stated that in 2015, the euro area accounted for one fifth of the total stock of inward investments, which is huge. The authors also tested the relevance of government institutions. They found that basic rights, such as rule of law, property rights, regulatory efficiency and the well-functioning of labor markets are relevant to foreign investors.

Petroulas (2006), studied the effects of the European Monetary Union on attracting foreign direct investment in member countries and concluded that the adoption of the euro as a common currency had increased foreign direct investment between euro area members from 14 up to 16 percent. During the analysis, the author also conducted a study on the economic geography of the euro, for which he stated that there is a tendency to concentrate foreign direct investment in some members of the euro area. The so-called big countries have received and sent a larger amount of foreign direct investment. Namely, Germany, France, Italy, and Spain have concentrated most of the increase in foreign direct investment, caused by the economic and monetary union of the euro area. It is interesting to note that in his study the author considered that foreign direct investment is strongly related to trade, as theoretically horizontal investments are seen as a substitute for trade, while vertical investments are seen as complementary to trade.

3. Methods and results

The effect of the single euro currency on attracting foreign direct investments in European countries can be seen by studying the data on the amount of the investments that are made. The figures below show the level of foreign direct investment inflows for the years 2001-2012, immediately after the adoption of the euro as the common currency, for certain countries. The data are analyzed by dividing them into four groups. The first group includes investments made by euro area member states towards euro area countries, the second group includes coming investments of countries that are not members of the euro area towards those that are members of the euro area, the third group consists of investments made by euro area member states towards those that are not members of the euro area, while the fourth group consists of investments made by countries that are not members of the euro area towards those which are also not are members of the euro area.

The main question that will need to be asked is whether the foreign direct investment attracted by the euro area is higher than that of countries that are not members of the euro area. If the answer were yes, then we would have indisputable evidence that membership in the euro area or any economic and monetary union would be beneficial to a country because it positively affects the growth of foreign direct investment.

The figure 1 (a), below presents the level of incoming foreign investment and compares it between countries that are members of the euro area and those that are not members of the euro area but are still members of the Union European. Data are expressed in millions of dollars, they are provided by the United Nations, for the period immediately after the implementation of the euro as the common currency, 2001-2012.

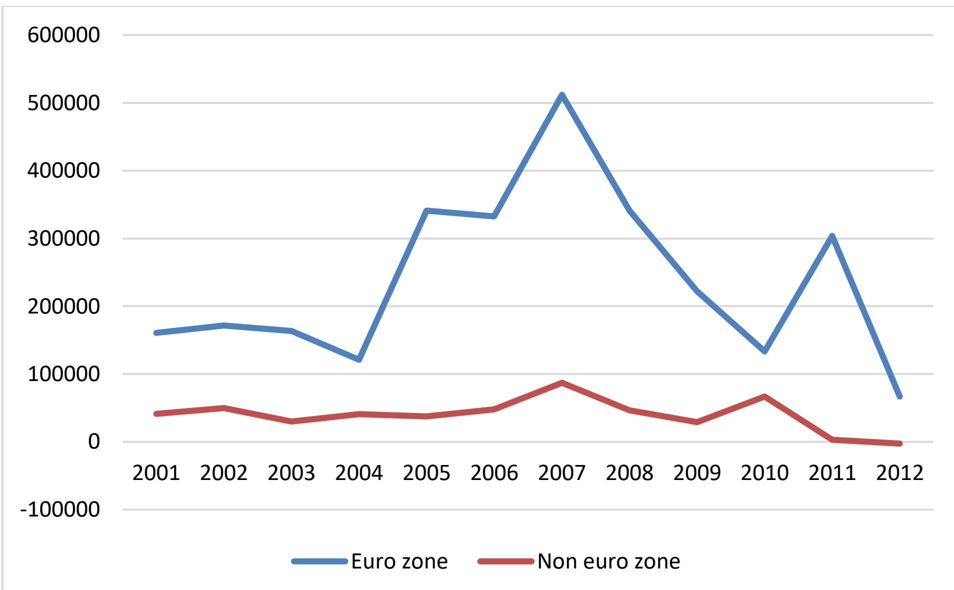

Figure 1 (a). Foreign direct investment

It can be seen from figure 1 (a), that the eurozone member countries have managed to attract foreign direct investments in mass, many times greater than those countries that have chosen to stay out of it. For each year, the data show that the members of the euro area have been more attractive to foreign direct investments than those that are not members.

To see how are distributed the levels of foreign direct investments in European countries, in the following figure 1 (b), are presented the levels of investments made in countries that are members of the euro area, for the same period mentioned above.

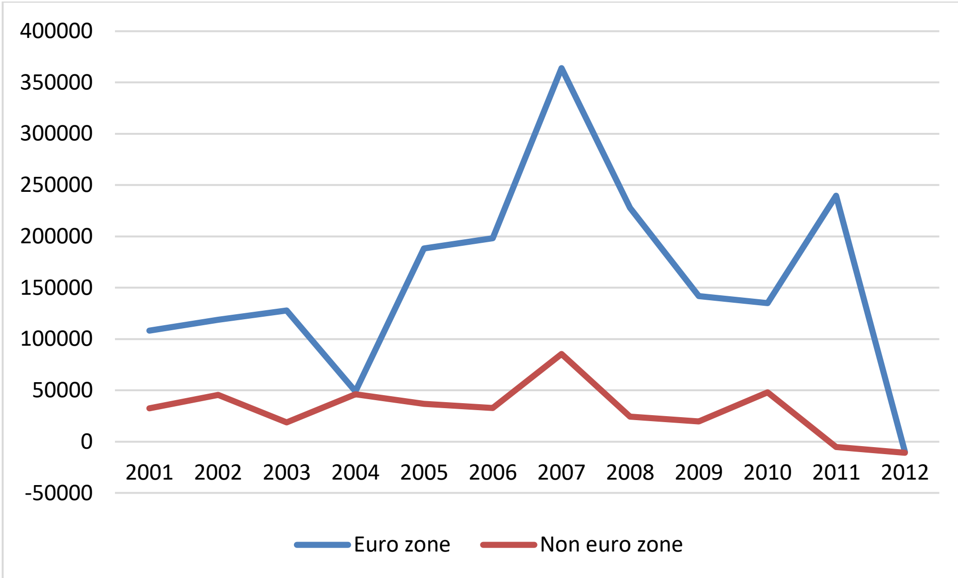

Figure 1 (b). FDI in EMU members

As it can be seen from figure 1 (b), the investments attracted by countries that are members of the euro area are also many times higher than those attracted by countries that are not members of the euro area. This shows that the common currency has increased the capacity of countries that have adopted it, as a means of payment, and attracted foreign investments many times more than those that didn't

In figure 1 (c), below, are presented the levels of foreign direct investments which are attracted by countries that are not members of the euro area, always for the period 2001-2012. From the figure, the level of investment is much lower than that of the euro area member countries, presented above. An interesting fact is that although these countries are not members of the euro area, they have attracted more foreign direct investment from the countries that are members of it than from those that are not members in this area. A conclusion can be drawn that the common currency has had a positive impact on the growth of foreign direct investment not only in countries that are members of the euro area but also in those that are not members yet.

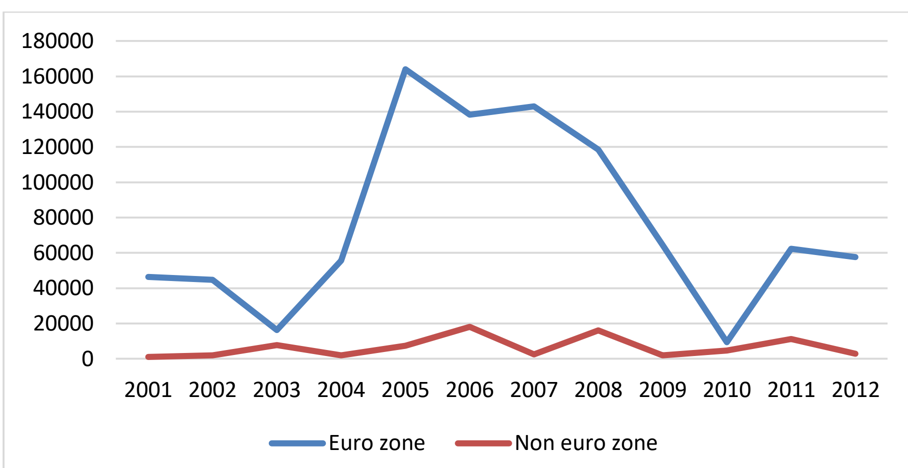

Figure 1 (c). FDI by non-members of EMU

Figure 2 (a), presented below shows a comparison of the level of inflow investments, in millions of dollars, of non-euro area member states, euro area members, and EU and eurozone members, attracted by countries which are members of the euro area. The data show that euro area member states, in terms of investments, have managed to attract more foreign investments from member countries than those that are not members and that the impact of the euro on this high level of investment is evident.

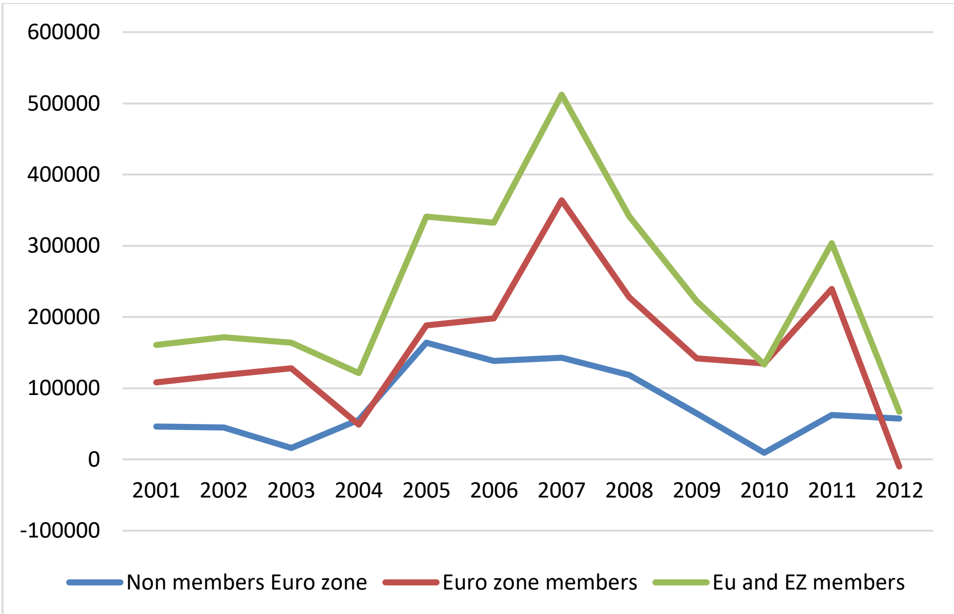

Figure 2 (a). Foreign direct investment by members of EMU

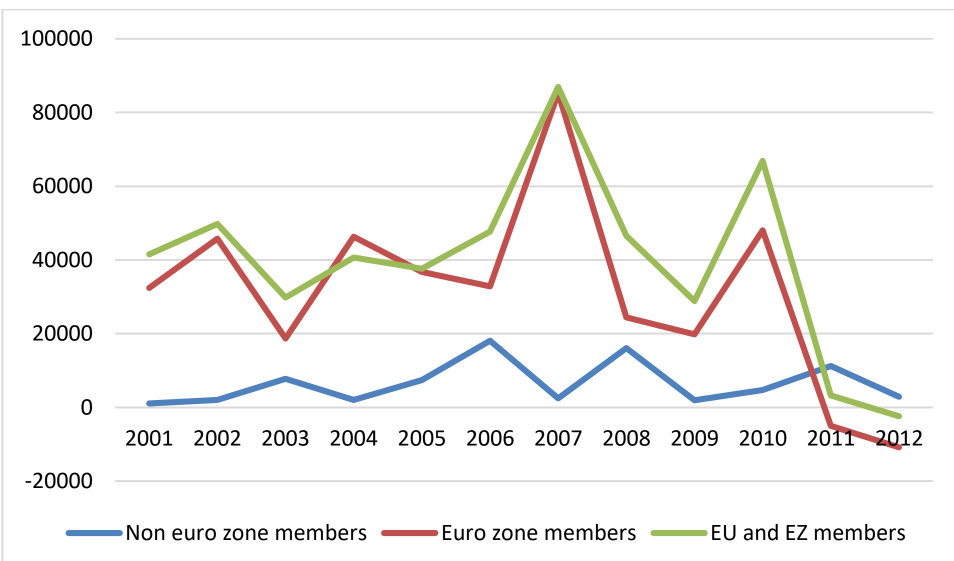

Figure 2 (b). Foreign direct investment inflow by non-members of EMU

Figure 2 (b) shows the levels of investments of non-euro area countries, euro area members, and those that are members of the euro area and the European Union, attracted by countries that are not members of the euro area. Even according to this figure, the countries that are members of the euro area have managed to attract more investment from non-member countries of this area than the non-member countries themselves.

The following figure 3, represents the level of foreign direct investment inflows in the Republic of North Macedonia. According to the data from the balance of payments, realized with the North Macedonian partners, in millions of euros, for the period 2003-2017, it can be said that the investment balance is positive except for 2005. For this period, the Republic of North Macedonia has managed to attract an average of 250 million euros per year of foreign investment from all over the world, reaching its peak in 2007, a year before the global crisis, with 506 million euros in investments attracted from its partners.

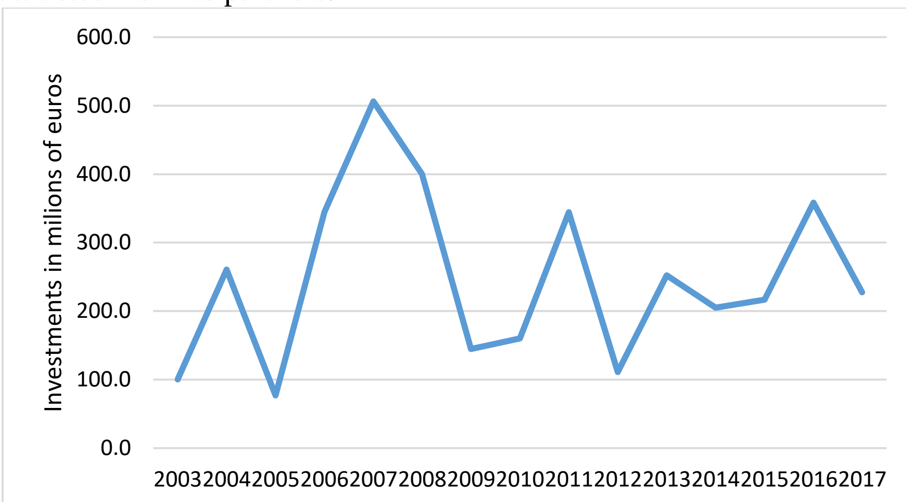

Figure 3. Foreign direct investment North Macedonia

The following figure provides a more detailed description of the level of investments presented above. From figure 4, below it can be seen the country of origin from, which foreign direct investments come and that have contributed the most to the domestic economy. For the analyzed period, the leaders of foreign direct investments in the Republic of North Macedonia are the Netherlands and Austria, both with over 500 million euros invested, representing 19 percent of the total of investments. While those that have realized less are France, Great Britain, and Hungary, the level of investments from these countries turns out to be negative, respectively, -140, -44.7, and - 16.8 million euros, and represent -5, -2 and - 1 percent of investments.

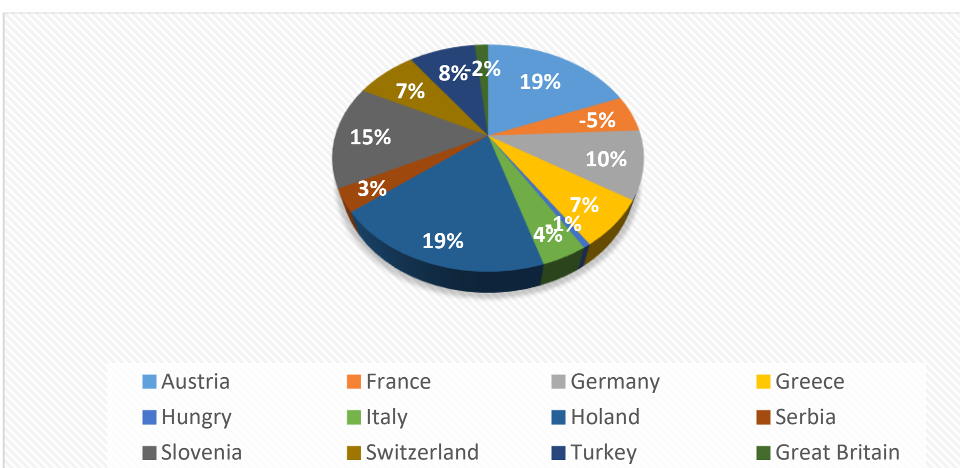

Figure 4. Foreign direct investment by country

Below is a description of foreign investments in the Republic of North Macedonia, i.e., investments inflows from 12 countries that represent the largest share of inflows investments in North Macedonia, for the period 2003-2017, in millions of euros.

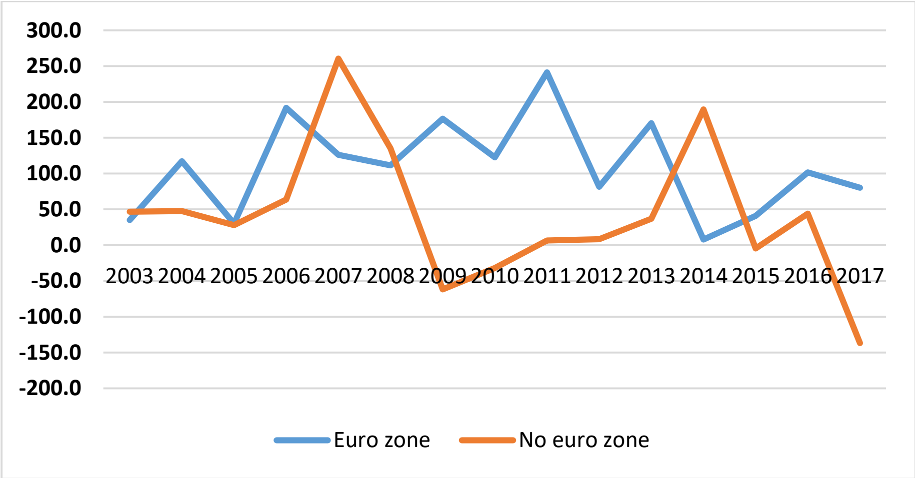

Figure 5. FDI from members and non-members

According to Figure 5, the level of foreign direct investment in North Macedonia has been largely realized by various companies which have had as their country of origin one of the member states of the euro area. Investments, reaching a maximum level in 2011 of 250 million euros, have been positive, each year, during this period and have not had significant volatility from year to year.

The stability of investments made by the euro area member countries in the Republic of North Macedonia may have been caused by the common currency of the member countries, as it has influenced their economies to resist large exchange rate fluctuations and consequently made them capable to make more stable investments.

On the contrary, the same cannot be said about the levels of investments that have been made by countries that have not been members of this economic and monetary union. Although the level of investment is maximum in 2007 with around 250 million euros invested in the Republic of North Macedonia, their higher volatility makes them riskier for the local economy. Moreover, the investments made by non-euro area countries, for the entire period analyzed, are at a lower level, in some cases even negative, than the investments coming from the euro area countries.

4. Discussions and conclusions

The euro area represents a market with over 350 million inhabitants, it shows with its size that it has a considerable capacity to attract foreign investment and that the interest of enterprises to have access to this market is very big. Member countries of this area have countless benefits from these investments. In addition to the direct benefits related to GDP growth, revenue growth for governments as well as revenue for the country's population, member countries can benefit also from the indirect effects that foreign investments may have by spreading their positive effects on consumers, various suppliers, etc.

The euro, as a common currency of the euro area, had a positive impact on the expansion of investments by small and medium enterprises. It influenced the growth of foreign investment within the euro area countries, but also the attraction of foreign investment from non-euro area countries. The effect of the euro has been demonstrated through the above studies that it is positive in terms of promoting and attracting foreign direct investment.

Membership in the euro area has a positive impact on investment, whether from member countries or non-members. The common currency, by creating an area with a low inflation rate and promoting stability enables private sector enterprises to reduce poor investments. Within area members, the cost of investment will be reduced by lower transaction costs and lower uncertainty that the exchange rate may cause. The analysis showed that the level of foreign direct investment coming from Eurozone member countries is much higher than that of those coming from non-member countries for the case of North Macedonia. Due to the limited period that is studied the results may underestimate the effect of the euro area, so further studies are needed to look more objectively at the impact of the common currency on investment.

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