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Foreign Direct Investment (FDI) Flow: Evaluation on Azerbaijan

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ABSTRACT

Foreign direct investment (FDI) played a substantial role in the international economy after the Second World War. In the globalizing world, the most important phenomenon is making direct and long-term investments in host countries.

FDI offers new technology and new workplaces to the country in which it is located, by purchasing any established factory or opening a new business in the host country. Today, world countries need FDI for economic growth and development.

Theoretical studies on FDI lead to better understanding of the economic mechanism and economics at both the micro and macro level, thus creating new fields of study in economic theory.

Keywords: FDI, FDI in the World, FDI flow in Azerbaijan

Jel Codes: E22, F21

1. INTRODUCTION

Foreign investment can be defined as the advancement of capital from the country to another country. The movement of capital to another country takes place through international financial money markets or FDI. FDI can be expressed as expanding the production of many multinational companies outside the borders of the country where their headquarters are located, opening a new company abroad on their own or with different partners, or purchasing a company that is (Kurtaran, 2007, p. 367). These investments not only increase the competitiveness of capital-issuing countries, but also affect economic development, the expansion of production, export capacities, employment and technology, and the improvement of quality (Kurtaran, 2007, p. 380).

The issue of FDI can be approached in two ways from the point of view of host countries and foreign investors. Host countries try to achieve certain social and economic benefits through foreign investment, including increased employment, the use of natural resources, and improved management and knowledge. Examples include increasing production, reducing the foreign trade deficit, increasing economic growth, etc. can be specified (Karagöz, 2007, p. 930).

The most important aspect of the GDP is to increase employment. In FDI theories, it is predicted that there may be an increase in rationing as a result of foreign investment. The first of these theories is the "OLI" theory, also known as the "Eclectic Paradigm". According to the theory, it is assumed that FDI can actually provide more employment in the places they go and be more effective than the local firms of the countries they go to (Ekinçi, 2011, p. 72).

In our study, it was tried to give information about the flow of FDI on the world and Azerbaijan in particular.

2. FOREIGN DIRECT INVESTMENT (FDI) DEFINITION AND QUALIFICATIONS

A company that wants to enter a foreign market has three options. The first is to give the market the right to use its own brand, the second can be realized in the form of producing a commodity in its own country, selling it to a foreign country and finally making FDI to the market.

The globalization of capital also causes the flows within countries (FDI) to accelerate. Due to transportation costs in exporting, it is more effective and advantageous to enter the market of a country with the FDI method. These

investments benefit both the host countries and the country in which the investment is made (Özcan and Arı, 2010, p. 66).

In general, foreign capital investments can be defined as financial or technical resources that a country can obtain from external sources and add to its economic strength to pay later (Aydemir, Arslan, and Uncu, 2012, p. 70).

The International Monetary Fund (IMF) defines the FDI as an investment to secure a permanent share in a business operating in a different economy than the investor (IMF, 2021).

The 1999 World Investment Report defines the FDI as an investment that encompasses a long-term relationship and demonstrates the lasting interest and control of an asset built into an economy directly in a foreign investor or main venture-based organization (UNCTAD, 1999). The aim of the organization that invests directly in my foreign investor is high turnover and long-term relationship.

It can be stated in the definitions of the IMF and UNCTAD that direct investment reflects the goal of an organization based in an economy to obtain a permanent affliat in an organization established in a different economy and is seen as a long-term investment in which the investor who makes FDI has authority in a foreign market outside his/her country of residence (uzmanpara, 2021).

Foreign Direct Investments (FDI) played an important role in the international economy after the Second World War. Theoretical studies on FDI have provided a better understanding of the economic mechanism at both micro and macro levels. FDI is necessary to achieve the goals of development and economic growth in the world. Foreign investors cannot leave host countries suddenly and there is a long-term relationship between the host and the investor. In addition, foreign direct investment can often offer new technologies, new management techniques, job creation, new access channels to global markets, and other opportunities to lay them out to receiving countries. Therefore, host countries predominantly prefer FDI types (Kurtaran, 2007, p. 367).

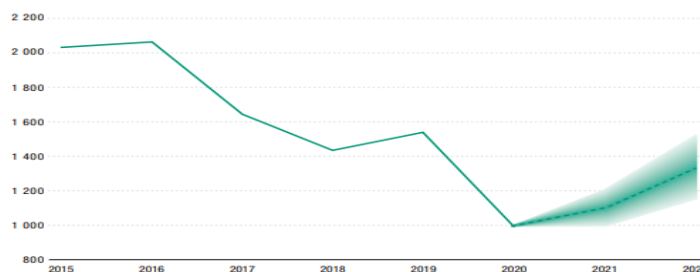
In table 1, the decisive factors of FDI are shown in terms of positive or negative factors. Accordingly, it is seen that tax rates in a country, for example, are among the positive factors that attract the FDI to that country, while on the contrary, low interest rates are among the negative factors that drive the FDI to other countries.

Table 1. Determinants of FDI

Attractive factors	Tax rate Privatization policies Bureaucracy and policy stability Exchange rate policies Macroeconomic stability Cheap raw material and labor costs Advances in transportation and communication technologies Low cost of raw materials and labor in developing countries
Repulsive factors	Low interest rates and reduced profitability in the markets of developed countries Regional trade agreements

Source: (Kara and Tatlısöz, 2008)

Graph 1 provides estimates of FDI and 2021-2022 worldwide. It is stated that the amount of FDI in 2020 is the lowest FDI amount recorded since 1990. Global FDI flows are expected to recover a part of the lost ground in 2021 with an increase of 10-15% after hitting rock bottom in 2020.

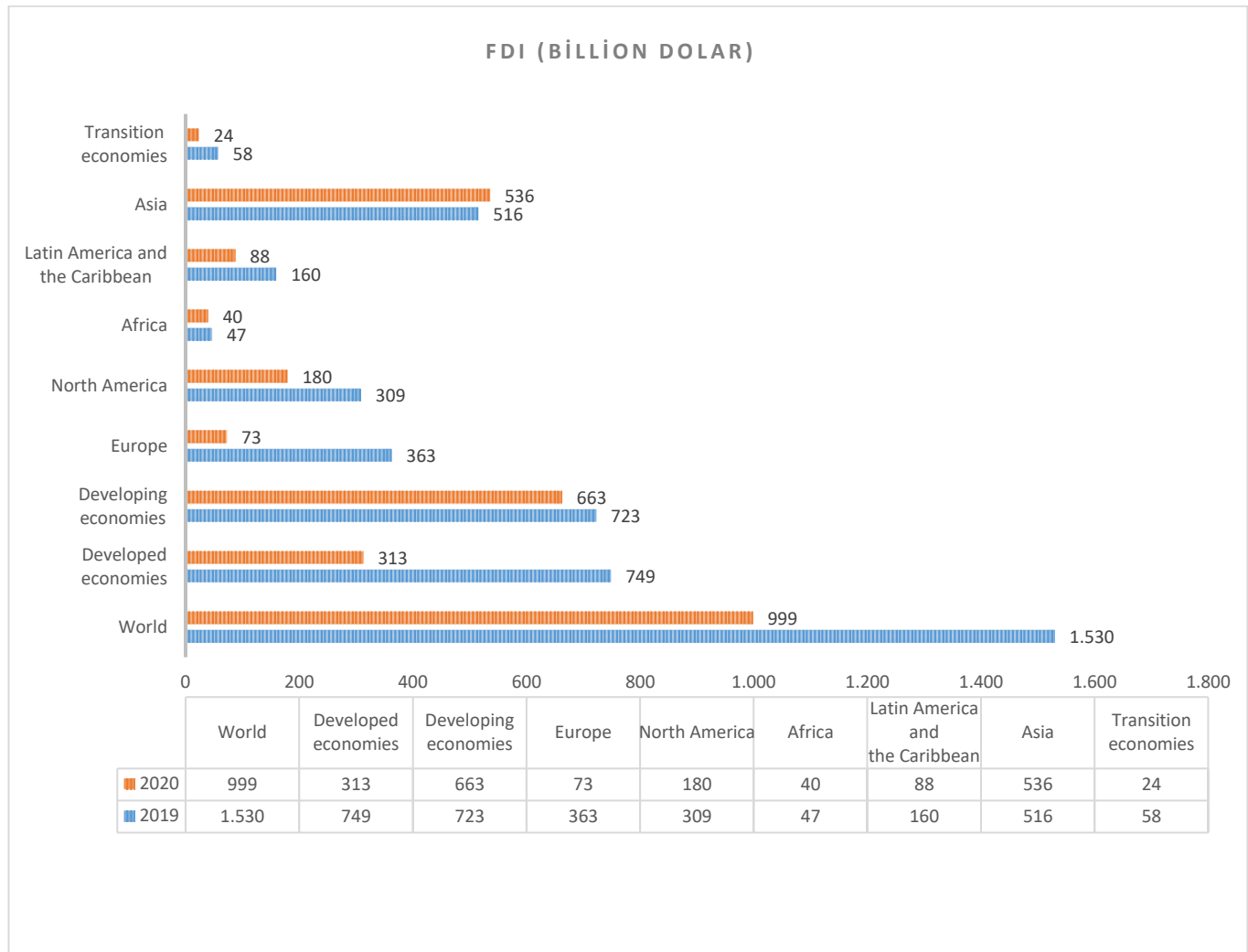


Graph 1: FDI Forecasts for 2021-2022

Source: (UNCTAD 2021)

According to the UNCTAD 2021 report, FDI flows fell by 35% globally in 2020, from \$1.5 trillion to \$1 trillion, the level in the previous year. Developed countries were less affected by this decline in 2020 than developing countries. Quarantines caused by the global COVID-19 pandemic have slowed existing investment projects, and expectations of recession have prompted multinationals to reassess new projects. Assuming continued growth, this means that the GDP will recover significantly by the end of 2022. In the optimistic scenario, the FDI is expected to return to about \$1.5 trillion by 2022, completely pre-pandemic. In the worst-case scenario, a prolonged decline in global

GDP is predicted. The FDI is expected to remain around \$1.2 trillion in 2021 and 2022. According to current estimates, by 2022, FDI could reach \$1.5 trillion or more from 2019 levels.

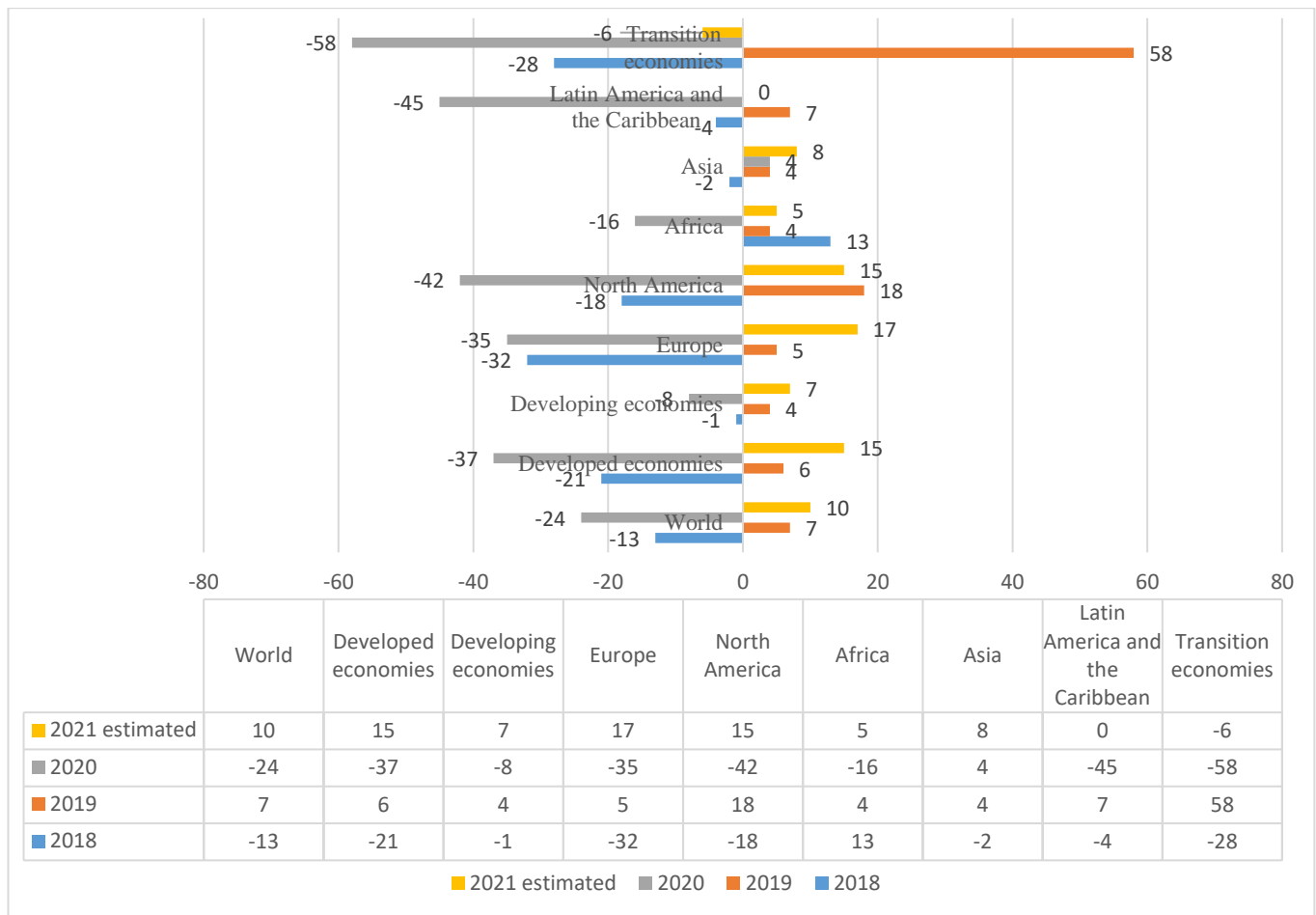


Graph 2: FDI by Regions
Source: (UNCTAD 2021)

In Graph 2, FDI flow decreased in the world in 2020 compared to the previous year, from \$1.530 billion to \$999 billion. In the same way, when advanced and developing economies are taken into consideration; it can be stated that the flow of foreign direct investment in developed economies decreased to \$313 billion in 2020 and decreased in developing economies from \$723 billion to \$663 billion.

When considering Europe and Asia region in 2020; the FDI flow of the European region decreased from \$363 billion to \$73 billion compared to the previous year. Compared to the decrease in FDI flow in the world, it can be stated that there is a recession in the Asian region. Accordingly, in 2020, the GDP in the Asian region increased from \$516 billion to \$536 billion.

As a result, it can be stated that all economies are affected by the global pandemic crisis in the world. The region most affected by the pandemic is the European region, as seen from graph 2, and it can be stated that the region least affected by the pandemic is the Asian region.



Graph 3: FDI Annual Growth
Source: (UNCTAD 2021)

Considering Graph 3; after the decrease of FDI at 13% in 2018, it can be stated that it has grown by 59% in 2019 and that the FDI has shrunk by -24% in 2020 due to the COVID-19 pandemic in late 2019 and early 2020. According to the 2021 forecasts, it is estimated that there will be a 10% increase in the level of FDI thanks to the effect of the acceleration in vaccination in the world and the elimination of the drastic measures taken against the pandemic.

In Asia, FDI growth is expected to continue in 2021 with an annual increase of 5% to 10%. Asia is important to show that the investment environment remains open despite the pandemic and the extensive regional and global links between FDI and growing markets, as it is the only region where FDI is resilient in 2020. Thanks to a global regional economic agreement signed in November 2020, the further growth of regional investment links can be supported. Export-based manufacturing economies in Southeast Asia stand to benefit from the resurgence of trade and rising curative demand. Rising oil prices are expected to boost foreign direct investment in West Asia. However, although the region has managed the health crisis relatively well, the recent second wave of COVID-19 in India shows that significant uncertainties persist, which have had a major impact on expectations for South Asia (UNCTAD, 2021).

FDI to Africa is expected to increase in 2021, but remain 15% below the 2019 level. Commodity prices have largely recovered from the 2020 slump, but expected growth in the region is uncertain. Most countries have fiscal and financial problems and vaccines are inadequate. In the medium term, the region's high potential and investment needs will accelerate foreign direct investment inflows, especially as the investment environment continues to improve. In this context, ongoing efforts under the African Continental Free Trade Agreement article of commerce, which includes measures to reduce barriers to intra-regional trade, are expected to support a significant flow of FDI (UNCTAD 2021).

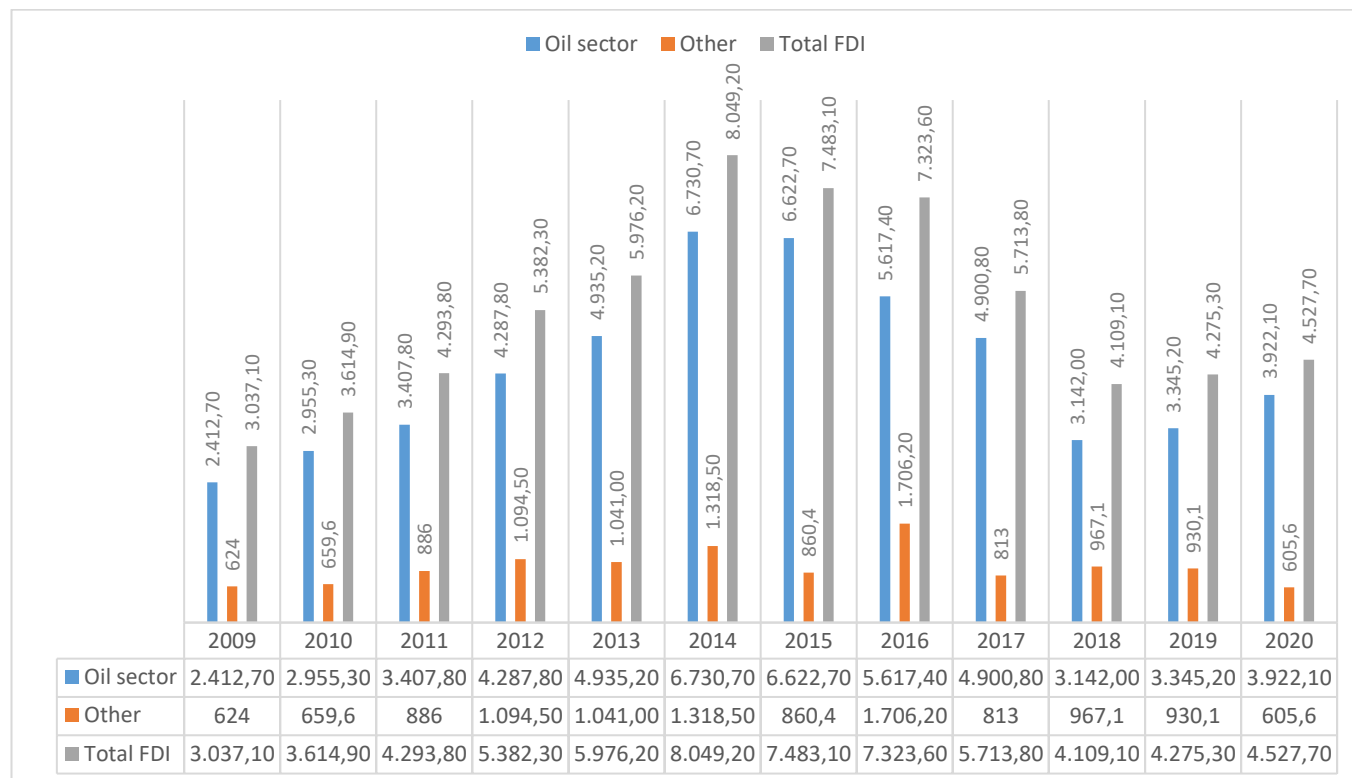
FDI flows in the Caribbean and Latin America regions are expected to stabilize towards recovery in 2021, after a 45% contraction in 2020 due to the COVID-19 pandemic.

Transition economies project a 6% reduction in FDI flow due to reductions in primary commodity and oil prices. FDI flows in the region have been weak for several years due to expected low growth in the region and economic

sanctions affecting Russia. It is estimated that there will be an increase trend in 2021 after a 58% contraction in 2020 due to the pandemic (UNCTAD 2021).

3. AZERBAIJAN IN FOREIGN DIRECT INVESTMENTS

It can be stated that the entry of FDI into the independent Azerbaijani economy began in 1995 (www.azadliq.org, 2020). In September 1994, the country's first international oil treaty, the Azeri-Apprentice-Sunny project, was realized after the ceasefire agreement (wikipedia.org), (Əsrin müqaviləsi, 1994).



Graph 4: FDI to Azerbaijan between 2009-2020 (Oil and Other Sectors)

Source: (www.ceicdata.com, 2021)

Considering the 2009 data in graph 4; it is seen that a large part of the foreign direct investment made in Azerbaijan is invested in the oil sector. In total, 3.037 billion of the USD 2.413 billion was invested in the oil sector and the remaining USD 624 million was invested in the non-oil sector. Azerbaijan, which is rapidly attracting FDI, achieved the highest figure in 2014. In 2014, a total of USD 8.049 billion was made to Azerbaijan, of which 6.731 billion was invested in the oil industry and the remaining 1.319 billion in non-oil sectors. From 2014 to 2020, there were decreases in FDI. In Azerbaijan, FDI was reported as USD 4.528 billion in 2020. This figure was USD 4.275 billion in 2019 and USD 4,109 billion in 2018.

In the 9-month report published by the Central Bank of Azerbaijan in 2021, it was stated that the FDI made to the country was USD 3.7 billion and the share of oil and gas in the investment was 84.2%. While it is stated that the amount of FDI made to the non-oil sector is 579.3 million, it is seen that the figure is 16.5% higher than the 9-month data for 2020 (www.cbar.az, 2021).

Table 2: Countries Investing Directly in Azerbaijan

	2019 FDI		2020 FDI		First 9 months of 2021	
Countries	\$1,000	%	\$1,000	%	\$1,000	%
Total	4.275.241	100,0	4.527.706	100,0	3.664.660	100,0
Great Britain	1.187.442	27,8	1.680.899	37,1	1.234.759	33,7
Turkey	570.993	13,4	577.993	12,8	530.051	14,5
USA	379.951	8,9	475.245	10,5	410.960	11,2
Japan	267.427	6,3	343.651	7,6	324.857	8,9
Malaysia	257.879	6,0	311.799	6,9	231.309	6,3
Cyprus	193.428	4,5	227.476	5,0	215.820	5,9
Islamic Republic of Iran	165.872	3,9	200.571	4,4	209.390	5,7
Norway	152.133	3,6	195.170	4,3	121.722	3,3
Russia	156.828	3,7	158.626	3,5	74.264	2,0
Netherlands	141.431	3,3	77.809	1,7	48.222	1,3

India	47.876	1,1	61.529	1,4	38.674	1,1
Austria	10.153	0,2	36.216	0,8	35.914	1,0
Switzerland	50.961	1,2	35.545	0,8	34.176	0,9
Georgia	34.621	0,8	29.109	0,6	32.368	0,9
UAE	63.362	1,5	26.852	0,6	17.179	0,5
Germany	140.451	3,3	17.919	0,4	17.054	0,5
Latvia	31.658	0,7	11.225	0,2	16.430	0,4
China	12.078	0,3	7.707	0,2	12.654	0,3
Ukraine	287	-	5.957	0,1	11.407	0,3
Spain	854	-	5.894	0,1	7.292	0,2
France	3.199	0,1	3.731	0,1	6.251	0,2
Korea	5.862	0,1	3.285	0,1	3.813	0,1
Singapore	1.208	-	3.028	0,1	3.147	0,1
Poland	607	-	2.948	0,1	2.792	0,1
Denmark	1.032	-	2.328	0,1	2.753	0,1
Belgium	5.633	0,1	1.878	0,1	2.535	0,1
Luxembourg	2.100	0,1	1.841	-	2.125	0,1
Israel	1.901	-	1.442	-	1.705	0,0
Other countries	388.012	9,1	20.034	0,4	15.039	0,4

Source: (www.cbar.az, 2021)

According to table 2, Great Britain and Turkey are always of great importance in the FDI invested in Azerbaijan. From these two countries, additional Azerbaijan is given FDI every year from the USA, UAE, Germany, France and Russia to non-oil sectors. When the data in table 2 is evaluated; it is seen that the country that made the most FDI in 2019 was Great Britain with 1.187.442,000 dollars and the share of the investment made in the total invested FDI in 2019 was 27.8%. It can be stated that the share of investment received from Turkey in 2019 is 13.4%.

If the economic problems caused by the COVID-19 pandemic are ignored in 2020; it is understood that the FDI invested in Azerbaijan was \$4.527.706,000 up from \$4.275.241,000 last year. In 2020, it is seen that the largest foreign direct investor is Great Britain, and it can be stated that Great Britain's share in the FDI invested in Azerbaijan in 2020 has increased to 37.1%. On the other hand, it can be stated that Turkey's share in the FDI invested in Azerbaijan in 2020 has diminished to 12,8% but has increased to 14,5% in 2021. In short, these two countries cover half of the FDI made to Azerbaijan in 2020 and 2021. When the 9-month data for 2021 are taken into consideration; it can be stated that the amount of FDI invested in Azerbaijan was 3.664.660,000 dollars and it was realized through Turkey and Great Britain, which made 48% of the investments.

4. CONCLUSION

Foreign direct investors who try to reduce the risks and uncertainties of doing business internationally as much as possible start their foreign activities with exports, follow license agreements and complete this process by starting production directly abroad and successfully completing this process. FDI, which has become one of the important cross-border activities with globalization, supports the efficient use of the world's limited resources. In this way, FDI can both increase the competitiveness of the countries that export capital and promote economic development, production, export capacities, employment and technology, as well as the dissemination of quality.

As described in graph 1; FDI flow, which has been declining since 2016, has decreased further with the outbreak of the COVID-19 pandemic. From here, it can be stated that the decrease in FDI flow in 2020 was the highest since 1990. In 2020, FDI flow decreased by 35% compared to the previous year to \$1 trillion. A positive trend is estimated in terms of increasing investments. Likewise, it is estimated that the FDI will reach \$1.5 trillion in 2022, that is, the positive trend will continue and will reach the level before the pandemic.

In addition, when the FDI made to Azerbaijan described in graph 4 are evaluated; it is seen that the most invested business sector in Azerbaijan is the oil sectors. Investments in non-oil sectors amount to a fraction of the total FDI. When graph 4 is considered; it is understood that the amount of FDI increased in 2009 to \$8 billion in 2014, the highest level, and that investments in the oil sectors constituted a significant part of the total amount of FDI made. In 2020, the amount of FDI performed in Azerbaijan, which was a volatile period since 2014 and the COVID-19 pandemic period, increased compared to the previous year. However, while this increase is seen as rises in investments in the oil sector, it can be stated that there has been a significant decrease in the amount of FDI invested in non-oil sectors.

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