Effects of Foreign Direct Investments (FDI) in Greek Economic Development: Some Policy Implications

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1. Foreign Direct Investment (FDI): A Working Definition

FDI is the acquisition of a controlling interest in a foreign firm or affiliate. According to World Trade Organization (WTO) the main criterion used in distinguishing between FDI and portfolio investment is that FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) *with the intent to manage that asset.* The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments.

Moreover FDI comprises three components:

a. New equity from the parent company in the home country to the subsidiary in the host country;

b. Reinvested profits of the subsidiary; and

c. Long and short term net loans from the parent to the subsidiary.
It could be argued that FDI is the vehicle whereby local production acquires national dimensions, or the device, transforming firms into multinational corporations (MNCs). The "orthodox" theory of the firm fails to account for the expansion of enterprises[1] as recorded in the present economic era, their ever-increasing influence on economic life and the reason why the provision of foreign markets with goods is not conducted through trade. The last argument is based on the assumption that the state is not self-sufficient and, as such, unable to cover the totality of its consumers' demands.

In the beginning of the transactions at an international level, the supply of goods in the market was due to trade. However, theories of international trade and capital movements could not explain the foreign operations concerning MNCs. Particularly, they could not

1. In the paper the words enterprise and corporation are used interchangeably.

explain two-ways flows of FDI between countries and still less between countries with similar factor proportions.

The key characteristic of the international production theories - and other fields of economic thought likewise - is their theoretical diversity. Both the focus and the economic environment these theories were attempting to explain, make this last assumption self-explanatory insofar as they were touching a diversity of issues, arguments and fields of economic activity. Likewise, the business environment itself in the way it determines international production is ever changing, adapts itself in emerging conditions and generates distinctive considerations that affect home and host countries in different ways.

It is assumed that a corporation decides to perform the FDI process upon concluding that the transfer of its production abroad will generate profits. In cost - benefit analysis terms, the headquarters will have to consider in cost estimations the fact that local competitors are knowledgeable of the prevailing conditions in the market, are covered by favorable state legislation and have an already established and recognizable brand in consumers' mind. Not least, the foreign enterprises will have to afford the expenses of the production installation and organization abroad.

Such an investment cannot prove profitable unless the enterprise has certain advantages over its local competitors. Provided that such advantages are visible and concrete and can be easily diffused in all organization parts of an enterprise, they can have the best possible outcome in terms of profits. These advantages are defined as "ownership" or "firm-specific" advantages which usually lower the unit costs of production and raise the profit margins of given firms relative to others in the same industry. They may include technology, production know-how, marketing skills, brand reputation and so forth.

The existence of such ownership-specific advantages represents a necessary but not sufficient condition for FDI. Although they manage to explain the investment procedures, they still fail to include the reasons why an enterprise will choose to proceed to foreign investments. It could exploit these advantages through producing at home, or by licensing a foreign producer.

To achieve a sufficient explanation of the production installation abroad, certain location-specific advantages should be taken in consideration. A "locational" advantage is a factor that pulls a firm to invest in a particular location. An inherent locational advantage refers to some natural feature of the particular foreign location. It could be related to geography; for example, the foreign investment could be motivated by a desire to minimize transportation costs or a desire to be close to customers so as to minimize distribution and service costs. Access to resources provides another set of inherent locational advantages, such as low-cost labor, skilled labor, research and development (R&D) facilities, cheap energy, mineral resources etc.

In essence, ownership and locational advantages are inter-related. The latter affect the activities of all enterprises, which decide to establish themselves in a foreign country whereas the former differentiate the way of exploiting these opportunities. Therefore, the two sets of factors altogether, represent the essential conditions for multinationality.

With regard to the form of market where the enterprise decides to adapt, the common elements of all investments is that they operate within an imperfect competition situation. Otherwise, with perfect competition, firms do not possess market power; they produce homogeneous products and have an equal access to all productive factors. No advantage could accrue to the prospective MNC; consequently, FDI is a by-product of imperfect markets. Market imperfections could be found in both the local and international markets and allow to the enterprise to acquire local advantages over other firms which will then be expanded - through the FDI mechanism - by transferring its production abroad.

2. The Effect of Foreign Investments in a Nation's Economic Development

The presence and activities of foreign operations all around the world has been the subject of controversy in discussions on development policy. The theoretical background for the negative verdict is largely from the ideological left (for example, the theory of peripheral capitalism and Latin American dependency theories) and it is based on the effects of FDI in developing countries. The skepticism shown is often partly based on negative experiences in the late 1960s and early 1970s, with examples of incorrect behavior e.g. inappropriate influence of political decisions, exploitative wages and poor social conditions. In recent years the impact on developing countries of multinational corporations has been judged more favorably.

Comparative surveys by the International Labor Organization (ILO) of social conditions, effects on employment, choice of technology and training by multinationals and local companies paint a positive picture for multinationals - certainly in comparison with local companies. This view is confirmed by studies from the UN Center for Transnational Corporations (UNCTC) since the early eighties.

Foreign Operations usually make a positive contribution to the economic growth of countries through their investments, products and services. This is primarily through:

Translating theoretical knowledge into practical results by the correct use of their products and services, for example in agriculture, health and industry;

Providing access to modern technological and management know-how (e.g. research, development, marketing, finance);

Investment and employment.

Training in all areas, on all hierarchical levels.

The benefits for host countries from a multinational's presence vary according to its structure, product range, services and sphere of activity. Suitable regulatory and financial conditions, a dependable legal system, an adequate infrastructure and a well-functioning government help reinforce such potentially positive effects, while their absence prevents or hinders them.

As is the case with any economic or social activity, multinationals can also generate conflicts of interest. A commercial enterprise seeking profit optimization pursues its own corporate objectives such as achieving an acceptable rate of return on invested capital, gaining market share, or ensuring its long term competitiveness, rather than supporting the host country's economic and social development objectives. The result is that corporations and host country authorities have diverging opinions on very fundamental issues:

Repatriation of profits to the parent company is in most cases essential in order to contribute to overhead costs incurred at headquarters (e.g. for research and development) as well as to corporate profits as repayment for financial risks. Host countries often consider this a regrettable drain on limited foreign exchange and a burden on the balance of payments.

Patents which safeguard the results of a company's research and the associated transfer of *patent and licensing* fees may lead to conflicts because some countries, mainly the developing ones, prefer the lower priced product imitations (e.g. generics).

A corporation's *research policy* and its strategic direction may also not coincide with the developing country's interests and needs.

A company's *location policy*, for example of production facilities, is largely determined by economic criteria (e.g. volume of production, market size, availability of high quality raw materials and technical skills), and not by a government's need to become self-sufficient through the local production of specific goods.

There are other potential areas of conflict that differ from company to company and country to country. Solving such conflicts requires a serious evaluation of the interests of and benefits to both parties, taking the overall social and economic benefit of a company and product concerned into consideration. There are no universally valid answers.

Corporations that act responsibly in a number of obvious areas reduce the potential for conflict between a socially and economically viable development policy and the impact of a corporation's involvement in a country's economic advancement.

3. Roles of FDI in a Host Country's Environment

The process of engaging in FDI procedure and establishing production operations in host countries stems from the strategic planning of the parent company. One can identify three stages in the process. The first stage is characterized by both the need for expanding the activities of the enterprise and the choice of a location suitable for its creation. The second stage includes the creation of the subsidiary and the third comprises its adaptation to the new environment. The last stage, which also seems to be the most important, defines the nature of the subsidiary, the extent of its independence from the parent company and its special features. It has been observed that, in the developed countries, the subsidiaries are involved in the production in a manner commensurate or not with that of the parent company. Subsidiaries, therefore, could incorporate different levels of independence and assume different productive roles.

In the literature, there are a lot of references on subsidiary typology. In the paper the following analysis is adopted: The first role that a subsidiary can assume is the production of the exact same product with the parent company, without its differentiation. These subsidiaries are called Truncated Miniature Replicas (TMRs). The main objective of this role is to supply the host market with goods that are already established elsewhere in the MNC's operations. It has been argued that it is very difficult for this type of subsidiary to cover the distinctive needs of the local markets. With the lowering of protectionism through GATT rounds and the emerge of free trade areas, and the general intensification of international competition, this role is often considered to be in decline. Consequently, the viability of this type of enterprises is doubtful. Hence, in an attempt to upgrade their role, adapt them into the new context and ensure that they acquire the largest share of the market, TMRs are trying to modernize themselves by means of a creative transition, i.e. the application of recent technology in their production process in an attempt to differentiate, in some degree, their products.

The second type of subsidiaries aims at the production and the supply of the market components of the final product, which is produced by the parent company. Their objective is to minimize the cost of production of the final output. In contemporary competitive environment, the production of the components of a technologically advanced product requires a highly specialized procedure. In addition to that, the local markets in which the subsidiaries operate may offer raw materials in lower prices. These subsidiaries are called Rationalized Product Subsidiaries (RPSs) and their role is considered to be of the utmost importance because they support the parent's company position in the international market. Therefore, it would be mistaken to characterize their role as static. The significance of their role becomes evident in fields such as the production of chemicals and electronic components, which call for the use of extensive knowledge and expertise, as well as flexible technological applications.

Though RPSs have a more dynamic role compared with TMRs, they cannot develop the creative human capital potential of the subsidiaries. Therefore, it can be assumed that a pure, fully networked RPS would supply a completely defined product in externally determined quantities to a MNC marketing network, eliminating scope for marketing or technological creativity and reducing its management to the dependent role of implementing a position in a wider strategy, which it cannot substantially influence.

The third role a subsidiary can assume is the production of differentiated products from the ones of the parent company. In other words, the subsidiary may take responsibility for the creation of a product, which derives from an idea that either emerges within the subsidiary itself, or is acquired from elsewhere in the group. The subsidiary's mandate relating to this product may then cover responsibility for its creation, production and marketing. A key point of emphasis, however, is that execution of this responsibility need not imply full autonomy in any of these functions. If, for example, full development of the product idea needs enhancement of the technological background through more applied research work, which exceeds the scope of the R&D resources possessed by the subsidiary itself, this may be subcontracted to another laboratory in the MNE group. In order to emphasize the autonomy of the subsidiary, and its retention of creative responsibility for the product, such an intra-group relationship, may take the form of a subcontracting one, implemented around quasi-commercial terms, with the creating knowledge becoming the property of the subsidiary, rather than the group.

Since this type of mandated creative subsidiaries have unique responsibility for a product that may well have a global-market potential it is categorized as Product Mandates (PMs). In this broad category one can include the subsidiaries, which are mandated to develop a specific regional variant of a new centrally-derived product concept, instead of achieving their derivation of a unique product on the basis on their own idea. In that case, under the pressures of global competition, the most effective application of the new product concept requires that it is innovative quickly in each major national or regional market, and also in ways which fully respond to the market needs and production conditions of each of these important and distinctive environments.

4. The Case of Greece

In order to analyze the overall strategic positioning of foreign subsidiaries operations in Greece and therefore to understand how they conceive the Greek economic environment so as to extract some policy implication, a survey was conducted regarding all subsidiaries of foreign operations. The data set included 317 subsidiaries[2] and the response rate was approximately 35%, which is considered quite reliable and satisfactory for these types of research.

Survey was conducted through questionnaires and interviews with subsidiaries top managers to allow for a more complete picture of subsidiaries' strategy. Where required, retired top managers were interviewed for ascribing to the research a more holistic and dynamic aspect. Respondents to the survey were asked to evaluate the degree of presence in their activity of each of four possible roles. The importance of each market was extracted by using a fourfold classification varying from "our only role" to "not a part of our role". Results are presented to the following table.

The first subsidiary role was defined as to "produce for Greece products that are already established in our MNE group's product range". This role can be ascribed to a Truncated Miniature Replica (TMR) subsidiary. Thus, a possible quite extensive product range derives from that which is already well established in the MNE's group wider operations, but it is applied to the narrow competitive environment of the subsidiary's local (Greek) market. Although some degree of product/strategy differentiation; some degree of creative scope is likely to emerge in these subsidiaries, this is limited to the extend of adaptation to the local conditions, and still leave their functional capabilities severely truncated by comparison with the parent or more strategic, subsidiaries elsewhere.

Of the total sample's subsidiaries sample, the 36.34% consider that to produce for Greece already established products is the only role for the subsidiary's operations and 38.62% felt that it took a predominant position. The results indicate that about the 75 percent of the overall foreign subsidiaries are ascribed with a TMR role in the Greek market. Some possible interpretations of evidence provided are that either Greek market is a quite similar one with the consumers possessing special preferences, or Greece may be a relatively insignificant wider strategic market. 15.88% of the respondents characterized the production of almost product as a secondary role for the Greek market and the rest 9.16% did not include it.

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2. The data set was collected from ICAP and it refers to the total number of foreign subsidiaries operating in Greece in 1999.

Table: Roles of Foreign Subsidiaries in Greece[1]

Production of Well Established Products (Per Cent of Cases), N=108					
	Only Role	Predominant Role	Secondary Role	Not Part of Subsidiary Role	Total
By Location of HQ					
EU Countries	15.90	15.90	6.81	6.81	45.42
Other European Countries[2]	7.95	5.68	4.54	2.27	20.44
USA	7.95	14.77	2.27	0.00	24.99
Japan	4.54	0.00	1.13	0.08	5.75
Rest of the World[3]	0.00	2.27	1.13	0.00	3.40
Total	36.34	38.62	15.88	9.16	100.00
χ^2= 18,931$^+$					

Specialization and supply of MNE network part of the Established Product Range (Per Cent of Cases), N=108					
	Only Role	Predominant Role	Secondary Role	Not Part of Subsidiary Role	Total
By Location of HQ					
EU Countries	2.27	14.77	7.95	20.45	45.44
Other European Countries[2]	0.00	2.27	4.54	13.63	20.44
USA	0.00	5.68	2.27	17.04	24.99
Japan	0.00	1.13	0.00	4.60	5.73
Rest of the World[3]	0.00	2.27	1.13	0.00	3.40
Total	2.27	26.12	15.89	55.72	100.00
χ^2= 13,183$^+$					

Production of Component Parts for Assembly Elsewhere (Per Cent of Cases), N=108					
	Only Role	Predominant Role	Secondary Role	Not Part of Subsidiary Role	Total
By Location of HQ					
EU Countries	0.00	4.54	7.95	32.95	45.45
Other European Countries[2]	0.00	1.13	1.13	18.18	20.45
USA	0.00	1.13	4.54	19.31	25.00
Japan	0.00	0.00	2.27	3.40	5.68
Rest of the World[3]	0.00	2.27	1.13	0.00	3.40
By Location of HQ					
Total	0.0	9.09	17.04	73.86	100.00
χ^2= 18,546^{+++}					

Production of Differentiated Products (Per Cent of Cases), N=108					
	Only Role	Predominant Role	Secondary Role	Not Part of Subsidiary Role	Total
By Location of HQ					
EU Countries	1.14	12.50	7.95	23.86	45.45
Other European Countries[2]	1.14	6.82	3.41	9.09	20.46
USA	0.00	5.68	6.82	12.50	25.00
Japan	0.00	1.14	0.00	4.54	5.68
Rest of the World[3]	0.00	2.27	1.14	0.00	3.41
Total	2.28	28.41	19.32	49.99	100.00
χ^2= 8.316					

$^{+}$ significant at 10%, $^{++}$ significant at 5%, $^{+++}$ significant at 1%

Notes

1. Covers subsidiaries that described them selves as only or predominately each type.
2. Includes substidiaries from Switzerland, Cyprus, Liechtenstein, Luxembourg and Russia.
3. Includes substidiaries from South Korea, Panama and Canada.

Source: Author, Survey on foreign substidiaries in Greece

The second type of subsidiary positioning offered for evaluation was to "to play a role in the MNE group's European supply network by specializing in the production and export of part of the established product range". This role ascribed to the subsidiary, classifies its operation as a rationalized product subsidiary (RPS). Under this type of organization, access to economies of scale is allowed, as a source of competitiveness, replacing the often-compromising pursuit of economies of scope of TMR.

Of the subsidiaries that evaluated the answer, only 2.27% said that it was their only role, 26.12% rated it as a predominant role, and 15.89% felt it took a secondary position whilst 55.72% believed it was absent.

A second type of RPS strategic positioning was designated as to "play a role in the MNE group's European supply network by producing and exporting component parts for assembly elsewhere". It can be assumed that the emergence of this role in an MNC's European supply network would aim to optimize the more static dimension of efficiency by achieving economies of scale, or by allowing the manufacture of particular components in locations that are especially favorable in terms of costs and relevant inputs. This role proved to be by far the least prevalent of the four, with 73.86% of the subsidiaries that evaluated it saying it played no part in their operations, 17.04% rated it as a secondary role and only the rest 9.09% characterized it as a predominant role. There was no answer that could confirm that the production and export of component parts of the final product can be the only role of a subsidiary.

This could mean that MNCs tend not to make extensive use of such dispersed component – supply networks in their European strategies and/or Greece is not often considered a relevant location for this kind of operations.

The last role a subsidiary is ascribed with, is the production of differentiated products with that of the parent company. This role assumes the dynamic dimension of subsidiaries' operations. The corporation seeks to capture the special characteristics of the host country by adapting its products to the specific needs of local consumers.

According to the results only 2.28 percent of subsidiaries denote the production of differentiated products as the main role of their operations. This indicates that in Greece there is a limited number of proactive subsidiaries that want to innovate well ahead of their rivals. Evidence may lead to the hypothesis that either subsidiaries in Greece are less able to engage in decentralized activities, or Greece may not be characterized as the center of a wider strategic market for the MNE group. Nevertheless, since 28.41 percent characterized the production of differentiation products as a predominant role for the corporation, this is an indicator that subsidiaries may act as a step to entrance. Almost the 50% of subsidiaries neglect completely the production of differentiated products; where the 19.32% consider it as a secondary role for their operations. The above result indicates that foreign operations in Greece are not ascribed with the role of "innovators at the edges". They still operate with well-established set of practices, and follow rather a centralized approach to international market.

5. Policy Implications

Greece seems not to be, at present, a recipient of investments that will enhance furthermore economic development, since the nature of subsidiaries do not allow to incorporate to Greek economic environment the advantages from FDI inflows stated in Section 2 of the present paper. The production of standardized products which seems to be the prevalent characteristic of foreign operations expansion strategy has two major deficiencies concerning the economic development of the host country:

The first consist that on the fact that standardized production does not require investments in technology, a field that would enhance the nation's competitive advantage. The effective use of technological resources and advancements may lead a corporation to an upgrading involvement in global innovative activities, which in turn, may generate distinctive capabilities for both the whole MNC environment and the host country alike. The second deals with the fact that the incorporation in the production process of standardized procedures do not allow for the application of innovative know-how, sophisticated management techniques, therefore they do not allow for the development of host managers possessing distinctive entrepreneurial skills.

Historically, Greece was a mass wave of FDI in the sixties, when the Investment Law 2687/1953 was introduced[3]. Evidence indicates that it is a recipient of inward FDI aiming mainly at catering the local market needs. The opening up of Eastern European markets, the extensive EU enlargement process, the introduction of Euro, the liberalization of trade and technological progress create a quite prosperous environment for investments. Greece should acquire the maximum advantages from inward FDI. Since Greece offers a stable political and business environment and provided the fact that the size of market is a given exogenous factor to the analysis, for long term sustainability of FDI, Greece should invest in technology.

Intensification of public research, the built up of an entrepreneurial knowledge culture in national laboratories and the investment in research and development activities from Greek public institutions could develop a more promising environment for FDI and lead to further economic development. To that end, it is believed that subsidiaries will incorporate in their production procedures supply side and environmental factors of Greece. That will lead them to operate in a context, which will provide a scope that exceeds beyond that needed in the more traditional roles. Creative activities should be operated in order to increase their autonomy and therefore the whole competitiveness of the group and the host country as well.

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3. This law offered financial incentives and succeed in attracting FDI, aiming at taking advantage of the cheap labor force and of the dynamism the new market was ascribed at that time. Const. GE. ATHANASSOPOULOS: La notion d' investissement productif privé. Bruxelles, 1994.