

Economic development with help of FDI (Montenegro example)

Mr. Anita CUCOVIĆ PhD Candidate
Msc. Alma SHEHU-LOKAJ

Abstract

Each state is forced to invest, because investing is the only way to realize the objectives of development. MN is a small developing country, both in its geographic size and population, and by its geopolitical importance, market size and aggregate demand, production, investment, export and technological potential. The specifics of its makes the need for carefully planned selective development and formulation of appropriate specific strategies adaptation and convergence with the EU, which must be based on comparative advantage and forcing the activation all internal reserves, and in particular the acceptance of strengthening dominant role of knowledge as the only unlimited resources, whose propulsive many territorial population and provides a remarkably small state place in the international division of labor

Key words: FDI, economic development, legislation.

JEL classification: O, K, D92

1.Introduction

During fifteen years of transition, MN failed, or some other post-socialist countries, to build new and effective economic institute. The establishment of various forms of pseudo-institutional relations and push for the institutional market monism crisis has led to many phenomena. Various market restrictions are started booming uncontrolled shape of the market, which were followed by low living standards, social disintegration, unemployment, insufficient rule of law, increase social pathology and others. The reform of macroeconomic instruments was carried out too late (by monitoring EU), which slowed the functional adjustment of the economy market principles and requirements. It is more reform rhetoric than the actual introduction of competitive market. The efficient market cannot exist without a dominant share of the specified protected private property, which is the basis of autonomy businesses in the exercise of free choice. Competition is reduced to a primitive market structures. Analysis of market relations in the MN show that Monopolies are used by the end of the chances they are indicated. Data from the Central Government sites testify to resolutely implement the institutionalization began. Thanks direct monitoring of the EU, the last several years adopted a number of laws and formulated is fairly liberal economic policies, especially fiscal policy (tax rates are low, non-taxation capital gains, etc.)

1. Montenegro and FDI

2.1. International comparisons of FDI inflows

In 2007 the continued inflow of FDI in the region of Southeast Europe (SEE) and Commonwealth of Independent States (CIS) and it has reached a record level of 86 billion dollars, which can be seen from the following

graphic (Graph 1).. In SEE countries FDI is predominantly dependent on privatization in the CIS was associated with the conquest of markets and providing access to natural resources.

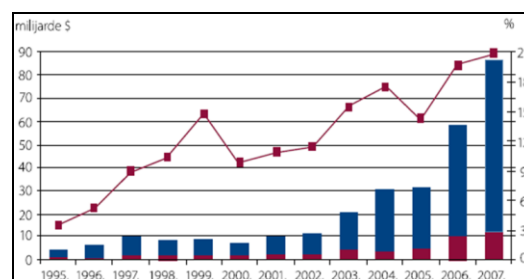
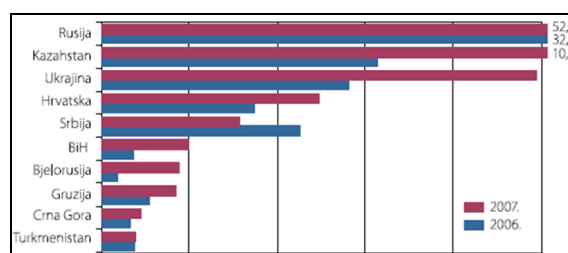


Chart no. Second a gross inflow of FDI and FDI as a percentage of gross¹

The maximum amount of gross FDI Russia has attracted 52.5 billion dollars, and Montenegro, although one of the smallest European countries found in the Group of 10, which attracted the largest amount of FDI in absolute terms (Graph. 2).



¹ World Investment Report, 2008

Chart no. 2. 2 The ten countries with the largest gross inflow of FDI²

Montenegro registered a very high inflow of FDI in recent years. Since the comparison of absolute levels of FDI inflows can lead to wrong conclusions considering different population, different levels of GDP and different size of countries is more correct to use a relative indicator, such as, for example, FDI inflows per capita or the share of FDI inflows in GDP -in.

On the following graphics shows the net inflow of FDI per capita in selected transition economies in the last three years. With a net inflow of FDI per capita in the amount of 2540 dollars, Montenegro is in second place behind Estonia, which had inflows of FDI per capita in the amount of 2901 dollars.

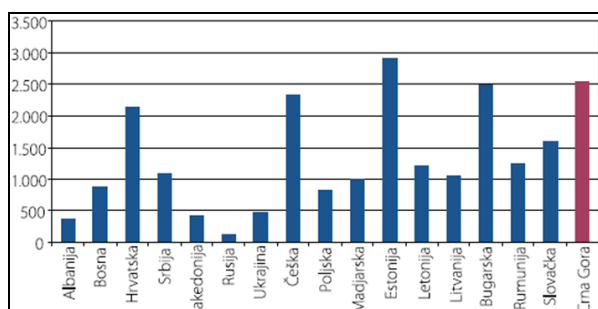


Chart no. Second 3 Net FDI inflows per capita in the period 2005-2007.³

2.2. Legislation current FDI regulations and short historical overview

The former Yugoslavia was the first socialist country to allow foreign investment in 1965 year. However, by the verbally stated principle of willingness to admit foreign investors in practice there are numerous barriers that restrict foreign investment. Therefore, in practice, foreign direct investment could be realized almost exclusively in the form of a joint venture with a domestic entity. The economic crisis of the eighties has influenced the change of attitude and accepts the reality that foreign capital is necessary for faster economic development. Then he passed the new Law on the basis of ownership ("Official SFRY" no. 6/80), which was twice amended⁴. Acquisition of title to real property was first allowed foreigners 1990th the amendments to the Law on Basic Property Relations. Since then, foreigners performing business activities may acquire ownership of real estate they need to perform the activity, but retained certain restrictions on disposal of property by private individuals. In order to protect the public interest and is normalized to the restriction that a foreigner cannot acquire ownership of real estate located in certain areas. In the mid nineties passed a new Foreign Investment Law ("Official Gazette of the FRY, no. 79/94 and 29/96), and Montenegro was his first Foreign Investment Law (" Official Gazette of RM no.

52/00) passed in 2000, as amended and filled up ("Official Gazette of RM no. 36/07).

The Montenegrin Law⁵ on foreign investment has meant a step forward in relation to the Act from the period of the FRY. The main advantages of the new law are:

- Simplified approval procedure on foreign investment contracts (in the old law called for the Federal Ministry for Economic Affairs approves the contracts of foreign investment, according to a new contract is only registered with the Agency for Foreign Investment);
- A foreign company is one in which the participation of foreign capital of more than 25% (in the old law nu - 51%);
- Expansion of activities in which an alien may have a majority share, because the old laws were prohibited, some activities such as media, telecom, and arms production and so on. Now there is only limit to the production of weapons;
- The question of concessions is left to be defined by special law, which is still pending;
- Especially prominent are the rights of foreign investors (national treatment, tax treatment no less favorable than for domestic entities, legal certainty, protection of property of foreign investors) and
- The law is significantly reduced, increasing its transparency and clarity for foreign investors.

The processes of foreign investment are still relevant following legislation:

- Decree on the determination of the state administration responsible for giving explanations and opinions in the process of title to real property of foreign persons engaged in business in the territory of Montenegro (Official Gazette, 34/05) - the method and procedure by which a foreign legal entity may acquire real property which is necessary for the performance of a foreign entity and
- Law on State Survey and Cadastre which defines the legal basis for entry change limitation or termination of property rights⁶

General Montenegrin legislation on foreign investments can be assessed as very liberal. There are no barriers to the repatriation of profits, dividends, interest and initial deposits. A foreign investor can manage the Company or the right of navigating transferred to another person. Foreign investors are guaranteed national treatment. Foreign investment may take the form of cash, securities, goods, services and rights. Resident individuals can acquire the treatment of foreign investors if they have lived abroad for at least a year before investing. Foreign investors are guaranteed protection against expropriation of property, and if it is necessary in the national interest are entitled to compensation in the amount of the full market price.

In case of change of the foreign investment after the investment, foreign investors are entitled to use solutions that are more favorable for them in old or new law. According to current regulations, foreigners may

² World Investment Report, 2008

³ World Investment Report, 2008 to net inflows of FDI and Transition Report 2007 for information on the population

⁴ Official SFRY" no. 6/80

⁵ (Official Gazette of RM no.36/07).

⁶ Official Gazette, 34/05)

acquire, without limitation rights of ownership of dwellings and business premises, and the acquisition of land ownership is restricted to legal entities for doing business. The Administrative Court of Montenegro in mid 2007 years decided that under the provisions of the Law on Basic Property Relations foreign natural person may acquire ownership of land.

This opened the problem of legal uncertainty, because a large number of foreigners already was registered this land as the land owner. This issue was dealt with very differently in different countries, the Stabilization and Association Agreement is envisaged that Montenegro will provide the citizens of EU member states national treatment with regard to the acquisition of real estate on its territory. According to the Decree on the determination of the state administration responsible for giving explanations and opinions in the process of title to real property of foreign persons engaged in business in the territory of Montenegro (Official Gazette, 34/05) opinion that the real property that is acquired by agreement necessary for the performance of foreign legal entities gives the Ministry of Finance on request of the competent authority or an interested party. It should also be noted that during the operation of the new Law on Basic Property Relations, which is expected to make a decision on these issues.

2.3. Flows of FDI

Montenegro recorded a very high inflow of foreign direct investment since 2005 Year (Graph 4) and since then at the top of European economies in transition. In order to attract foreign investors, Montenegro has created an attractive legal framework that includes a "national treatment to foreigners", which means that foreign investors have the same rights as domestic ones. The law also provided for various measures to encourage investors to invest in Montenegro.

In the period of 2001-September 2008 The FDI inflow in Montenegro has cumulatively amounted to 2.89 billion euro. In the coming period is expected to be the realization of major infrastructure projects, then projects in tourism and other fields. It is certain that Montenegro is a long time to have a high inflow of FDI given the still significant untapped potential for foreign direct investment especially in tourism (Valdanos, Jaz, Buljarica, Long Beach et al.).

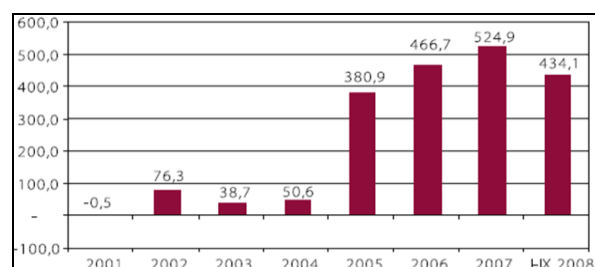


Chart no. Second 4 Net FDI inflows (in euro million)

	2001.	2002.	2003.	2004.	2005.	2006.	2007.	I-IX 2008.
Ulaganja u preduzeća i banke	4,704.350	76.386.802	38.482.634	41.783.604	322.392.288	252.076.604	377.589.177	226.292.346
Prod u dio drug. dom. Pred						6.063.943	-	459.955
Prod nepokretnosti u inostranstvu						1.162.289	61.930	1.483.835
Interkompanijski dug						45.146.178	115.674.823	172.629.042
Smanjenje kapitala u inostranstvu						2.004.873	-	2.211.965
Prodaja nekretnina	-	-	5.315.350	10.868.089	70.333.388	337.879.347	514.357.980	265.421.078
UKUPNO	4,704.350	76.386.802	43.797.984	52.651.693	392.725.676	644.333.236	1,007.683.910	668.498.221

Table no. Second a gross inflow of FDI in the euro

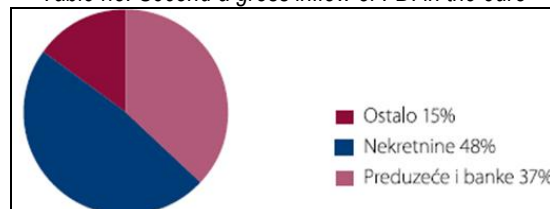


Chart no. A second 5 Structure of FDI in the period 2006-September 2008 (in %)

When it comes to the inflow of FDI can draw the following conclusions:

- that a significant portion of FDI inflows realized in real estate (especially in 2006. and 2007.)
- that still dominate FDI associated with privatization process privatization process, while the green field investments are still relatively under-represented
- the largest amount of FDI was directed towards tourism, banking, industry and telecommunications and
- that the structure of foreign direct investment gradually improved in 2008 year decline in participation over FDI in real estate, and growth in the real sector.

Many analyzes have already shown that between FDI and economic growth there is a direct and significant interaction, but the structure of investment is more significant than the amount of funds received. Evidently, in the last few years, the greatest object of interest of foreign investors in Montenegro was the real estate. Thus in 2006 year, the total inflow of foreign direct investment accounted for 52.6% of even n and real estate.

Property investment has significant positive effects on the economy of Montenegro to the direct charge of the budget over to various administrative fees (for building and other permits for construction), one-time hiring local construction firms, domestic consumption of products necessary to build properties etc., and such indirect in the case of productive investment of funds received from sale of property by residents. But much more important and influential in the growth and productivity growth in investment companies and banks leading to job creation and increased employment in the long run. Therefore, it is encouraging that is slowly changing share of foreign investments in favor of investment firms and banks. In particular, a significant increase in inflows in the form of intercompany debt (in the graph below shows company's debt by item bar "Other" and so, for the first nine months of this year 50% of "Other investments")

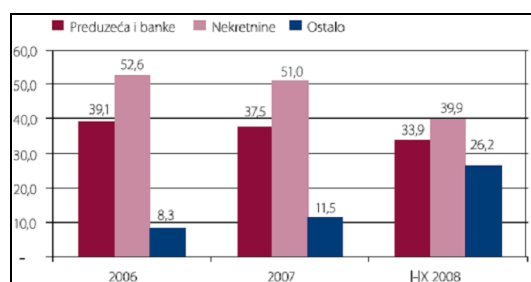


Chart no. 6 Trends in the second structure of FDI inflow in the period 2006-September 2008 (in %)

2.4. The regional structure of FDI inflow

When it comes to the origin of foreign direct investment should be noted that the inflow of foreign direct investment followed by ITRS system. This means that the country of origin as it registers the country from which came the influx of money. Under present conditions of globalization of business that does not necessarily mean that it is a real country of origin and foreign direct investment. Multinational companies have their accounts in many countries and they can make the payment from any country. This is not a problem that is specific only for Montenegro, but also for other countries. Regarding the regional distribution of foreign direct investment is considered to be a favorable situation if the inflow of FDI is coming from as many countries, because then the country of foreign capital inflow to a lesser extent under the influence of negative trends in the BCS of individual markets.

Bearing in mind that, in the case of Montenegro foreign investors comes from 107 countries (since 2001 Year) the current situation can be characterized as extremely favorable. Investments from 46 countries was less than a million, so that investors from 61 countries have invested more than a million, which is still extremely high regional diversification of foreign direct investment. There is something worse situation if we observe the total amount of income from 10 countries that are most invested in Montenegro, because they account for 73% of total gross inflows of FDI. Of the total gross inflow of FDI in the period in 2001 years - June 2008 was only 77.77 million or 2.89% is paid from off-shore destinations.

2. EFFECTS OF FDI INFLOWS

The inflow of FDI is a factor that greatly affected the economic development. Montenegro does not have sufficient resources of their own accumulation, therefore, is largely focused on the inflow side of the reservoir. GDP growth is influenced by many factors, and FDI inflows are certainly one of the factors significant. At the next graphic shows the relationship between FDI inflows trends and developments of GDP. Graph clearly confirms the earlier hypothesis that the present FDI is one of the important drivers of economic growth.

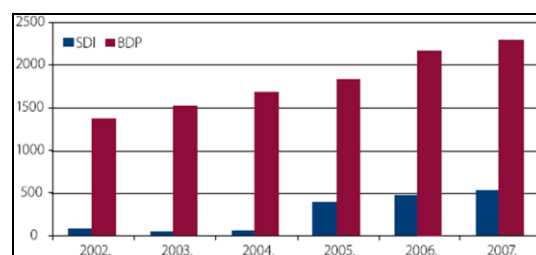


Chart no. 3 1 the interdependence between FDI inflows and GDP (in euro million)⁷

It should also be borne in mind that the realization of FDI and its effect on economic growth there is some temporal jump delay. What harm, after the fact that a certain period of time to activate investments, which means that in future we can expect significant effects as a result of activation of current FDI.

Both variables, as net inflows of FDI and nominal value GDP of Montenegro shows a similar, upward trend. Bearing in mind that data is available annually for only seven years, is unenforceable stationary test, but based on the graphic it is obvious that this is a non-stationary series, which in perspective should be analyzed over the growth rate. GDP and net FDI in Montenegro show a strong high and positive correlation that exists between these two variables of 0.92 (taking into going to the correlation coefficient ranges between -1 and 1), which is in line with prevailing economic theory of the positive impact inflow of FDI on economic growth, with the main conclusion based on the idea that FDI inflows provide quality transmission technology and know-how, increasing productivity in the recipient countries of FDI.

High inflow of FDI has had a significant effect on deposit growth and hence the development of the banking system and capital markets. The effect on deposit growth was twofold. On the one hand as a result of the sale of assets and properties of a particular age j is slow money into the banking system as deposits. On the other hand through the process of foreign investment on the Montenegrin market appeared credible foreign companies that have become a significant customer of the banking system as a depositor and a borrower. Process of foreign investment has had a significant effect on the budget. The process of foreign investment is influenced on one hand the growth of economic activity and, accordingly, to increase tax revenues, and on the other hand through the process of foreign investment is preserved a significant number of jobs, making it easier situation of state funds. However, foreign direct investment had some negative effects.

Thus, for example, foreign direct investments have a direct impact on the deficit of current account deficit. On the one hand this is due to rapid growth, as foreign investors committed an additional investment in companies that bought, to increase their level of competitiveness. For example, foreign investors who bought hotels are importing building materials, furniture, interior and other means to reconstruct and modernize the hotel.

After a certain period of time these investments should have significant positive effects on the economy growth days. The second course was last harm, the fact that a

⁷ CBM and Monstat

large number of individuals selling real estate significantly increased its level of living standards. In such conditions, there was significant growth in consumption of cars, household appliances and the like. These are durable goods that are not produced in Montenegro, so the result was the growth in imports. Interdependence between FDI and imports is not specific only for Montenegro, but also for other economies in transition. Moving correlation between FDI inflows and growth in the current account deficit is shown in the following graphic.

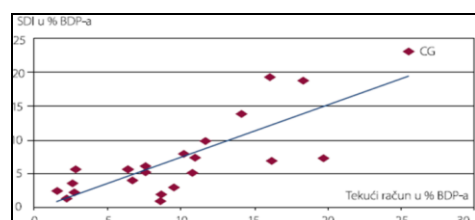


Chart no. 3rd 2 Correlation between FDI inflows and current account deficit⁸

Over-investment in certain coastal municipalities without giving enough attention to protecting the environment to some extent degraded natural environment that has so far been a significant comparative advantage of Montenegro. Regarding the last couple of years ago it is the interest of foreign investors in the sector of so-called irreplaceable property - real estate, banking, telecommunications, retail, all of which have very small effects on exports of Montenegro (excluding investments in tourism). From a development perspective the most important investments that foster productivity growth and technological progress, which is currently still a bit in Montenegro. Finally, it should be noted that the flow of foreign direct investment is largely influenced by the positive global economic boom. The emergence of the global financial crisis which affects the operation of a large number of companies around the world, and that will lead to a negative welfare effect will inevitably have a negative effect on attracting foreign direct investment in the future.

All forecasts indicate that the global financial crisis will affect flows of foreign direct investment in the period 2011 first year. Forecasts to reduce the influx of different and ranged from 30% to 50%. When it comes to Montenegro potential for FDI inflow is not used and it is realistic to expect in the future high inflows of FDI. Of course one cannot exclude the possibility that a number of foreign investors who planned to come to Montenegro postpone its investment in a subsequent period due to the fact that next year will be reduced availability of credit at the global level, and that they will be more expensive. You need to be aware of the fact that most of the foreign investment financed from loans, the global environment is not favorable. This does not mean that these investors will go to another country permanently or lose interest in Montenegro, but it will postpone to a certain period of their investment. It is realistic to expect that Montenegro will next year have a high inflow of FDI and will be at the top of the European economies in transition.

3. Conclusion

First of all I have to emphasize that the issue that was discussed and the complex research. We tried that in the shorter lines in the best way to approach it on the issues and the role of foreign direct investments, which are also one of the most pressing issues in developing countries. Knowing that foreign investors are required to all countries, most countries in transition, which escape from chronic shortage of own capital, management skills (management), modern technology, export channels, and those who do not have domestic savings from which they could fund their own development. As an alternative to the arrival of FDI are loans - commercial loans and international financial institutions (this requires government investment), and the financing of investment from domestic savings. Since foreign investment is expected output growth, wage growth, employment, exports, tax revenues, technical and managerial skills, weakening the power of domestic monopolies and increase competition.

The businesslike practice and theory of law used the term "international capital movements", "foreign investment", "import and export of capital", while legislation to serve the term "foreign investment". Movement of capital in the international level is manifested in the form of foreign direct investment, portfolio investment and international borrowings with repayment period of at least five years. The range of disputes that achieved by investors, multilateral agreement is the most famous Washington Convention on the agreement of investment disputes between states and citizens of other countries, a famous institution, the International Centre for Settlement of investment disputes with the International Bank for Reconstruction and Development as a specialized institution

The experience of countries in transition shows that the fastest and easiest privatized factories that which is most successful with the best profit. Another motive for investors is cheap and qualified labor and also the possibility of reducing the workforce and increasing competition. Leading MNCs have great realization of the profitability of different sectors of the economy, and also gaining new markets is one of the motives for the new venture. The motive for foreign investors can be and often the removal of "dirty technologies" in less developed countries they don't have well-constructed institutions and legal mechanisms to protect the environment. Thus avoiding paying large sums of money to protect their country, ecology, and also realize some other comparative economic advantages. The main motive of the recipient country's capital was forced to substitute the missing domestic funds through foreign direct investment as the most cost effective form of economic investment.

I conclude from this entire can say the following: that the foreign direct investment is one of the most important factors affecting the economic development of developing countries, improve production, stimulate exports and of course lead to a quicker realization of capital.

⁸ Montenegro Selected Issues, IMF, 2008

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