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THE COURSE OF FOREIGN DIRECT INVESTMENT IN THE GREEK ECONOMY

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ABSTRACT

FDI is considered an important element of economic globalization that enchases efficiency, growth and leads to technological improvement. The purpose of the present paper is to provide an overview on the issue of FDI in Greece. Results showed that despite the country's efforts, foreign investment has not yet reached its potential. Greece did not exploit the opportunities that were presented, and is still struggling to attract foreign investors. FDI inflows were focused on services and derived from the traditional European exporting countries. In relation to the Ease of Doing Business Report, it appears that inflows were not affected by Greece's rank.

Keywords: Foreign Direct Investment, Greece, External Finance

JEL Classification: F21, F43, F63, G18

Introduction

Foreign Direct Investment (FDI) is considered an important element of economic globalization that enchases efficiency, growth and leads to technological improvement (OECD, 1996; Bayraktar, 2013). According to the United Nations Conference on Trade and Development (UNCTAD) and the Global Investment Trends Monitor (2014) global FDI flows increased by 11% in 2013 reaching a $1,32 trillion, while at the same time inflows rose in all economies (developed, developing and in transition).

Over the years, many economies have reduced barriers and created the appropriate infrastructure in order to attract more FDI, as a mean of additional capital and a source of external finance (Hanson, 2001; Marina and Schnitzer, 2011). Furthermore, policy makers endeavor to increase FDI in an attempt to expand their country's participation in international trade (Chakrabarti, 2001). Accordingly, it is extremely important to identify the systematic patterns of foreign investments' behaviour (Filippaios and Kottaridi, 2004). But at the same time, crucial questions about FDI's usefulness have been raised to economists all over the world, in both developed and developing countries (IMF, 2003).

With the Greek economy being at a crucial turning point, it becomes imperative to examine once again the concept of FDI. The purpose of the present paper is to provide an overview on the issue of Foreign Direct Investment in Greece. More specifically it intends to:

i. Analyse the concept of FDI.
ii. Clarify the factors that determine FDI inflows, as well as FDI's impact on the host economy.
iii. Examine the course of FDI inflows in Greece for the period 2003-2013.
iv. Investigate whether it could contribute to the development of the Greek economy.

The study is organized as follows. In the subsequent section the theoretical and empirical literature is presented, focusing on the factors affecting FDI, and the consequences that this type of investment has on the recipient countries. The following section is devoted to presenting the course of FDI in Greece. The final section contains the concluding remarks.

Theoretical Background

FDI was defined by the International Monetary Fund (IMF) as an international investment that represents "the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy" (IMF, 1993, p.93). The same interpretation was also adopted by the Organization for Economic Co-Operation and Development (OECD) in the Benchmark Definition of Foreign Direct Investment (OECD, 1996, p.7). By interpreting the above definition the "resident entity" constitutes the *direct investor* while the term "enterprise" represents the *direct investment enterprise.* The direct investor could be an individual, a group of people, a government, various estates and trusts, organizations, or an enterprise (public or private, incorporated or unincorporated) that carries out an investment (i.e. another enterprise) in a country other than the investor's residence. The direct investment enterprise, on the other hand, could have the form of a subsidiary (the direct investor owns more the fifty percent of the enterprise), an associate company (the investor owns fifty percent or less) or a branch (an unincorporated enterprise that is wholly or jointly owned). It should also be mentioned that the direct investment includes not only the initial transaction between the two entities but all the capital transactions that follow as well.

The phrase *lasting interest* in the aforementioned definition, denotes the establishment of a long-term, direct relationship between the investor and the enterprise, with the participation of the foreign investor in the company's management to a significant extent, but without exerting full authority. More specifically, there is a guideline for a ten percent (or more) ownership of the direct investor, on the ordinary shares or voting power (in the case of a incorporated enterprise) or the equivalent (in the case of an unincorporated enterprise). Regardless of the ownership percentage criterion, the active involvement and the strong influence over managerial decisions on behalf of the direct investor, is the important element that distinguishes a direct investment enterprise from other forms of investment such as the portfolio investment. Furthermore, FDI is a broader concept than just a foreign controlled resident enterprise (IMF, 1993; OECD 1996). Although the OECD definition has been characterized as "vague", it completely evades the idea of "control" (Lipsey, 1999).

In some cases, the relationship between the two entities is enchased by other elements such as: the investor's representation on the board of directors and his participation in policy-making processes, the material inter-company transactions, the interchange of managerial personnel and the provision of technical information or long-term loans at lower than existing market rates (OECD, 1996). FDI can be divided into two broad categories: horizontal FDI, where a firm duplicates its activities in the host countries, and vertical FDI, where a company locates various stages of production in different countries (Helpman et al., 2003; Ramondo et al., 2014). Despite all of the above, there is no formal and specific form that links two enterprises operating in distinct economies (OECD, 1996).

According to the World Bank (2012) FDI is also defined as the net flows of investment to attain a lasting interest between the two entities. With the intention of avoiding ambiguities, the types of capital flows that are considered as FDI should be mentioned. The World Bank analyses FDI as the "sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments". In order for the essential element of the "lasting management interest" to be present, only the capital originated from the direct investor (directly or through another related enterprise) should be considered as FDI (including intra company loans) (UNCTAD, 2013). It should also be clarified that FDI is linked only to the residency of the investor and not his citizenship or nationality. In addition, borrowing capital from unrelated entities that are guaranteed by the direct investor should not be regarded as FDI (IMF, 2003). Furthermore, FDI is described as "capital flows resulting from the behavior of multinational companies (MNCs)" (Agiomirgianakis et al.,2003). It should also be noted that as a concept, FDI is mutually related to trade, and has been considered both as its substitute, in the case of horizontal FDI flows, as well as its complement, in the case of vertical FDI flows (Petroulas, 2006).

Determinants of Inward FDI

It appears that a country's ability to attract FDI is affected by various macroeconomic characteristics, combined with its overall financial performance (Hanson, 2001). Accordingly, countries with different economic structures vary in features affecting FDI flows, such as volatility and location (Zhang and Hou, 2014). Over the years, several theoretical models have been developed in order to examine the determinants that make locations more attractive for foreign investors (e.g. Dunning, 1958; Brainard, 1993; Eaton and Tamura, 1994; Borrmann et al., 2005; Antras et al., 2009 etc.). These models (e.g. the gravity model) were based on factors such as market size or proximity to the host country, and mainly used country-level data (Buch et al., 2003).

More specifically, investors seem to be affected by the traditional variables of labour cost, taxes, level of human capital, natural resources, infrastructure, trade openness, political determinants and the investment climate. For example, low labour costs and tax rates have a positive impact on FDI (Bayraktar, 2013). FDI also depends to a significant extent to the inflation, exchange and growth rate of the host economy (Cevis and Camuran, 2007). Another important factor is the level of human capital (in terms of quality and availability), since a highly skilled workforce is essential for the implementation of innovative technologies or the adaptation of a diverse business culture (e.g. Noorbakhsh et al., 2001; Carstensen and Toubal, 2004; Kottaridi and Stengos, 2010). The country's market size, access and its overall potential (growth prospects), as well as the level of economic development also have a very important influence on attracting FDI (Agiomirgianakis et al.,2003). The same applies to the regional trade agreements of the host country (Blonigen and Piger, 2011). Cheng and Kwan (2000) noted that FDI has a significant self-reinforcing effect on itself.

Researchers not always agree on the effects that the political and socioeconomic environment has on FDI. Asiedu (2002), for example, argued that FDI is not really affected by the factors of political instability, democracy or corruption in the host economies, while Lucas (1990) and Haksoon (2010) stated that recipient countries with higher level of corruption tend to receive more FDI inflows from developed and politically stable countries. On the other hand, a number of studies demonstrated that political and financial risk have a negative impact on attracting FDI (e.g. Bevan and Estrin, 2004; Busse and Hefeker, 2007; Jensen, 2008; Khan and Akbar, 2013).

More determinants, that seem to have a positive effect on FDI, are the regional integration, for example with the European Union (Bevan et al., 2001; Braconier and Ekholm, 2001 ; Petroulas, 2006; Kilic et al., 2014), and the existence of agglomeration economies (e.g. Wheeler and Mody, 1992; Barrel and Pain, 1999; Guimaraes et al., 2000; Campos and Kinoshita, 2003). The provision of various incentives in order to influence the investors' decisions also have a significant role (UNCTAD, 2000). These could be fiscal (e.g lower taxes) and financial (e.g. grants and preferential loans) incentives or even market preferences and monopoly rights (OECD, 2002). Timing is crucial in the context of FDI as well, and its impact is directly related to the privileges deriving from the order of market entry (Blandon, 2001; Tsen, 2005). Li (2008, p.17) argued that the "early (or first) movers" receive the following advantages: "gate-keeper role of host country government, strategic choice of local partner, strategic choice of local market, better incentives and local government support, less stringent requirements, competing against weak local firms, and longer learning curve".

The Benefits and Costs of FDI to the Host Country

There is a strong controversy about what is considered FDI's most important benefit: its contribution to economic growth, as no definite answer has been provided in the literature regarding this debate (Kamara, 2013). Oliva and Rivera-Batiz (2002) stated that a higher ratio of FDI to GDP leads to a higher growth rate, and that the actual growth effect of FDI is often higher compared to the domestic investment to GDP ratio. According to McKinney (2014) FDI contributes to growth by increasing competition, productivity, prosperity and technology spillover. It also introduces new industries and products to the recipient country, and further connects it to the global trading system (Lipsey, 2002). On the other hand, Lyroudi et al. (2004) suggested that FDI is not linked to growth in the case of transition economies.

Most studies agree that FDI enhances productivity and leads to financial development in the host countries under certain conditions, suggesting that FDI does not lead to growth on its own and that other requirements should be met (Dritsaki et al., 2004; Kamara, 2013). Based on an OECD's report (1998), growth should be linked to innovation and technology diffusion policies, through the input of capital, goods, people and ideas. In addition, human capital was pointed by Borensztein et al. (1998) as the local factor that determined whether FDI could actually lead to growth more efficiently, in comparison to domestic investments. This variable was proved essential for the adequate absorption of advanced technology by the host economies. Growth, in particular, was found to be closely related to the recipient country's financial markets as well (Alfaro et al., 2006; 2010). Alfaro (2003) also concluded that the relationship between FDI and growth varied even between economic sectors. In contrast to the primary sector which produced negative results, manufacturing had a positive development, while the outcome of the services sector was illusive. Busse and Groizard (2006) suggested that in order for FDI to enchase growth there should be a sufficient institutional framework.

Regarding the other advantages of this form of foreign investment, Hood and Young (1987) argued that FDI provides the recipient economy with a combination of knowledge, capital and entrepreneurship. Additionally, Chung (2010) stated that FDI contributes to a country's welfare through the provision of a permanent income to the domestic labour force, and as a supplementary source of finance. FDI also appears to be a rather stable (or less sensitive) form of investment, even in times of economic crisis (Lipsey, 1999). Based on Loungani and Razin (2001), FDI was proved strong during the Latin American debt crisis (1980s), the Mexican crisis (1994-95) and the East Asian countries downturn (1997-98). Particularly in the last case and for the same period, FDI was more resilient compared to other types of private capital flows (e.g. dept flows, portfolio equity). De Grigorio (2003) pointed that these investments cannot be withdrawn as easily as other liquid forms of capital, and therefore retain a certain level of stability. Adams et al. (2014), added that FDI could increase employment in the host country, stimulate its economy and therefore reduce the effects of the global financial crisis.

But there are some costs associated with the inward of FDI in the recipient country as well, and it would be inaccurate to assume that such investments lead to success by definition (Pavlinek, 2002). Tayyebi and Hortamani (2007) referred to the repatriation of profits to the investor company, which may ultimately cause balance of payments difficulties to the host country. Others pointed that FDI creates economic dependence on extremely unstable capital investments which could lead to the "disarticulation" of the host economy in the long run (e.g. Dixon. and Boswell, 1996; Kentor and Boswell, 2003). Foreign investors have also been criticized for exploiting their leading positions in the recipient countries' market and sometimes using transfer pricing in order to reduce their tax obligations (Demekas et al., 2007). Furthermore, Ram and Zhang (2002) mentioned that FDI has been accused for transferring technologies and cultures that could be characterised as inappropriate in the host country, for eliminating domestic enterprises due to intense competition, and for creating distortions in the home country's policies as well as to its social and economic structure. Salim and Bloch (2014) referred to the efficiency gaps that prevail between the home and the host countries. They concluded that FDI spillovers were positive only when the efficiency gap was large (i.e. high-efficiency domestic companies had negative spillovers).

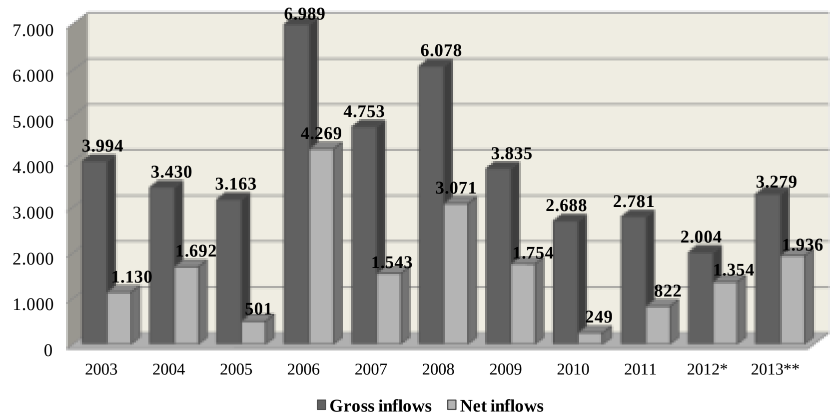
Foreign Direct Investment in Greece

Greece's efforts to attract foreign investment capital began in the early 1950s, and aimed at reconstructing its economy and developing the industrial sector. It mainly involved the establishment of investment laws (e.g. Law 2687/53) and the provision of business incentives, which although were mostly fiscal, led (in combination with the anticipation of the country's entry in the European Economic Community) to a significant increase of FDI inflows between 1955 and 1980. Particularly in the 1960s the average annual growth rate of FDI inflows was 19% and raised to 22% in the 1970s. The biggest shares belonged to the fields of basic metals, chemicals and transportation (Kokkinou and Psycharis, 2004; Filippaios, 2006 ; Bitzenis et al., 2007). For the latter half of the 1970s the country's FDI/GDP ratio was constantly one of the three highest in the OECD area, which in turn raised the investors' confidence to its economy (OECD, 1998b). In the two decades that followed Greece's accession to the European Union (in 1981), there was a shift towards other sectors on FDI inflows, such as consumer electronics, textiles, food and drink. Meanwhile, the government provided fiscal and financial incentives through revised and improved investment laws (e.g. Law 2601/1998) in an attempt to simplify procedures, and enchase competitiveness (Kokkinou and Psycharis, 2004; Filippaios, 2006). But at the same time the negative impact that Greece's macroeconomic environment and variables (e.g. prices, wages and income) had on its ability to draw FDI, was pointed by researchers (e.g. Apergis and Katrakylidis, 1998).

In the years that followed, the country's policy was to create an environment that would attract FDI by offering cash grants, tax allowances and exceptions, and labour cost subsidies. Since 2004, most sectors are either open to foreign investors (e.g. the telecommunications market) or in the process of being liberalized (e.g. the energy industry). Furthermore, capital inflows are allowed freely into the country, but there are some limitations regarding purchases of land in border regions and certain islands. There are also some ownership restrictions in specific industries (e.g. television, ships, and mining). The Hellenic Centre for Investments (ELKE) is a government agency that has been characterised as a "one-stop investment shop", and provides future investors with significant information and guidance on investment opportunities (UNCTAD, 2005). The latest investment law (Law 4146/2013) intended to increase liquidity, accelerate investment procedures (by speeding up the approval process) and to ensure transparency (Enterprise Greece, 2015a).

Figure 1 presents the course of FDI inflows in Greece for the decade of 2003-2013, which covers the time period starting right before the Olympic Games of 2004 and ending three years after the outbreak of the debt crisis in Greece in 2010.

Figure 1: Greece's FDI inflows in million euro (2003-2013)



Source: Enterprise Greece, 2015b
* 2012: Revised Data
**2013: Temporary Data

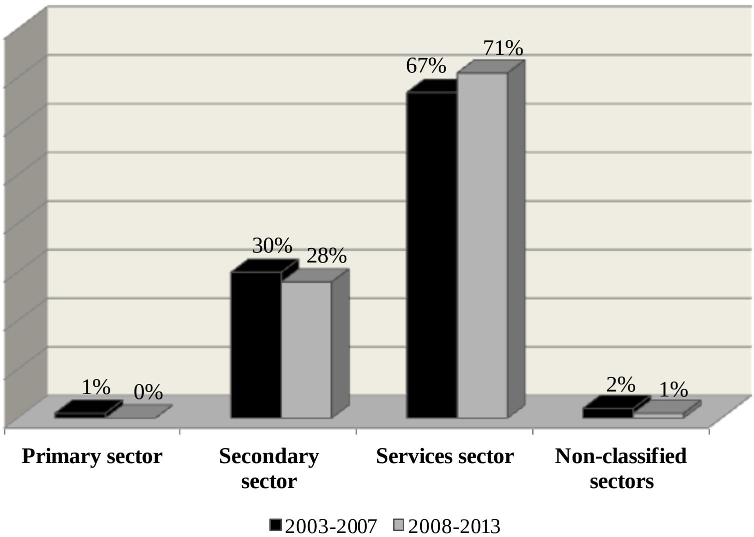
Data showed, that although Greece managed to improve its inflows in 2006 and then again in 2008 (showing a tremendous increase in FDI net inflows from 501 in 2005 to 4.269 million euro the following year), failed to hold those high levels especially after the economic crisis showed its signs. As a result, inflows suffered a remarkable decline. Nonetheless, in recent years there has been a slight improvement (in 2012 and 2013). Kyrkilis et al. (2008) pointed that the increase in previous years was not substantial and was mainly the result of circumstantial causes (e.g. privatization of local companies) that did not reflect a tangible economic growth or corresponding gains in the country's competitiveness.

It appears that the country's course of FDI inflows was "below its potential", despite the aforementioned efforts, and as a result it is still struggling for foreign investors. Greece did not manage to exploit the opportunity of the Olympic Games in 2004, and did not make any significant improvements in terms of attractiveness and competitiveness (Pantelidis et al., 2011). Moreover, Georgopoulos and Preusse (2006) concluded that the country did not benefit from its participation in the EU in terms of increasing its position and becoming a production base for TNCs. This poor performance was mainly attributed to bureaucracy issues, inefficient public governance, high taxation, inefficient infrastructure, location weaknesses, the absence of clear investment incentives, and market variables such as market size and labour costs (Filippaios and Kottaridi, 2004; Filippaios, 2006; Bitzenis et al., 2007; Leitao, 2010; Pantelidis et al., 2011). In their comparative study Barrios et al. (2004) also concluded that there was no compelling evidence for significant FDI spillovers in Greece. This phenomenon was mainly attributed to three factors: the size of the local companies (the larger companies were not so interactive and responsive to the foreign investors as the smaller ones), the "stress on majority foreign-owned firms" and FDI's focus on more traditional and low-technology economic sectors. The last two years increase is associated with the reforms that have been made and the cost reduction of production (Enterprise Greece, 2015b).

The segregation of the evidence by sectors and subsectors is presented in Figures 2 and 3 and is divided in two periods (2003-2007 and 2008-2013). It is evident that FDI inflows are focused on services, which is a sector of limited potential and confirms the results of Barrios et al. (2004) that were mentioned above. Regarding manufacturing, investors have been primarily interested in chemicals, machinery, food and metal products without any specific alteration over the years.

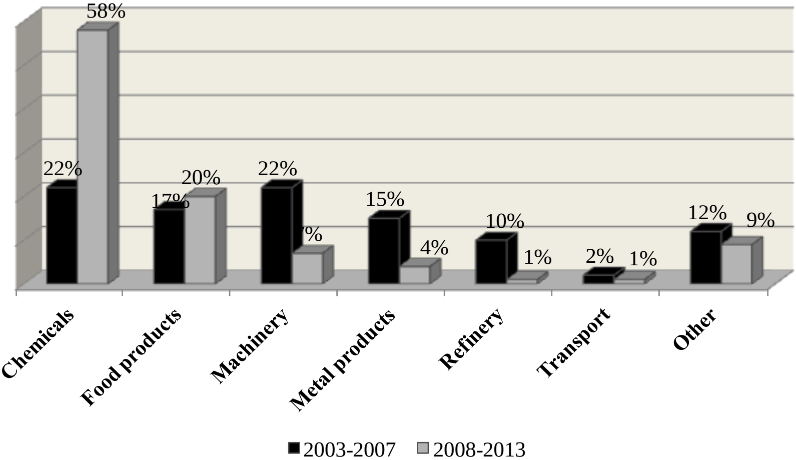
In Table 1 the FDI inflows by continent of origin are outlined for the period 2003-2013. It appears that the majority of foreign investments originates primarily from the EU. The significant decrease of FDI originating from America and Asia should be noted. The next figure (Figure 4) shows the investment capital by country of origin. The main countries that invest in Greece are the traditional exporting countries (such as Germany, the United Kingdom, France, Belgium, Luxembourg and Italy) although the smaller participation of the USA and Cyprus should not be neglected. In particular, the stability of inflows from France and the impressive increase of FDI from Germany should be pointed.

Figure 2: FDI inflows by economic sector (2003-2013)



Source: Enterprise Greece, 2015b

Figure 3: Total FDI inflows in manufacturing (2003-2013)



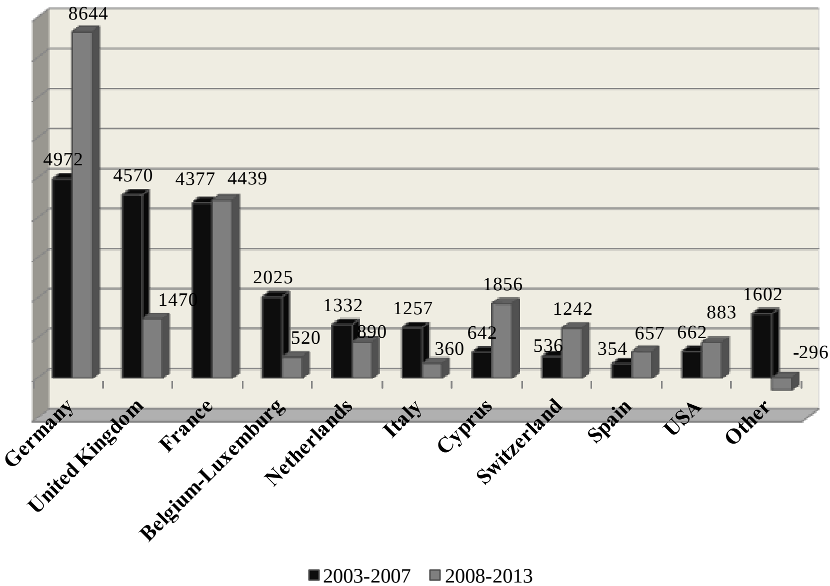
Source: Enterprise Greece, 2015b

Table 1: FDI inflows by continent of origin (2003-2013)

	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012***	**2013***
Continent of origin											
Europe	1.386,40	1.445,00	298,2	4.223,80	1.498,00	2.982,30	1.624,30	300,7	455,8	1.717,60	2.255,40
America	-11,9	267,7	190,6	-373,5	54,1	79,2	30	-45,7	390,2	-144,2	-123,7
Oceania	-0,9	0,7	-1,3	5	0,3	-3,4	-1,9	-0,3	1,8	2,8	4,2
Asia	2,5	6,8	1,4	400,9	-4,9	29,4	124,5	13,5	-4,2	-189,3	-166,9
Africa	5,7	2,3	6,4	8	-3	-19	-33	-18,1	-21,1	-33	-32,6
Non allocated country	-251,9	-29,9	5,9	4,8	-1,9	2,9	9,9	-0,9	-0,1	0,5	0,1
Total	**1.130**	**1.692**	**501**	**4.269**	**1.543**	**3.071**	**1.754**	**249**	**822**	**1.354**	**1.936**

Source: Bank of Greece, 2014
Notes:
1.The negative sign (-) means a decrease of the net direct investment.
2. The geographical breakdown is based on Eurostat's classification in Balance of Payments Vademecum.
3. FDI data include reinvested earnings.
* provisional data

Figure 4: Total FDI inflows by country of origin in million euro (2003-2013)



Source: Enterprise Greece, 2015b

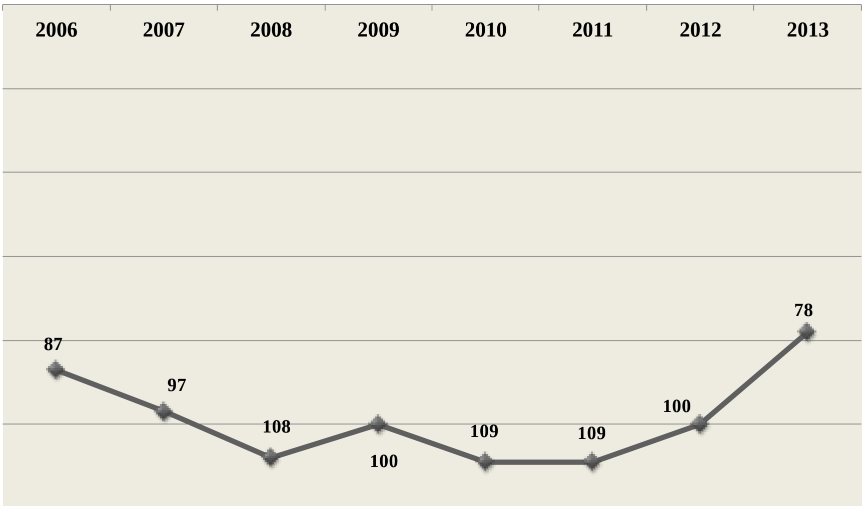
Foreign Direct Investment and the Ease of Doing Business Indicator

Based on a research study by Bayraktar (2013), economies with higher scores in the "Ease of Doing Business" index had the tendency to attract more FDI. Although it could not be regarded as the main factor affecting FDI flows, it appears that the change in the countries' ranking could be considered as an influential point, especially in the case of developing countries. It was considered appropriate to investigate that relationship for the case of Greece as well.

The Doing Business Report was first published in 2003 featuring 5 indicator sets that measured business regulation in 133 countries. In 2013 the annual publication covered 10 indicator sets in 185 economies. For each country, the ranking was calculated as the average of the percentile rankings on the following 10 indicators: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency (Doing Business Report, 2013).

In the following graph (Figure 5) Greece's change in the rank of the "Ease of Doing Business" report for the years 2006 to 2013 is presented. It should be noted that the ranking for the years prior to 2006 were not available. As it is shown in the diagram, Greece's position had significantly deteriorated in the years between 2006 and 2008 (from the 87th to the 108th place), and under the influence of the sovereign debt crisis dropped a few ranks again (in 2010 and 2011). The country greatly improved its position in 2012 due to the reforms that were made, and in 2013 further improved its ranking. The same year Greece was between the ten countries that had shown the greatest improvement regarding the measures of the Doing Business report. More specifically, the government reduced the time required to carry out certain business activities, enhanced investor protection and made efforts to resolve insolvency (Doing Business Report, 2013).

Figure 5: Greece's rankings on the Ease of Doing Business (2003-2013)



Source: Doing Business Reports, World Bank Group, 2006-2013

Comparing Greece's FDI net inflows (in million euro) between 2006 and 2013 to the country's ranking in the Doing Business reports we produced mixed results, revealing that the rank alone was not an important determinant of FDI inflows. For example, in 2007 the net inflows were decreased and so did the country's rank. The same applies for 2010. But in 2009 when the inflows decreased, the country's rank improved. Furthermore, although the inflows in 2006 were higher than those of 2013 the country's ranking was higher (from the 87th place in 2006 to the 78th in 2013).

Conclusions

For the last few years, Greece has been attempting to transform its economy and it has been widely suggested that FDI could contribute to those efforts. Nonetheless, as it was demonstrated by the literature FDI is not the "magic pill" that would certainly lead to growth but it is rather "a mixed blessing". As a source of external finance it has both opponents and proponents, but its significant impact on the host country's economy is indisputable. It affects employment, imports, exports, trade, income, production and ultimately economic growth. But at the same time, foreign investors could take advantage of the provided incentives, and lead the recipient country to losses and distortions. Conclusively, the truth about FDI lies somewhere in between.

In the case of Greece, and certainly under the current economic situation, FDI could contribute to the development of its economy as it is a form of capital that does not create anymore debt and has proved resilient in times of economic crisis. Therefore, FDI could become the base for a sustainable economic growth. Nevertheless, policy makers should be cautious on the provided incentives, since what is beneficial for an investor could not be favourable for the host economy.

For the last few years, Greek governments have made reforms and provided motives such as tax allowances, market attractiveness and location advantages in order to draw foreign investors, but FDI volumes remain below its potential. The country still struggles with bureaucracy issues, inefficient public governance and infrastructure, and most of all economic instability. In order to improve the inflow of FDI Greece should not only try to resolve these problems, but they should also turn to the countries that did not have a large investment share in the past but have the ability to offer more in the future (e.g. the Russian Federation and China).

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