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THE DYNAMIC PRIVATIZATION AND FOREIGN DIRECT INVESTMENT

ДИНАМИЧЕСКАЯ ПРИВАТИЗАЦИЯ И ИНОСТРАННЫЕ ПРЯМЫЕ ИНВЕСТИЦИИ

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Abstract. The article examines the relation between foreign direct investments (FDI) and privatization. It reveals hypothesize of privatization has an impact on FDI as the process of attracting the investors. Moreover, the privatization appeals capital inflows, fundraising, new technologies, improvements in human capital, new managerial skills and improved corporate governance. Therefore, the investors are interested in privatization process in companies. As result of it, the FDI causes environment of competition among companies and provides government to develop investment climate.

Аннотация. В статье рассматривается взаимосвязь между прямыми иностранными инвестициями (ПИИ) и приватизацией. Раскрывается гипотеза о приватизации, которая влияет на ПИИ как на процесс привлечения инвесторов. Кроме того, приватизация привлекает приток капитала, сбор средств, новые технологии, улучшение человеческого капитала, новые управленческие навыки и совершенствование корпоративного управления. Поэтому инвесторы заинтересованы в процессе приватизации в компаниях. В результате этого ПИИ вызывают конкуренцию между компаниями и обеспечивают правительству развитие инвестиционного климата.

Keywords: FDI, privatization, capital, investment, technologies, competition, investment climate.

Ключевые слова: ПИИ, приватизация, капитал, инвестиции, технологии, конкуренция, инвестиционный климат.

Introduction

Initially, the Federal Republic of Germany conducted the idea of privatization in 1957. The German authority sold majority shares of Volkswagen to private investors [1]. From 1960s to 1970s, history pages indicate that sudden expansion of public sector in the developing world. The next decade was seen as new era of the economic affairs as it called privatization of public enterprises. Earlier policy makers accepted the privatization process as intervention of state to private markets in order to redress failures. The process of privatization process was popular in the UK under Margaret Thatcher's authority. Thatcher managed to privatize the Britain Telecom [2]. In France, Chirac privatized large banks in 1986 [3]. Later, the process spread to the world and international communities supported it as well. According to stat, from 1984 to 1994, the privatization process reached to USD 468 billions [4].

Interaction between the governments and the markets should not consider that these two forces can be interchangeable and if the competition in the market is the most effective way of the organization of production and distribution of goods and services, the state has to provide the relevant institutional structure and has to interfere if the markets are inadequate or limited. It is important to study the reasons and consequences of refusal of the market.

The best way to understand a market failure to begin with understands of success in the market. Adam Smith claimed that each person pursues own interests, and in the conditions of market economy they serve the general wellbeing. Therefore, according to the neoliberal theory if the markets are full, that it has not been lost any transactions and if there are enough buyers and sellers that nobody could influence the prices, the result of functioning of the market runs effectively. Therefore, resources are fully used, properly distributed for the effective companies, and the optimum combination of the made goods and services. In other words, a combination which maximize welfare of consumers reach, adequately reward owners of the capital and resources due to optimum achievement of income.

Moreover, the effective markets also depend on the assumption that information is perfect that providing the information of the market. Control for information leads to market failure and to monopoly for resources. Therefore, it becomes clear that development of competitive markets is complicated, and the understanding of the nature and degree of imperfection is very important. The state intervention can be justified only if resources are not involved completely or if distribution of results in the market is unacceptable.

Defining privatization

The privatization covered many industries, fabrics, manufactures and even those that had never been owned before. The process also cited decentralization. It caused to change political balance in many countries. Therefore, the new trend of concept was given scholarly views. For example, Nicolas Van concept of privatization is “a transfer of ownership and control from the public to the private sector, with particular reference to asset sales” [5], Jenifer Piesse identified “privatization is to improve economic efficiency, competitiveness and sustainability of the private sector from the entire economy”[6], and the Economic times defines it “the transfer of ownership, property or business from the government to the private sector is termed privatization” [7]. The OECD cited it “as privatization may be considered any material transaction by which the state’s ultimate ownership of corporate entities is reduced” [8].

Theoretical framework

The theoretical aspect of privatization depends on understanding the concept of property rights. The society is required to have an efficient way of dealing with numerous transaction in order to develop market system. Specialization and distribution of resources depend on low transaction expenses, which are dictated by the prices in market economy. The competitive markets in which transactions are effectively processed by market prices substantially depend on formal, accurately certain property rights.

De Soto claimed that “to be exchanged in expanded markets, property rights must be ‘formalized’, in other words, embodied in universally obtainable, standardized instruments of exchange that are registered in a central system governed by legal rules”. Indeed, De Soto claim’s indicates that the lack of formal rights of property might be cited as the missing tire of the car, which causes the restriction for development of countries. Moreover, the lack of property rights also influence to amount of goods and services that might be merchandized in the market. Easterly held the same concept of property rights as De Soto. According to Easterly, creating strong incentives, property rights lead to an increase in investment since people are certain and secure about the ownership of their property.

Poole gave the statement that privatization directly guides the political goals to economic goals, thereby it leads to development of the market economy. In other words, the political behavior can be redirected to new way of the governance. By reducing it, the economy of country will run for further development. Moreover, Poole cited that by privatization the role of government is reduced in the economy. Thereby, there is less chance for government to impact negatively into economy. That statement also supported by Easterly also. Easterly noted that downsizing a bad government policy or government corruption can play essential role for developing.

The method of privatization

The OECD divided the method of privatization into two groups on basis of State owned enterprises (SOEs) or by the state. One more difference between methods of privatization is a direct transfer of SOE to a private property (the natural person, the company or closely related structure) and the SOE list in the stock markets. Moreover, the OECD provided the four methods of privatization based on the scale of process. It can be seen on the Table 1.

Table 1.

FOUR METHODS OF PRIVATIZATION

Method	*Description*
Trade sales	It can be made by private placement or at auctions for sale. The coordinated sales of the completely state enterprises rather seldom meet the preferable participant of the transaction in OECD while it is more frequent to offer tranches of actions in already listed state enterprises to individuals for groups of preferable. The state enterprises can be also sold by an auction from the largest bidder, as a rule, of the private companies.
Share offerings	Initial public offering of shares of all or part of the company's shares on a stock exchange, a secondary public offering, or offering through accelerated book building, when the government accuses many financial intermediaries in the placing shares of the already listed SOEs with institutional investors.
Management or employee buy-out	SOEs can be sold to legal entities.
Privatization can be led by the SOE	This can be done by increasing capital, releasing an additional stock, thus dissolving the share of government ownership, or through indirect privatization. Another method is the indirect privatization of the sale of tangible SOE assets. In particular, privatization occurs when fully state-owned enterprises sell their corporate property, branches or commercial activities in accordance with government regulations

The first method is trade sales. In this method, the state decide which companies should be sold and through use of the market mechanism, investors are able to buy shares. The advantages of this method is to create badly needed revenues for the state while giving it to investors who have incentives to invest and restricting companies. On the other hand, finding local investors seems hard especially in underdeveloped countries. The method has been successful in Jamaica, when the country managed to privatized its National Commercial Bank through sale of shares to local investors.

The second method is cited as share offerings. The government distributes vouchers to its citizens. The method does not create revenues for the state, but it shifts to privatize state-owned company. Canada and Russian Federation have implemented this method, but the Czech Republic has developed the most known program of privatization of the shares. The main purpose of this method is to consolidate shares and diversify risk for the citizen. Thereby, the capital is oriented to expand investment funds and citizens are provided to obtain dividends from shares.

The third method focuses on the internal privatization. The state owned enterprise is sold to its employees or managers who are already familiar with the company. This method provides the minimum revenue for state. This method stimulates, but incentives are much stronger when firms are sold to strategic investors. Besides, new owners often have no resources for investments and restructuring that is extremely necessary in underdeveloped countries. The third method is well known in Slovenia, due to the majority of the state assets were distributed to state owned investors and the rest of assets sold to employees.

The last method of privatization has been used in some circumstances, but is not used almost as often as the three methods discussed previously. Restitution - the process of returning ownership of the company to the original owner. Along with the difficulty of finding the original owner, there are many shortcomings to this privatization method, since the value of the company varies over time. Hungary implemented this method. The result caused an inflow of foreign capital, which led to technological improvement and increased competition climate. The World Bank praised Hungary’s growth and its method of privatization. Argentina, Mexico, and Peru countries also conduct the privatization as Hungary way. These countries revenues from privatization were orientated to pay of the outstanding debt.

Issues of privatization

The method of privatization should also cover the local context. For example, the initial public offering (IPO) are hard to implement in the countries, where capital markets are not developed. In this case, trade sales to foreign companies might be better method of privatization. Moreover, the OECD also grouped some factors that cause not to success the privatization processes based on observations. The Table 2 shows these factors.

Table 2.

CENTRAL ISSUES OF PRIVATIZATION

Factors	*Description*
Market structure and degree of contestability of the market	The sectorial context is key to understanding the potential for successful privatization. In particular, the need for privatization, as well as the result of privatization, depends on the structure of the market and the degree of market controversy. In fact, it is necessary to distinguish between firms that are a natural monopoly and that the benefit of state ownership is important and firms in sectors in which competition can be strengthened through privatization. The structure of market might to have impacts on both methods and privatization revenues.
The potential for spill-overs	A successful privatization can bring benefit to the economy which does not depend on efficiency of the privatized firm. Advantages of privatization can flow to other sectors and consumers, for example, reducing the prices and increasing quality. Expenses can spread through distribution effects
The institutional and political context	The first point is that institutions in the North sense, the countries where privatization is conducted, determines the limitation within which the privatization process will operate. In an economy with competitive markets, with clearly defined and enforced ownership rights, the privatization process should be smoother and the success rate higher than in a transitional economy, for example, where management is typically weak. The second point is the privatization outcomes depend on political economy factors. Whether a country privatizes and liberalizes a particular sector will depend on its political structure, and the configuration of interest groups.

The role of FDI on privatization

The role of economic reform programs seeks to decrease government control and transfers ownership from state to private sectors. The ownership status of company favors foreign investors, particularly from multi corporations in the form of foreign direct investment (FDI). This trend runs for developing countries. According to World Bank, FDI has become capital flow for developing countries.

In 1999, seven of the ten largest the FDI transaction around the world was reached to USD 1 billions. The FDI brings many advantages such as fundraising, new technologies, improvements in human capital, new managerial skills and improved corporate governance. Therefore, the investors are interested in privatization process in companies. Moreover, the role of FDI in privatization is essential due to it flows are foundation stone for economic growth and institutional development. Moreover, the process assesses the link between privatization and FDI.

Narjess Boubakri and his group [9] analyzed the relation between FDI and privatization. They managed to analyze various (22 developed and 31 developing) countries. They found that the FDI influences to privatization and suggested that privatization can play role of attracting FDI, which causes to domestic economic growth. Moreover, the privatization possesses a credible signal of less policy risk for investors and it attracts more FDI.

The World Bank's statistic information showed that FDI flows continued to expand. In 2006, FDI direction to developing countries reached to USD 325 billions. If the flow separated into groups, the largest portion directed to banking and telecommunication sectors. Moreover, the World Bank's data base information 1990-2000s shows that 44 countries carried out 4580 transactions of privatization. In the 1990s, privatization processes averaged between USD 30 billions in developing countries. In 1997, the process peaked to almost USD 90 billions. However, the following years, the revenues declined in result of East Asian financial crisis and the Russian debt crisis.

Table 3.

THE INDICATOR OF FDI IN RESPECTIVE YEARS (BILLIONS OF USD).

	1990	*2005-2007 (pre-crisis average)*	*2014*	*2015*	*2016*
FDI inflows	205	1 426	1 324	1 774	1 746
FDI outflows	244	1 459	1 253	1 594	1 425
Income on inward FDI	2 197	14 496	25 108	25 191	26 728
Income of outward FDI	82	1 025	1 631	1 480	1 511

Source: UNTCAD, World investment report 2017

According to the United Nations Conference on Trade and Development (UNTCAD), report indicates the comparative analysis of FDI around the world. The table 3 shows the FDI indicators from 1990 until 2016 years. The interesting part is the trend of FDI increased slightly from 2000s. In 2014 the FDI inflow was 1 324 billions of dollars, the following years the trend increased slightly and reached to 1 746 billions of dollars. Ironically, all indicators the FDI inflow, outflows and income (inward and outward) are soared until financial crisis. After 2008, the FDI trend decreased slightly and resumed growing.

Conclusion, the market-orientated countries should take into consideration of policy of attracting of investors. Therefore, the government authorities are required to implement the policy of privatization. The privatization is a form of governance that shifts from political to economic goals. Afterwards, country's economic condition will get the next step of development. The process of privatization has been covered almost all countries around the world especially it run well for developing countries.

Moreover, the privatization process is divided into four methods and nowadays these methods are cited as one of the trusted and tested. However, there are factors that causes hindrances for privatization. These factors are divided into three groups. The World Bank and UNTCAD showed the flow of FDI indicators. These two worldwide groups' statistic information show the privatization process around is increasing.

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