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FINANCIAL INFRASTRUCTURE OF INVESTMENTS FLOWS BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

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Abstract

This article describes the main areas of foreign investments and the problem of the under-utilization of capacities of developing countries due to incorrect interpretation of the stakeholders' behavior. Four hypotheses were studied in this article and as a result there were formed suggestions for solving the underlying problem. Research proves that it is necessary to encourage public-private partnerships, to raise capital needed for the development of regional projects. Summing up all mentioned above, it could be suggested that foreign direct investment is a very important financial indicator in the 21st century. While the need in foreign investments sharply arises, more and more problems appear for the developing countries looking forward to attracting investors' attention. Initially, investors mostly tend to profit, but the fear of not getting it at all, the loss of their funds, st
vestors from putting their money in the developing economies.

Keywords*: Foreign Direct Investments; Behavioral Economy; Risk-Return Strategy; Developing Countries; Developed Countries.*

ФИНАНСОВАЯ ИНФРАСТРУКТУРА ИНВЕСТИЦИЙ МЕЖДУ РАЗВИТЫМИ И РАЗВИВАЮЩИМИСЯ СТРАНАМИ

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Аннотация

В этой статье описываются основные барьеры, препятствующие развитию международных инвестиционных программ между развитыми и развивающимися странами в том числе ввиду наличия противоречий в интересах различных сторон. Были изучены четыре гипотезы и, в результате, были сформированы предложения для решения основной проблемы. Исследования показывают, что необходимо поощрять партнерство между государственным и частным секторами, привлекать капитал, необходимый для разработки региональных проектов. Резюмируя вышеизложенное, можно предположить, что прямые иностранные инвестиции являются очень важным финансовым показателем в XXI веке. В то время как потребность

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в иностранных инвестициях резко возрастает, все больше и больше барьеров появляется для развивающихся стран, желающих привлечь внимание инвесторов. И хотя инвесторы стремятся получить прибыль, но страх не получить ее вообще, при потере своих средств, не позволяет инвесторам вкладывать свои деньги в развивающиеся экономики.

Ключевые слова*: прямые иностранные инвестиции, поведенческая экономика, стратегия риск-доходность, развивающиеся страны, развитые страны.*

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1. Introduction

Nowadays we observe rapid spread of means of communication and information technologies that influence economic activity [1]. Faster crumbling national barriers and opening up a new avenues of trade and investment in the financial markets mean that globalization becomes commonplace. One of the major trends in globalization is foreign direct investment (FDI) [2]. Countries are trying to increase its appeal to attract them. Foreign direct investment – is a form of participation of the capital from investors in the recipient country, which use them to implement important projects and involves new technology and innovation systems [3]. It is obvious that many scientists find negative components of foreign investment, such as inherent risk, or the possibility of corruption in the government-recipient, but it was always displayed a single result – without foreign direct investment the progress in the country slows, or disappears altogether [4].

It can be selected a sufficient number of prerequisites for the growing importance of globalization and FDI flows [5]. The first will be the most obvious and important – the need to create a competitive advantage in manufacturing technology. Every country goes through the stage of development, but its own resources for this process are not always enough [6], as well as existing technologies in the country. The world's progress is based on the cross-country competition, i.e., each country, developing production technology (which is possible in a full way only with the existence of FDI), has contributed to the progress and, consequently, improves its position in the global arena.

The next prerequisite is a low cost (for example, in China). Generally, industry producing placed where they can operate efficiently at the lowest cost to the manufacturing process. Investors prefer countries where restrictions on production as little as possible [7]. The processes of business units functioning are considered by Glukhov etc [8, 9, 10].

However, there are prerequisites, often pointing to the irrationality of investing. These assumptions include differences in the institutional system of the economy in both developed and developing countries. The level of relations between the state, the legislative framework and financial institutions is different for developed and developing countries. On this basis, there arises a model of investment in which developed countries are investing in developing countries (where there are fewer restrictions and more profit), and developing to developed (where risks are reduced).

In addition, various stakeholders, making cross-country investments, have very wrong behavioral aspects, incentives and constraints of each other. In this case the phenomenon of false demand for risk [11] and investment is appeared.

At this moment, this question is quite relevant in connection with the economic situation in the world. There are several groups of authors who work with this theme:

1. Authors, considering aspects of investment and the main problems and perspectives from developed countries. It considered in general and in connection with the specifics of this article, for example, Australia [12, 13].

2. Authors allocating the benefits of investing in developing countries, especially Russia, as an object in this article [14, 15, 16].

3. The authors conducting research on specific countries, where they indicate the role and effects of foreign direct investment. It show the specific directions of the FDI and its influence in China and India [17], Poland [18], BRIC countries [19

2. Literature Review

For the first time Adam Smith [20] mentioned the concept of investment and investment bank in early 1776, but John Keynes firstly mentioned the investment as a factor influencing the economic development. He explained investments as a current growth of capital values of property because of industrial activity for the certain period and was closely intertwined with the concept of international trade.

Initially, there were several theories of international trade [18]. First, the theory of comparative advantage of Ricardo appeared, where he argues that each country specializes in the production of those goods for which its labour costs are lower compared to other industries, even if the production abroad would be more beneficial. Then everything turned to Herschel-Ohlin theory explains that countries export goods from sectors where there is an excess of the product, and foreign investment, in turn, will be sent to those industries where is observed the relative lack of resources. However, this theory has been refuted in the study of Leontief. In his paradox, he explored America 50-70th years and revealed that despite the abundance of capital, the country was exporting intellectual products. Then, when in the developed economies have started the wages grow, it was appeared a system of moving production to other countries because of cheaper resources. And now economies move to the new level of attraction of the capital, which is described in the model of Paul Krugman, "center – periphery", which revealed that some centers in the country create innovations collecting resources from the periphery, and after creation, innovation spreads into the periphery. That means that system if self-regulating and an important prerequisite for the creation of "centers" is the technical potential of the territory. Now the main competitive advantage will be the scientific basis [21], the ability to create and implement new technologies, so funding will flock to where such opportunities are created. Initially developed countries have better conditions for the creation of such opportunities, but the return on capital is higher in developing countries, and if these countries will be able to develop the scientific and technical component, to provide highly qualified personnel, foreign investors will prefer to invest in developing countries [22].

The behavioural abnormalities vastly contribute in decision-making of the investor side. Daniel Kahneman investigated this issue in prospect theory, which describes the various stakeholder choices in possible solutions associated with risks in different conditions. It is particularly important to take into account features of behavioural abnormalities when considering the institutional systems in developing economies.

3. Research methodology

We have identified four groups of prerequisites for the development of globalization and foreign investment. The first is the need to create and produce competitive advantages in production technology [23]. Next is a low cost price for the transfer of production to other countries. Third is the difference in the institutional system of the economy in both developed and developing countries. In addition, the last is that stakeholders have wrong behavioural aspects, incentives and constraints of each other. Separately, stands out as a prerequisite the need for innovation [6], but not only innovations provide a competitive advantage, but the whole complex, so we have identified a broader meaning as a prerequisite. The presence of the resource base and cheap labour other authors define as a second prerequisite [16], the indicators that we have identified as a low cost. Much attention is paid to the fact that in developing countries, such as Russia [14] or China [5], the state is not always due attention paid to the development of regions, and does not follow the decrease in corruption [7], while in developed countries, corruption is minimized. Nevertheless, here and there

are contradictions, as bribable country prefers to invest in countries with high levels of corruption [24]. This model highlights the incorrect premise of behavioural aspects, especially connected with the understanding of risk strategy [11], which in turn may be due to misinterpretation to reduce investment in the country.

On the basis of these prerequisites the main problem arises in foreign direct investment, it is incomplete use of the potential utility maximization [25] in terms of attracting investment by developing countries due to lack of a multicriteria model taking into account behavioural characteristics in the process of determining strategies based on the concept of risk-return.

Due to the problems, it turns out that the cross-country specialization deepened with the production of certain groups of goods to the production of individual parts and the rate of acceleration of the level of development of cross-country communications reach extremely high levels [26]. However, the barriers between developing and developed countries, in terms of more effective cooperation, still quite significant. These barriers are the difference between the interest rates, the cost of investment resources, taking into account the free movement of capital in centers with a high yield [27]. The question is precisely that in developing countries there is a need in investment, equity financing, where part of the risk takes on a country-investor and the question is how to attract investors.

Next consequence is that a huge amount of resources in developing economies are either not involved in the global turnover, or inefficiently mined because of heavy losses, the lack of new technologies and funding from developed countries. This is stagnation, when the resource base of the country irrationally uses. Even in developed countries this problem exists (in example of Australia's coal), but due to enough amount of the investment this problem can be solved [28].

One of the consequences, on the contrary, can serve as a "leak" of a large number of resources in the developed economies, where the yield of the normal functioning is decreased to the minimum limits so that it leads to a growing number of economic bubbles, strains and crises. It came to the situation where it is specifically arranged fluctuations in the market to increase the profitability of a minimum level of 2-3%. For comparison, in developing countries the rate of return is much higher, but just there is a shortage of financial resources.

4. Model and Analysis Results

On the base of previous information, we formed four hypotheses.

Hypothesis 1 – The system of relations that should be built between developed and developing economies in terms of investment should have a multicriteria character. Conditions of the functioning of economies and the external environment vary with fast speed and due to the increased frequency of changes in the environment it needs to be introduced a new model of relations. This model should include such effects, through which it will be self-regulating.

Hypothesis 2 – The model must be stabilized independently, autonomously adapt to the changing of external environment or, at a minimum, provide for the company timely detecting of the deformation and overcome it, preventing the negative effects. The internal stabilization mechanisms need to be included in the model in order to minimize losses.

Hypothesis 3 – Multicriteria model among other things must ensure constant readiness for potential possibilities. It is necessary to provide the financial base that can be used in order to catch the possibility and implement it [29].

Hypothesis 4 – For the successful implementation of the hypotheses is necessary to improve the institutional system and financial instruments [30]. There is the need for close cooperation of the

government of a developing economy, its enterprises that needs an investment, the government of the country-investor and his companies. In this case, the clear separation desired between the initiator (state or company) and impact strength (sufficient stimulation, a clear distinction between the obligations or public-private partnerships, joint projects and sharing of risks).

Applying these hypotheses, we can put forward the following proposals to solve this problem.

For the most part, the government of a developing economy alone or with businesses that need to invested funds [31], advocate for the creation of programs of investment in emerging economies. Discuss and agree on proposals and interests of investors from developed countries and their governments it is taken certain measures to stimulate investment [32]. There are two ways to implement them: either the government forces or based on self-regulating market relations company in need of investment, independently participate in programs designed to attract them. By this method of implementation is the development of competition, when companies try as much as possible to participate in such programs to take a greater share of the market [33], as well as the principle of public-private partnerships (PPP). Table 1 shows the model and possible variations of the PPP.

Table 1. The model of the public-private partnerships

Regulating force	Government	Business	PPP
Government	Strategy A	Strategy B	Strategy C
Business	Strategy D	Strategy E	Strategy F
PPP	Strategy G	Strategy H	Strategy J

Strategy A – The government of a developing economy creates conditions for attracting foreign investments, and then the state makes its corporations use these opportunities to attract investment;

Strategy B – The government creates conditions, corporations themselves tend to use these opportunities;

Strategy C – The government creates conditions and then both, government and corporation, joint projects;

Strategy D – Market yourself encourages companies to create a program, the state is forcing companies to participate;

Strategy E – Companies create conditions that companies themselves are involved in programs;

Strategy F – Companies create conditions and then joint projects with government;

Strategy G – State and corporations jointly come up with the program, the state corporation makes use of opportunities;

Strategy H – The state and the corporation jointly come up with programs that corporations use;

Strategy J – The state and the corporation jointly come up with a program, then both, government and corporation, joint projects.

As a result, the strategy J is the most successful, as in both sides the advantages appear. For the state there is attracting a private capital for the construction of public facilities; involvement of management and intellectual capital from the private sector. For the company there is a risk sharing with the state; guarantees from the government [34]; administrative and political assistance from the state in the implementation of the project.

It should also be clarified that in the process of public-private partnership an important indicator should be considered – how many dollars of foreign investment accounted for one dollar of government investment. Today, emerging economies is crucial to maximize the amount of attracted investments per dollar of government investments. That can be estimated as the effectiveness of public-private partnerships, because foreign investors, in the first place, invest heavily in the area where not only company involved but also the government [35].

The next group of suggestions is the suggestions in the sphere of the direct involvement of the state in stimulating investment processes in the region, firmly is the systematic implementation of the trilateral policy with the purpose of maximizing the multiplier of government spending in the context of attracting financial resources to the regions. Firstly, to attract foreign investment in the non-profit sphere of infrastructure projects in the region with a guarantee of a certain level of profitability, in order to use the effect of financial leverage in the form of implicit lending of regional economy, as well as improving the investment climate through the direct participation of the foreign investor and its adaptation to local conditions [36]. Secondly, to adjust all of the planned investment expenditure in the region by attracting the additional investment, comparing to one dollar of government investment. Thirdly, to consolidate the compulsory sale of the state share after passing certain stages of the investment cycle in order to create an appropriate investment proposal [37] in the form of certain financial products targeted at specific investors through appropriate investment institutions of the international financial market from the very beginning of the project. For example, in 2012, the one unit of public investment in the region accounted for one unit of investment by domestic private sources in the region, one unit by investment by parent outside organizations, and only 0.08 units of foreign investment.

5. Conclusions

Summing up all mentioned above, it could be suggested that foreign direct investment is a very important financial indicator in the 21st century [38]. While the need in foreign investments sharply arises, more and more problems appear for the developing countries looking forward to attracting investors attention. Initially, investors mostly tend to profit [39], but the fear of not getting it at all [40], the loss of their funds, stops investors from putting their money in the developing economies. It is important to take into account the level of development of business relations [41, 42].That is the reason for a lack of investment in developing countries. Having analyzed the basic premises of foreign direct investment [43], we identified the main problem solving, as well as the necessity of introducing these decisions in the economy. In addition, it is important to know the characteristics of connections between different markets and developing countries features [44, 45, 46]. All the options proposed may help to solve the problem of irrational investment and, therefore, to develop the economies of developing countries.

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