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How to Attract Foreign Investments in Greece and the Role of Public Administration

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1. Introduction

This paper is based on an eclectic use of the literature on Foreign Direct Investments (FDI)[1]. The selection criteria are subjective and serve the author's predetermined views on how private investments, part of which are FDI, could be promoted in Greece. The author's long and analytical experience of the Greek case has predetermined the conclusions on how it can be done. This paper looks at the international literature to support his conclusions and rectify them any inconsistencies that might exist. The first step was to look at how the idiosyncratic characteristics of a country affects foreign capital formation. Idiosyncrasies are either natural (e.g. geographical distance) or manmade (e.g. cultural, language, legal system etc).

A PEST analysis and a SWOT analysis will illustrate both the natural and manmade characteristics which make a country an attractive place to invest. However, such analysis is beyond the scope of this note[2]. There is though a fundamental question: what are the determinants of investment? This issue is discussed in the next section of this paper. Selected papers are reviewed which are considered relevant and applicable to the current Greek investment environment. This relevance is illustrated in the third section of the paper. The next section is a story telling to demonstrate some of the aspects of Greece's inability to attract foreign investment. As all stories, the mythical and the real are interwoven. The moral of the story is more important than the narrative itself. Based on all these (pertinent literature, relevance to Greece and stories), I attempt to propose some policy interventions which are deemed necessary to attract foreign direct investment to Greece. It is the author's belief that there is huge latent international investment demand for Greece. One way to realize this demand is proposed in section IV.

A word of caution is at stake here. I am not dealing with investment which require agreements between two nations such as the Greek Government and Chinese Government. My analysis is relevant for investments of small international private business because Greece cannot accommodate big investments. For example, no car company will come and produce in Greece. Also, FDI has been the subject of great skepticism for both the home and the host country. The host country is concerned with foreign control of domestic assets which might undermine

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[1] I do not review the literature at all but I select those papers which fit my predetermined and most probably biased views on Greece. Helpman (2006), among others, provides an excellent review of the theoretical literature, providing empirical evidence when necessary because as he mentions (p. 591-592) "[T]he interplay between theory and empirics is particularly important here because many of these theoretical studies have been motivated by evidence".

[2] I have in mind not so much analyses of consulting firms and banks as studies of the type produced by Dunning (1998) examining the environment of international business activity in the 1970s up to 1990s.

national security and sovereignty. It might also aggravate macroeconomic instability since foreign capital tends to move faster in cases of global and national economic crises. On the other hand, the home country worries that its national capital is going abroad depleting the home country of important capital resources. In Greece it is a recent phenomenon the capital export to neighboring countries, which has been blamed for the recent economic crisis and unemployment rise, particularly in the Northern Regions of Greece. However, as Desai et al (2005, p. 37) have reported:

> *"[N]ew evidence from analyses of American multinational firms suggests instead that greater foreign investment is associated with higher levels of domestic investment. This estimated complementarity implies that firms combine home production with foreign production to generate final output at lower cost than would be possible with production in just one country, making each stage of the production process more profitable, and therefore, in equilibrium, more abundant. It is clear that the simple story, in which the world has a fixed stock of investment capital that can either go to one place or another, is due for rethinking. The growing prominence of multinational firms, their reliance on their internal product and capital markets, and this evidence on the complementarity of their investment worldwide suggest the importance and possible contours of such a reconsideration".*

And in a more recent study by the same authors Desai et al (2009, p. 37), they found that "10 percent greater FDI is associated with 2.6 percent greater domestic investment, and 10 percent greater foreign employee compensation is associated with 3.7 percent greater domestic employee compensation".

This story explains very well what happened in Germany during the heydays of the euro years (up to 2009). The strong euro permitted German production to benefit from outsourcing part of its input production to neighboring noneuro and cheap labor countries. Germany's exports increased dramatically at the expense of south European countries trade deficit.

Similar evidence for the impact of outward FDI on domestic investment is reported by Herzer (2008) for Italy. He found that outward FDI has had negative short run impact on domestic investment but the long run impact was positive. Javorcik (2004) has found evidence of positive impact of FDI on the productivity of domestic firms in Lithuania.

2. The Investment Scenario

In widely cited paper, Davidson (1980) stated the country specific variables which influence foreign investment location decisions. In his words these variables are:

1. Market size and growth are widely associated with investment patterns.
2. Tariff and non-tariff barriers to trade, input costs and geographic proximity affect the economics of direct investment.
3. Legal, political and economic conditions are considered important factors in investment decisions.
4. The host country's similarity to the investing firm's home country has also been hypothesized to affect location decisions.

Davidson (1980, p. 18) concludes "The effect of corporate experience on location patterns is twofold. Firms prefer nations in which they are already active to those in which they are not. In addition, firms with extensive experience exhibit less preference for near, similar and familiar markets. Markets that others may perceive as less attractive because of high uncertainty levels are given increased priority as the firm's experience rises. As firms gain experience, the location of foreign investment activity will increasingly represent an efficient response to global economic opportunities and conditions".

These four variables are very vital and it should be taken into consideration by all those who are responsible in writing the Greek investment scenario. Other studies have supported Davidson's conclusion. In a study of FDI within the United States (Coughlin et al, 1991), the authors concluded that variables which measure the market size (demand) such as per capita income and manufacturing density (agglomeration economies). Factor costs such as wage rates, labour-management environment and the availability of labour. Lastly, government plays an important role through taxes and building the transportation and other infrastructure facilities.

This study keeps one important variable constant, namely the cultural affinity between the home and host regions of FDI. In the case of the various states of USA, the host regions culture is the same. Other studies have found that FDI goes to similar countries with common cultural characteristics such as language. Actually, most of this FDI is of intra-industry nature and between subsidiaries and parent companies (see Alfaro & Charlton, 2009).

Geographical proximity has been also investigated. In a very recent study (Bodman & Le, 2013), the authors found that geographical proximity (measured by physical distances) is an important determinant of FDI. In addition to geographical distance, the authors examine the impact of FDI in building human capital through the transfer of knowledge embodied in the new investment. The results enable the authors to recommend two basic policies:

- countries that have embraced a relatively more open international investment regime have usually grown significantly faster than others who have not. The fact that FDI transmits technological knowledge, as well as contributing to the physical capital stock, suggests that openness to direct physical investment, as well as to trade and financial flows, provides an important driver of economic growth.
- Human capital is not only necessary for the direct general enhancement of the technological level itself, but is also essential for the ability to learn from foreign technological sources. This has important implications for the ability of education enhancement policies to raise living standards through multiple channels.

Almost all studies find the role of government very important. This is the third category of variables in Davidson's lest above. The Legal, political and economic conditions include the tax and economic environment of the host country. Country compete for FDIs offering favorable tax and regulatory environment with a very flexible and effective public administration. At the extreme, there are some countries which are considered tax havens or treasure islands as a recent study has called them (Hines, 2010). This list includes many small islands and relatively poor countries but it also includes countries members of the eurozone such as Cyprus, Ireland, Malta and Luxembourg) as well as other rich countries such as Singapore and Switzerland. Greece's islands range from 1600 to 6000 and the number of inhabited ranging from 166 to 227[3]. It is really a pity that some of them have not been used as treasure islands.

3. The Greek Investment Scenario

The previous eclectic review of some FDI studies has certain implications for the Greek FDI scenario and I sketch them very briefly below.

First, Greece's size is small both its population and its land. It is also located far away from the center of Europe and her neighboring countries, similar in culture, but belong to a different international economic cluster. The most important of them is Turkey.

Second, the factor cost relative to its neighboring countries is high, especially when the productivity of labor is taken into account. It should be mentioned that the

[3] See http://en.wikipedia.org/wiki/List_of_islands_of_Greece.

average productivity of labor does not depend only on human capital but on the quality of physical capital, the quality of Greek capitalists (entrepreneurs) and the quality of public administration.

Third, the cultural proximity with other countries is problematic. Greece's culture proximity countries (apart from Cyprus) are the countries in the region such as Turkey. However, there is a tremendous and unexploited potential of foreign direct investors with very strong cultural ties with Greece. These are successful entrepreneurs in USA, Canada, Australia and in other countries of Greek descent. Greece's future should be based on these two areas: Turkey and the other Balkan nations and the Greek Diaspora of entrepreneurs. The latter also includes the Greek tycoons of the international shipping industry.

Fourth, the Greek public administration, along with the Greek trade Unions and the state nurtured capitalists are the most important impediment to any private investment in Greece. For very rational reasons all three groups do not want any healthy foreign direct investment to come to Greece. By rationality I mean that if Greece becomes a modern economy, then these three groups will be in a worse off position. It is for this reason that any attempt to "modernize" the existing Greek public administration is doomed to fail. The solution must come from the political process and a correct reading of the recent election results might show the way towards a healthy long waited capitalist development of Greece. Once this is achieved, then we Greeks can debate whether the next stage of development will be: socialist, communist, anarchist or even Plato's utopia.

After I tell some stories in the next section, I will come back to what I think it should be done for a capitalist development in Greece.

4. The Stories

The following stories whether were told to me by some of the participants of the stories and/or I was one of them.

A. State Nurtured Capitalists and Trade Unions

In the 1960s, a large mining company used the trade unions to prevent a large multinational company to invest in Greece. They were striking against the multinational company and providing Greek resources to be exploited by international capitalists who by the way pay higher wages than local state nurtured capitalists. Local state nurtured Greek "capitalists" collaborated with left and communist trade unions to keep FDI out of Greece. The first benefit because their inefficiency and ineffectiveness can survive only under protection. The latter because FDI pays higher wages postponing the inevitable immiserisation of the working class. Both groups have reached a dynamic equilibrium keeping away good Greek and non-Greek capitalists. No wonder what happened to Greek economy in the decades that followed the 1960s.

B. The Joke of Chinese and Russian FDI

China and Russia do not have the private investors Greece needs. During the beginning of the current crisis many people thought China can help. During an official visit of a political economic delegation from China we discussed the potential of collaborations. The Chinese leaders of the mission were repeating all the time how China can help Greece to get out of the crisis either through direct investment, portfolio investment and Chinese imports of Greek products and services. The services included Chinese tourists. At the end of the meeting, I was approached by a high ranking official from the Chinese delegation whom I knew for years and with a smile told me that the meeting was very good and he invited me to China (the Greek tax payers would have paid for the trip) to continue this fruitful discussion. I told him in my cynical way that nothing would happen and the whole meeting was to justify the trip. If he really wanted to help Greece, we would have a private meeting. This meeting was arranged and I had with me three people (personal consultants) with long experience in small business, including tourism. I also had a Greek who spoke Chinese. Straight from the beginning I told him that I wanted his help in two things. First, to have one private Chinese investor who will invest in Greece at least 1 million euro employing 5 people and most of the production will be exported. Second, to make an arrangement so every month we have a group of 20 Chinese who will come as tourists. If these two small projects were successful, then we can for further. Both projects needed no government assistance. After one week he sent me forms to fill in and I told him that I ma not going to fill any forms and the idea was dropped. I have another similar experience with Russian investors but not as high as the one with China.

C. The Myth of Structural Funds and Other Subsidies

The Community Structural Funds and any State Aid to the State-Nourished Greek Capitalists Operate according to **Gresham's law** "When a government supports (bad) "capitalists", the (good) capitalists will leave the country or disappear, while the state nourished "capitalists" will mushroom". Any state aid to such "capitalists" should stop immediately. Then the good ones might return. All subsidies and structural funds crowd out good and sustainable investments. The case of a luxury hotel in Northern Aegean Island is good example. The cost was 1 billion drachmae and the effective subsidies were 1.2 billion drachmae. The owner made 200 million drachmae and the hotel never opened. The nominal subsidy was 80% of the total budget; the effective 120%.

D. The Tragedy of Elliniko

In 2003 a group of economists prepared a study (cost-benefit analyses) of the post Olympic use of the various venues, including the Elliniko of 6000 stremmata. After estimating the cost of building (1-2 billion euro) and maintaining the park (300 million per year), the group of economists suggested unofficially the following: 1000 strematta should be sold for one million euro each generating one billion euro. These will be used for private dwellings with 20% coverage (200 square meters and two floors) with the rest an open landscape maintained by the owners according to some specified guidelines. This would have generated a garden-park of 800 stremmata. Another 1000 stremmata that face the sea will be auctioned off without any predetermined guidelines. Potential investors will suggest how to build, what to build and how much they would be willing to pay. All will be under the law of any eurozone country. Legality will be determined ex post and morality will be ignored. Future generations will determine the ethical use of the place. This would have generated additional funds of 5 billion euro and an annual revenue of 300 million euro which would have been used to maintain a metropolitan park of 4000 stremmata. After these suggestions, the team of economists received a letter to restrict itself what the Presidential Decree determined for the Elliniko. The team responded that nothing would happen. Nine years after nothing has happened which is translated in huge financial losses, output decline and unemployment.

5. The Need to Rewrite the Greek Investment Scenario

The new investment scenario should take into consideration the following factors. First, actual private investments can come to Greece only from those with cultural proximity with the Greek proximity. Greek-Americans, Turkish and Israeli's are good examples of people with a cultural proximity. All our efforts should be aiming at attracting investments from these international cohorts of investors. However, there is the big impediment of the international economic environment. For the case of Turkey, it is in Greece's vested economic and I would argue national security interest to play a leading role in promoting Turkey's entry into the eurozone. This is necessary but not sufficient which brings me to the next point.

Second, there is a need for one investment law. A potential foreign or domestic must have the freedom to choose any legal and institutional framework from the eurozone countries. This will apply to all aspects including industrial relations, wage compensation and environment protection.

Third, abolish all subsidies and agencies which promote investments. Not only they do not bring more investments but they are the main barriers for the types of investments Greece has an advantage on.

Fourth, Greece's size is small. The optimal (economically, socially and politically) level of foreign investments is the one that generates a turnover of 1 million to 10 million euro. In other words, this does not include the fixed and sunk cost of investment and excludes all investment which require land and other concessions from the Greek government such as mining.

Fifth, the Greek public administration, the trade unions and the state nurtured capitalists cannot change. The only solution is political. A potential investor must have the right to choose the legal and the institutional framework of any eurozone country. This includes taxes, the level of wages and insurance coverage to be paid to the Greek government. This will be particularly beneficial for the private islands and other private properties which cannot be developed because of the coalition of the troika: public administration, state nourished capitalists and trade unions. This troika has been able to exploit the rest of Greek people for two centuries now. These are the sons and daughters of those who killed Kapodistria.

Sixth, all nonpublic institutions should not be financed by the state and they should not participate in state committees and boards of state enterprises. In particular the following organizations are the great impediments to Greek Progress: the three professional associations of Doctors, Lawyers and Engineers; the two trade unions and the three employees' organizations. They should return to their role: advisory and protect the interest of their members.

Seventh, reform the tax system in a way that minimizes corruption and weakens both politically and physically the number Greek public employees. Income tax and VAT should be abolished and in the long run the Greek Tax Revenue (Efories) should be closed down. Government revenue will come from three sources which make up what economists define as wealth: property tax, tax on savings' interest and various excise taxes with inelastic demand. But the most important source of revenue is from fully and an unashamedly exploitation of all public resources which is my next point. Private land not used should be heavily taxed. The same applies to all private buildings.

Eighth, all public capital, physical and cultural, must fully be exploited by private agents by the use of the tool to Build Operate and Never Transfer (BONT) and all proceeds should equally to support (a) low pensions (b) health (c) education and (d) building up public savings. A good start is PARTHENON and ACROPOLIS. Then all the uninhabited public islands must follow. As said the investor will have the choice to select the law system of one the eurozone countries. The process will be very simple. The government passes a law that says we are open for business. If you want to exploit some public properties that you know of, please send in one page what you want to do and how much you want to give as down payment, how much every year and which legal system you want to apply. The government makes it public and asks others to outbid the offer primarily on the down payment. My rough calculations shows that this revenue can reach 100 billion euro per year when everything has been fully exploited.

I am not naïve to believe that this can be implemented without a countervailing political force that can bring down the most devastating troika of the last 200 years of public employees, trade unions and state nourished capitalists. However, the recent election results leave room for hope. All we need is to let Greek people decide through referendum what they want. Let people vote how many times they want their ports to be blocked by any group of people. Let people vote if they want the 6000 stremmata of Elliniko to become a metropolitan park and of course let them know how much there are going to pay as taxes to build such a park and maintain it. Let the Greek people vote if they want Parthenon to be open 24 hours a day and so on. After all it is in this city that direct democracy was invented and ostracism was a kind of a referendum. Ostracism can be used to decided when an investment should be turned down or accepted it.

On the eight issues I will come back with separate papers for each one. The approach will be similar as this one. International and theoretical literature will be used to develop a practical guide on how these eight issues could be implemented taken into consideration my predetermined and biased views on the subject. After all the ultimate criterion of success is its effectiveness (obtaining results) and efficiency. In our case what it means immediate higher economic growth and employment creation in Greece.

6. Conclusions

Greece can attract a considerable amount of foreign direct investment which is small and it will come from investors with a cultural proximity. The Greek Diaspora is number one in the list but other people such us Turkish and Israelis can jump in.

The most important barrier is the troika that has ruled Greece for the last 200 years. It can be destroyed only through the political process. It is a very difficult but noble task. If it is successful, Greece can give rise to a new type of civilization such as the one of the 5th century B.C.

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