

Foreign direct investment in Black Sea region

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Abstract:

This paper analyzes policies to attract Foreign Direct Investment (FDI) International competition to attract foreign direct investment (FDI) has increasingly intensified. After this study the conclusion is that the Black Sea presents great opportunities that remain largely unrealized.

Keywords: foreign investment, business climate, management

Policies to attract Foreign Direct Investment (FDI) have become standard in most countries, irrespective of their level of development, geographical location or industrial structure. Some analysis shows which variables impact economically and statistically significant on inward FDI stock it does not give an impression which of the (policy) variables should be altered to attract FDI given a country's relative position with respect to the various policy measures, i.e. whether a country is below or above the "best practice policy" values. An analysis based on the gap between estimated and potential FDI also shows which FDI attraction policies should be carried out by a particular country in a particular industry.

There are promising trends in global foreign direct investment (FDI) flows for developing and transition economies. Each year more and more FDI is flowing not only from developed into developing economies but also from one developing or transition economy to another. Indeed, developing and transition economies' share of global FDI inflows rose from roughly 19 percent in 2000 to 52 percent in 2010 - for the first time

exceeding half the total. And half the top 20 FDI recipients in 2010 were developing or transition economies.

In the past few decades hundreds of theoretical and empirical studies have attempted to pinpoint the main factors in investors' decisions on where to invest. Most empirical work has found that multiple factors are significantly associated with FDI inflows and that in some cases they interact. The determinants identified as significant vary depending on the countries, sectors, years, and types of investment studied. And many studies have been unable to overcome econometric identification challenges. Thus a definitive understanding of what drives investment decisions would require an understanding of the context for each FDI project.

The experts said that while the presence of natural resources remains a key FDI driver to Black Sea, investment climate variables such as economic, political and policy options matter as well in attracting investment.

The Black Sea basin is a strategically important region at the crossroads between Europe, the Middle East, and Asia. The region serves as a pivotal East-West and North-South corridor and a crossroad of geopolitics, commerce, energy, and culture where the interests of four major international actors overlap: the European Union (EU), the United States (U.S.), NATO, and Russia. It is a very dynamic area that presents various challenges and offers numerous opportunities. As a result, its development requires special consideration by policy makers.

The Black Sea (known as the Euxine Sea in antiquity) is an Inland Sea between southeastern Europe and Asia Minor. Countries bordering on the Black Sea are Romania, Ukraine, Russia, Georgia, Turkey and Bulgaria. Important cities along the coast include Constanța, Yalta, Odessa, Sevastopol, Kerch, Novorossiysk, Sochi, Sukhumi, Batumi, Trabzon, Samsun, Istanbul, Burgas, Varna.

Intense commercial activity around the Black Sea dates back to Antiquity. Since the end of the Cold War, the Black Sea states have intensified regional co-operation. Beyond oil and gas trade, regional electricity trade in Southeast Europe and Turkey will become increasingly important in the medium term. Both Romania and Bulgaria have surplus refining capacity, which, if adequately upgraded, could sell products to the entire Southeast European market.

All the country in the Black Sea region requires massive foreign investment to develop their energy production, transport and

distribution sectors. Political stability and economic reform are required for these countries to compete successfully with other regions of the world for scarce investment dollars.

Since the end of the Cold War, the Black Sea region has no longer been a static border between the West and the East. Western institutions focused primarily on the transition of Central and Eastern Europe and did not view the Black Sea region as a distinct zone. For about a decade after 1989, the Black Sea area largely remained outside the reform and integration agenda of the European project. The Black Sea region is re-emerging from the periphery and establishing itself as a part of the Euro Atlantic project.

All these countries Romania, Bulgaria, Turkey, Georgia, but also Russia and Ukraine are competing to establish themselves as energy transit countries. They also offer potential opportunities in the refining and distribution sector. The gas market is expected to grow substantially in all riveran states.

The energy profiles of the six countries are very diverse: Bulgaria, Romania and Turkey are trying to reduce their heavy reliance on domestic coal by increasing gas imports. Romania – with its Canadian-design plant – and Bulgaria – with two more recent reactors – will continue to rely on nuclear energy. Turkey plans to build a nuclear plant as well. These countries are net importers, ranging from Romania, which imports 39% of Total Primary Energy Supply, to Georgia 80% of TPES imported.

Thereby the attraction of Foreign Direct Investment (FDI) is of paramount importance to the countries of the Black Sea Region. The benefits arising from FDI are the obvious ones stemming from the influx of capital and creation of new jobs. However, of equal if not greater importance, especially for the Transition Economies of that Region, is the linkages and the other spill over effects they can generate. The term linkages refer to the connection of the supply chains of Multinational Companies (MNC) to the supply chains of local Small and Medium Enterprises SMEs. This connection, for example in the form of an SME becoming a supplier of the MNC, will help the SMEs in Region harvest the benefits of the globalize economy instead of just suffering through the competitive pressures it brings. As to the spill over effects, these include the transfer of new technologies of production and distribution, new management and corporate practices, new working methods, even new mentalities.

However, at the time where FDI is needed the most the global outlook is dim. In the last few years the global flows have decreased. However more and more developing countries try to attract foreign investments in a hugely competitive environment, in which the developed countries have traditionally been getting the lion's share.

The FDI that the Black Sea Region has been attracting in the last few years has been insignificant. Investors had turned away from the Region. In contrast, Central and Eastern Europe (Hungary, Poland and Czech Republic etc.) have been getting a steady larger stream of global FDI flows.

A good **business climate** is of primary importance to the attraction of FDI and, unfortunately, in the Black Sea Region it's easy to find barriers and disincentives for businesspeople. Bureaucracy, frequently changing rules of the game, corruption continues making the life of local and foreign businesspeople difficult in many places within the Region. The primary strategy countries should develop is the improvement of the business climate. What is needed, however, is first and foremost political will for the enforcement and implementation of legislation that is already largely in place. The 16% flat tax introduced in Romania in 2005 is a good example that hopefully the business climate is changing and will attract investors.

Second importance has the **market**. Questions prospective investors have about a country are: Is there a market for my products? Or, is there access to markets for my products? The answer to this question brings into sharp focus the value of the regional cooperation. By establishing a regional market it can be showed to the global investors that investing in any of these countries automatically gives them access to a huge market of one third of a billion people. It is therefore imperative to bring down as many as possible non-tariff barriers within the Region and thus increase our internal trade flows.

Apart from the above two general overriding needs – favourable business climate, access to markets – each investor has other important needs of specific nature that Governments must understand thoroughly.

Conclusions

Both a review of the empirical literature and analysis using new data sources suggest that business opportunities - as represented by, for example, the size and growth potential of markets - are by far the most powerful determinants of FDI. But investment climate features such as

strong institutions and investor-friendly regulations also matter for developing and transition economies seeking to attract additional FDI. In a poor investment climate foreign investors and host economies may not be able to benefit fully from business opportunities created by market size and growth potential. An economy that has a poor investment climate is therefore likely to attract both less FDI and lower-quality FDI than it otherwise could.

Regarding economic development, privatization, attracting FDI, and modernization of infrastructure should be at the forefront of all government agendas. In addition, restructuring the inefficient industries and encouraging entrepreneurship will stimulate growth and decrease the large current account deficits of the states in the Black sea area.

The Black Sea Region has been out of the international investors' paths for several years and all Black Sea countries must cooperate to put the Region firmly again on the investors map. It is only to be hoped that we will now start seeing more and more FDI flows coming into those countries.

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