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THE ROLE OF PRIVATIZATION IN ATTRACTING FOREIGN INVESTMENT

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Abstract

This paper explores the relation between FDI and the privatization of state-owned companies. We believe that privatization impacts FDI, as the mechanism of promoting involvement of the private sector always goes hand in hand with steps of liberalization and by allocating the stock of newly privatised firms to foreign investors. They do anticipate FDI to promote restructuring attempts, as capital inflows, technologies and management skills that follow FDI make the environment more productive and offer governments a good climate for the privatization of dysfunctional firms. Our findings help our conclusions.

Keywords: Privatization, Investment, FDI, Capital inflow

INTRODUCTION

The attractiveness and successful use of innovations in our country is of social and economic significance in the circumstances of the transformation and diversification of the market economy. Investments affect the rate and volume of reproduction in the economy, and provide the majority of the population with scientific and technical development and employment. One of the major reasons for this is the large-scale reliance on investment activities on radical structural changes in our economy, rational and optimal allocation and development of work resources.

Numerous nations around the world participated more than 20 years ago in economic reform efforts aimed at creating an autonomous private sector, like privatization. This aims to reduce economic policy influence and transfer resources and assets from government to private investors. The inefficiencies in government-owned companies, which were key drivers of privatization, was attributable, according to Shleifer (1998), largely to the political goals attained by government officials and bureaucracies who regulate these firms.

Privatization spread globally as the markets developed into globalization and integration. In fact, increasing international competition, global stock market liberalisation and reduction of trade barriers around the world has continued to accelerate the need to expand and encourage operations in the private sector, leading to an ongoing move towards private-sector expansion.

The pace of the privatization process was manageable as well as global in developing and advanced countries, but it shows no sign that it has decelerated, although more than two decades have passed since then (World Bank 2006). (International Bank, 2007). Foreign investors, particularly multinationals, gained great attention as countries followed private-own economic policies in the field of foreign direct investment (FDI). This is particularly true in developing countries. For starters, World Bank (2003) reports that FDI has become the most important and stable source of capital flows for developed countries in particular. Several studies show that privatization has played a significant role in the growth of global FDIs. Baer (1994), for example, suggests that privatization has an effect on international investment in several Latin American countries, as he reports that, as government involvement in the economy has dwindled, the position of foreign capital has increased. Some literature argues that in the last 20 years privatization has contributed to an increased migration of FDIs, sometimes coupled with other reform measures to improve competitiveness, lift trade barriers and create a better more productive administrative climate. FDI has undergone significant reforms globally, including restructuring. Recent studies from the World Bank indicate the growing trend in FDIs across several regions worldwide. The World Bank (2002) reports in particular that FDI responded positively to the policy implementation of the privatization projects, stating that seven of FDI's ten biggest beneficiaries earned more than $1 billion in privatization transactions for foreign investment in 1999. A massive increase in FDI flows seems to support the level of the privatization initiative, which continued to increase during the 2000s. FDI has many advantages, including financing, new technologies, the development of human capital, new management capacities and enhanced corporate governance. Nevertheless, it is not surprising that multiple bond sales transactions included the direct sale of a band to foreign investors.

The purpose of this paper is to examine whether FDI has been affected by privatization and whether FDI accelerates the successful privatization cycle. This paper is aimed at investigating the relationship between these phenomena. We are especially interested in answering the following questions: how does FDI impact privatization? What are these two interactions? The use of international data from developed and developing economies provides new information and creates several new prospects and political consequences.

It is important to look empirically at the role of privatization in the FDI evaluation and the contribution of the FDI to privatization for several reasons. Secondly, FDI flows are a catalyst for future economic and institutional development. Consequently, it is important to consider the position of specific economic reforms as a determinant of the FDI for political purposes.

Furthermore, the connection between a (sometimes contrary) redistributive policy such as privatisation and a pattern equally divisive ought to be investigated for theoretical purposes. Several countries have had civic unrest when engaged in restructuring, further aggravated by announcing the future buyers are abroad. In previous studies the connection between foreign engagement and business success post-privatization has been investigated (Boubakri, Cosset, Guedhami 2005). At macro-economic level, though, the question remains how similarly definite FDI and privatization are. Why should privatization and FDI go beyond the above-mentioned anecdotal evidence? Various potential outlets may be available. First, privatization usually enhances the investment environment, making investment attractive for domestic and foreign investors and contributing to the growth and growth process. For starters, a recent survey carried out by Boubakri, Cosset and Smaoui (2007) found that privatization would boost a country's overall effectiveness, i.e. the rule of law and law enforcement systems. Finally, privatization should strengthen the globalization phenomenon, as privatization has a positive impact on the developments in financial markets and drains FDI through stock issues. With regard to private risks. At the same time, we say a higher chance of privatizing economies that are politically more open. Until now, the implementation mechanisms for FDI and privatization remained unexplored. Privatization, defined as government transition to the private sector of state-owned companies, and FDI are therefore two simultaneous privatization mechanisms that have been implemented in two literature ranges to date. In 1984-2005, we applied an overall GMM method to a diverse panel with a combination of 22 industrialized and 31 developing countries, trying to confirm our theory. In fact, as we notice in the literature on the decision to privatize FDI flows have a positive impact on the process of privatization and the program of privatisation. Nevertheless, we remember that privatization (but not abolition) affects the degree of the FDI in an area.

Our results show that privatization would contribute to the FDI's domestic economic growth. Likewise, privatization gives a positive signal that foreign investors are less politically risky and likely to draw more FDI.

RESEARCH METHODOLOGY

Variables

The data base of the International Monetary Fund (IMF) calculates FDI as a percentage of GDP. Privatisation is determined by (1) regional nominal GDP (PRIVPROC) privatisation. This measures the country's privatization rate and reflects the commitment of the policy to market change and transformation (Perotti and van Oijen, 2001). That mix shows the ability to privatize the programs and the economic impact of privatization in a world (Bortolotti, Fantini and Siniscalco, 2003). They use the share issue privatizations (SIPs) to catch the investment process and policy capacity to make use of the stock market as a funding source for the entire number of privatizations in the world (PRIVMETH). The turnaround moves of SDC Thomson Financial. Structural and macroeconomic indicators are included in FDI criteria. Secondly, the International Country Risk Guide (ICRG) provides law and order. There are some indicators in the World Development Indicators (WDI) index such as GDP per capita and exchange transparency, whereas the level of liberalization comes from IFC. The IFS metrics include expenditure accounts, although total debt estimates are drawn from WDIs, while the World Bank's index of political institutions offers international advice, whereas La Port Lopez-de-Silanes Shleifer and Vishny (1998) are legal guides.

Hypothesis H1A FDI has a positive effect on turnaround income, with everything else close.

H1B The FDI has a positive effect on the percentage of the privatization issue group, both equal, of the total amount of privatization transactions.

H2A Privatization developments have a positive impact on FDI, with all other comparisons.

H2B A similar, positive effect for FDI is the share problem privatization percentage of the total number of privatization transactions.

Study focuses on a dynamic panel architecture GMM systems to examine the (potentially) increasing connection between anomalies, privatization and globalization. The use of information both in the cross-cutting (cross-country) and in timescales makes it possible to more effectively estimate parameters because panel data create more variability by integrating differences in time with changes in countries, minimizing problems of multi-coallinearity (Baltagi 2001). This method often allows for analysis of mutual endogeneity issues for independent variables (reverse causality and simultaneousness) and terrestrial heterogeneity (i.e. country specific results that were not considered) (Arellano and Bond 1991; Arellano and Bover 1995).

We are working in particular to locate empirical evidence to support the two-way link between foreign direct investment and privatization flows, and vice versa. Therefore, we use an analytical approach that reflects simultaneity prejudice in a series of data complex panels arising from possible reverse causalities between the two phenomena. We use the two-stage

GMM method Blunderell and Bond (1998) dynamic panel data calculation in order to solve this problem, with efficiency gains by using the whole information contained in the data set, which allows the use not only of specific regressions but also of rate regressions. For each regression type, a set of instrumental variables are created to deal with endogeneity problems that are lagging values of endogenous and exogenous variables in various regressions and lagging variations in rate regression.

In the broad sense, the Generalized Moment method, initially introduced in 1982 by Hansen and then extended in Arellano and Bonds (1991), Arellano and Bover (1995) and Blundell and Bond (1998) in order to handle the dynamic data panel sets, is an evaluation process which, through information from the data generation step, is not necessary to produce valid conclusions. The GMM methodology is commonly used in a number of fields (finance, macro-economics, etc.) with less distributional expectations on processes for data generation.

The effective two-stage GMM estimator is also prone to the finite-sample fixed defect throughout the process after Windmeijer (2005). The two-step GMM model errors are considered substantially downward, leading without this adjustment to mechanically small p-values.

The coherence of the GMM estimator, though, relies on the interpretation of the relevant system and the sequential similarity between the error conditions. In order to test both hypotheses, we perform two concept tests, each suggested by Hansen (1982) and Bond (1991). The first test, defined as the J test, is an overidentifying test, which tests whether the integrity of the instruments meets the orthogonal requirements. If so, the numbers for J should be almost zero to help the argument that the procedures are valid. In other terms, our projections are sufficient to avoid the null hypothesis of over-identification constraints. The second checks the nil theory that the µi error variable does not serially correspond. The examination investigates whether the word "unfortunately," "t" has a second order serial autocorrelation. The inability to dismiss the null hypothesis underpins our plan.

To assess the influence on foreign direct investments of privatization and reciprocally, the consequences found in the literature must be tracked. Consequently, the architecture of our data analysis panel incorporates the effect of other factors as follows.

For the sources of foreign direct investment (FDI), we consider:

$$FDI_{it} = \rho FDI_{it-1} + ß_1 PRIV + ß_2 LIBER_{it-1} + ß_3 TRADE_{it-1} + ß_4 GDPC_{it-1} + ß_5 LAW\_AND\_ORDER_{it-1} + \mu_i + \varepsilon_{it}$$

and for the privatization equation:

$PRIV_{it} = \rho PRIV_{it\text{-}1} + ß_1 FDI_{it} + ß_2 DEBT_{it\text{-}1} + ß_3 BUDGETBAL_{it\text{-}1} + ß_4 LEGAL_{it\text{-}1} + ß_5 POLITO_{it\text{-}1} + \mu_i + \varepsilon_{it}$

with i denoting the country (i=1, … ,N) and

t the time index (t=1, …, T) for yearly observations;

μ_i will account for the unobserved country-specific effect.

Sample Description

The study covers 31 emerging and 22 developed countries with annual reports from 1984 to 2005. Table 1 displays the list and description of the variables and their sources of data.

Table 1. Definitions, Proxies and Data sources

Variable	Proxy	Label	Expected sign	Source
Foreign direct investment	Ratio of inflows and outflows to the GDP (in log)	FDI		IMF data base
Privatization proceeds Method of Privatization	Log of the annual privatization proceeds to GDP Log of the number of privatizations by share issues to the total number of privatizations	PRIVPROC PRIVMETH	+ +	SDC Platinium, Thomson Financial International Financial Statistics
Trade openness Level of wealth Financial liberalization Law and Order	Log of the sum of imports and exports of good and services Log of the GDP per Capita based on purchasing power parity, in current international US$ Index measuring the degree of openness as the number of investment restrictions imposed on entry in the local stock market. Index=0 for a closed market and index=1 for fully open market. (Bekaert *et al.* 2005) Assessment of the strength and impartiality of the legal system and of popular observance	TRADE GDPC LIBER Law and Order	+ + + +	World Development Indicator (WDI) International Finance Corporation International Country Risk Guide (ICRG)
Total debt Budget Balance	Log of the total debt(domestic and foreign) as a share of GDP Cash surplus/deficit as a share of GDP	DEBT BUDGETBAL	+ -	World Development Indicators (WDI) International Financial Statistics (IFS)
Legal Origin Political Orientation	Dummy that is equal to one if the legal origin is common law, and zero otherwise Dummy that is equal to one for a right-wing government	LEGAL POLITO	+ +	La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) Database on Political Institutions (WORLD BANK)

We can see that foreign direct investment flows were more important at the end of the 1990s, in the early 2000s (between 1997 and 2002). It hit a remarkable high at the end of the century in the mid-1990s. The FDI has become the most lucrative developed country with the hardest nucleus followed by countries in northern Europe such as Belgium, Denmark, Sweden, Ireland, Switzerland, the Netherlands, Britain and France and also Singapore in East Asia. Developing countries, including the remarkable cases of Peru, Trinidad & Tobago and Jamaica, have also gained from FDI. About privatization sales, they began to rise steadily until they spiked rapidly at the very start of the Asian crisis in 1997 and 1998. After a small decline in 2003, the income from privatization remains strong. The Philippines, Trinidad & Tobago, Argentina, Jamaica and Denmark and Finland also gained more from privatizing their sales among the developing countries. As a result, globalization has contributed significantly to reducing income for developing countries. The past of this measure of picks between 1994, 1996 and 2004 is quite unclear about the sale of stock issues. Developing countries like Algeria, Pakistan, Malaysia, South Korea, Senegal, Ecuador and Jordan used stock markets in the mid-1990s to transfer control. In the same years, Ireland and Japan have profit from the stock market to privatize. The main players in this area were Thailand, Indonesia, Brazil, Peru and Jamaica in 2004.

Table 2. Descriptive statistics (panel A)

Variable	Obs	Mean	Std. Dev.	Min	Max
FDI	1042	1.202556	.8035513	-1.854664	5.210179
PRIVPROC	1076	.2132306	.3688746	0	2.202567
PRIVMETH	700	.1402257	.1954829	0	.6931472
TRADE	1140	4.028233	.5385985	2.591217	6.124876
LIBER	900	.685	.4252494	0	1
LAW AND ORDER	1160	4.042349	1.652064	0	6
GDPC	1165	8.353014	1.578863	5.019722	11.06702
DEBT	880	2.033206	1.917634	0	5.252699
BUDGETBAL	779	-5.285532	27.47681	-336.3994	48.00256
LEGAL	880	.4545455	.4982128	0	1
POLITO	819	.3199023	.4667235	0	1

Table 3 Descriptive statistics by years (panel B)

Year	Statistic	FDI	PRIVPROC	PRIVMETH	Year	Statistic	FDI	PRIVPROC	PRIVMETH
1984	MEAN	.6122	.00029	0	2000	MEAN	1.9882	.3437	.1428
1985	STD	.5170	.00205	.	2001	STD	1.0599	.4726	.1927
1986	MEAN	.6543	.00009	.2027	2002	MEAN	1.6080	.2446	.0903
1987	STD	.5560	.00045	.2867	2003	STD	.9322	.4558	.1690
1988	MEAN	.7216	.0228	.0308	2004	MEAN	1.4415	.2455	.1371
1989	STD	.5887	.1326	.0689	2005	STD	.7523	.3643	.1877
1990	MEAN	.8174	.0202	.07985		MEAN	1.4173	.2008	.1342
1991	STD	.6075	.0582	.1316		STD	.7104	.3446	.1797
1992	MEAN	.8695	.0500	.0929		MEAN	1.3116	.2047	.1597
1993	STD	.6649	.1243	.2307		STD	.7991	.2904	.2107
1994	MEAN	1.0445	.1220	.1016		MEAN	1.6497	.2058	.0688
1995	STD	.6840	.3467	.2112		STD	.7546	.3573	.1256
1996	MEAN	1.0003	.1699	.0822					
1997	STD	.6560	.3965	.1668					
1998	MEAN	.9352	.1680	.1166					
1999	STD	.6295	.3569	.2066					
	MEAN	.8913	.2080	.1594					
	STD	.6737	.3044	.2075					
	MEAN	1.1434	.2905	.2376					
	STD	.5903	.3477	.1919					
	MEAN	1.2737	.3664	.16234					
	STD	.6784	.4856	.16239					
	MEAN	1.2159	.3068	.1835					
	STD	.6334	.3114	.2179					
	MEAN	1.2592	.3305	.1604					
	STD	.6617	.3417	.2262					
	MEAN	1.4455	.4738	.1059					
	STD	.6525	.5287	.1806					
	MEAN	1.6345	.4329	.1155					
	STD	.7954	.4387	.1731					
	MEAN	1.8066	.3106	.1619					
	STD	1.0131	.3774	.2221					

EMPIRICAL RESULTS

Impact of FDI on Privatization

Table 4 shows the effects of the analysis of the privatization GDP logarithm (PRIVPROC) on the FDI (FDI) logarithm. First of all, the lagged dependent variable's coefficient is important at all standard rates (p value=0,000). Thus, a complex definition for the equation of privatization helps us to understand how this process develops over time. Furthermore, we notice that at 5 percent (p value=0.015) the FDI coefficient is important. Our findings also confirm our initial assumption (H1A) that foreign direct investment flows have a positive impact on privatization revenues. In fact, a 1 percent increase in foreign direct investment means a 66 percent increase in privatization revenues. In terms of the debt considerations, the budget imbalances provide strong incentives to implement privatisation to fill the state's empty currency, as described in Bortolotti, Fantini and Siniscalco (2003). The coefficient is negative and very important (with a p value= 0,000). The total debt effect is less pronounced (with p-value= 0.073) than the fiscal deficit that in this context seems to be the main determinant. As to the dummy variables, the results show not that common law countries that better protect investor rights and the privatizing government's (right-wing / left-wing) political orientation affect privatization revenues because both variables are of little significance at a traditional level.

Table 4 Impact of FDI on Privatization

Variable	Expected sign	Coefficient	Robust Standard Error	T	p-value
PRIVPROC-L	+	.3090969	.0633383	4.88	0.000
FDI	+	.0893926	.0352359	2.54	0.015
DEBT	+	.0165211	.0089702	1.84	0.073
BUDGETBAL	-	-.0011787	.0003061	-3.85	0.000
LEGAL	+	-.043784	.037602	-1.16	0.252
POLITO		.0356458	.0317841	1.12	0.269
A-B test for AR(1)				-3.15	0.002
A-B test for AR(2)				1.94	0.053
Hansen J test					1.000
Number of observations = 510					
PRIVMETH-L	+	.1521399	.1023873	1.49	0.146
FDI	+	.0298082	.0164611	1.81	0.078
DEBT	+	.0070089	.0055219	1.27	0.212
BUDGETBAL	-	-.0004641	.000283	-1.64	0.110
LEGAL	+	.0500508	.0237547	2.11	0.042
POLITO	+	.0270264	.0220987	1.22	0.229
A-B test for AR(1)				-3.07	0.002
A-B test for AR(2)				0.69	0.492
Hansen J test					1.000
Number. of observations =363					

The results of the regressions calculated in the dynamic panel using the GMM framework procedure in Blundell and Bond (1998) for the period 1984 to 2005 are reported in this table, for the entire sample. The privatization model is as follows (PRIVPROC / PRIVMETH):

$$PRIV_{it} = \rho PRIV_{it-1} + ß_1 FDI_{it} + ß_2 DEBT_{it-1} + ß_3 BUDGETBAL_{it-1} + ß_4 LEGAL_{it-1} + ß_5 POLITO_{it-1} + \mu_i + \varepsilon_{it}$$

As regards privatization, we find that privatization reforms attract foreign investors into the stock market because the positive impact of FDI on the amount of share problem privatizations at 10 percent level is important (with a p value= 0,078). Such results help our theory (H1B). In reality, a rise of 1% of the FDI constitutes an 87% improvement in the privatization of share issues. As for the lagging predictor, its predictive power is not surprisingly small (with a p-value= 0.146).

Nevertheless, it is impossible for the sector to show any sign of remembrance with privatizations occurring very seldom over such a short period of time. Debt and deficit-related factors are not important even if the importance of fiscal imbalances is approximately 10 percent. In comparison, the legal origin predictor at the 5% level (p-value 0.042) supports the hypothesis that the legal origin is an important determinant of the privatization of the share issue. The legal and literature on finance has shown here that French civil law countries tend to be correlated with inadequate security by minority shareholders. Legal protection occurs as securities are given to pass rights of ownership.

Then we verify if the model is correctly defined by checking Hansen (1982) for the validity of the instruments and the autocorrelation evaluation of the residuals of Arellano and Bond (1991). Table 4 demonstrates that the Hansen J method can not refute the nil hypothesis of the appropriateness of our methods. In the first differences, the Arellano and Bond autocorrelationship test should find a faux autocorrelation of order 1 and no sign of autocorrelation of order 2. The Arellano and Bond test can not reject the null hypothesis that there is no autocorrelation of the residue in second order (at the 5% meaning level). With this in mind, the output of Table 4 does not show that the model is misidentified at the conventional levels of 1% and 5%.

Impact of Privatization on FDI

Table 5 shows the findings of the FDI logarithm analysis (FDI) for the GDP privatization logarithm (PRIVPROC). We notice that at the traditional level of 5 percent the PRIVPROC coefficient is important (p value= 0.019). Our findings also confirm our (H2A) hypothesis that contemporary privatization proceeds have a favorable and significant effect on foreign direct investment flows. In fact, a 1% rise in privatization income contributes to a 40% improvement in direct foreign investment. We notice also that the existence of recent foreign investment encourages new FDI by means of a positive coefficient of significant deficit (p= 0.000) promoting the option of the FDI equation dynamic specification. In order to dissociate FDI from side benefits from the effects of the sole privatization, we incorporate some control variables into the specification. The results demonstrate the relevance of exchange transparency (p value= 0.005) and wealth levels (p value= 0.018) for foreign investors, all of which lead to an improved economic environment and profitable market growth opportunities. Nonetheless, on traditional measures both the rule and the order variable coefficients and the financial liberalization index are not relevant.

Table 5 Impact of Privatization on FDI

Variable	Expected sign	Coefficient	Robust Standard Error	T	p-value
FDI-L	+	.6451673	.0662044	9.75	0.000
PRIVPROC	+	.1989593	.0818513	2.43	0.019
LIBER	+	.0203502	.0695516	0.29	0.771
TRADE	+	.1467477	.0497719	2.95	0.005
GDPC	+	.0466939	.0190848	2.45	0.018
LAW AND ORDER	+	.0027789	.015994	0.17	0.863
A-B test for AR(1)				-3.56	0.000
A-B test for AR(2)				0.52	0.600
Hansen J test					1.000
Number of observations = 781					
FDI-L	+	.6161758	.0544696	11.31	0.000
PRIVMETH	+	.0858217	.1570865	0.55	0.588
LIBER	+	-.018648	.067852	-0.27	0.785
TRADE	+	.1835041	.0552776	3.32	0.002
GDPC	+	.0652761	.0304999	2.14	0.038
LAW AND ORDER	+	-.00012	.0182926	-0.01	0.995
A-B test for AR(1)				-3.06	0.002
A-B test for AR(2)				0.23	0.816
Hansen J test					1.000
Number of observations = 572					

This table shows, for the entire sample, the regression results for the period 1984-2005 in a dynamic panel estimated by a GMM system as in Blundell and Bond (1998). This is the FDI model:

$FDI_{it} = \rho FDI_{it-1} + ß_1 PRIV + ß_2 LIBER_{it-1} + ß_3 TRADE_{it-1} + ß_4 GDPC_{it-1} + ß_5 LAW\_AND\_ORDER_{it-1} + \mu_i + \varepsilon_{it}$

We carry out further tests to verify the validity of the pattern. The findings shown in Table 5 do not indicate that the pattern is misspelled. As for the Hansen J study, the recorded p value is almost 1 randomly and does not question the exogenous existence of the instruments. We also can not dismiss the null hypothesis (at the 5 percent significance level) that the residuals do not have a second order association that fits our model requirements.

In relation to PRIVMETH's system of privatization, the results appear to not accept the (H2B) theory that stock market privatization will raise FDI. A glance at the World Bank's privatization transaction data base indicates that foreign investment is often correlated with private sales to foreign investors by former state-owned enterprises. Nonetheless, we should be vigilant to make any definitive remarks in as far as a ton of missed PRIVMETH values can be related to this lack of proof in favour of the (H2B) hypothesis.

CONCLUSION

This paper explores the connection between FDI and the privatization of state-owned companies in a multi-country sample that involves both developed and developing countries. They believe that FDI is affected by privatization, because the mechanism of promoting private sector involvement often included the transfer of substantial stakes to foreign investors in newly privatized businesses. We anticipate FDI to encourage restructuring activities as the new capital inflows, innovations and management skills that follow FDI render the market more productive and provide a good environment for policymakers to privatize distressed businesses that need to be turned around. There is some empirical evidence that there is a two-way connection between FDI and privatization and vice versa. The correlation between privatization and the revenue from these transactions and GDP is high. The relation between FDI and the amount of share privatizations seems to be harder to find, mostly because of the limited data collection. In view of these findings, however, we are advancing that there is a two-way relationship between these two main phenomena over the last 20 years. In this way, through an enhanced business environment, privatization tends to attract investors, both domestic and foreign, and leads to the cycle of growth and development. One policy consequence of our analysis is that restructuring policies in an investment-friendly environment are allowing foreign investors to put in the flow of capital, technologies and managerial skills needed to convert bloated companies. Another strategic interpretation of the analysis is that the sale of stock issues is more likely to succeed in places where the legal system protects shareholder interests, a popular rule of law rather than a structure of civil law. FDI flows have followed and reacted positively to policy reform policies from the FDI viewpoint. There seems to be a massive increase in FDI flows in the 2000s which has increased the pace of the privatization initiatives. It is therefore no wonder that various privatization transactions on the stock market involved the sale of a tranche aimed directly at foreign investors. So the worldwide launch of privatization programs and FDI flows appear to reinforce both phenomena.

To our knowledge, our first empirical multinational study is on the two-way relationship between privatization and FDI flows. The evidence we have for such a partnership, especially for the privatization proceeds, is new but it should be seen as tentative for various reasons. First of all, we show that there is a two-directional relation between privatization and foreign direct investment flows, but we do not test these two phenomena directly. The key purpose of this study was to explain the presence of such a relation in a relative simplicity of methodology. A thorough examination of such a relationship requires a more elaborate statistical framework that has been specifically designed for causal testing (e.g., Granger and instant causal tests requiring a panel vector autoregressive model). These empirical tests extend beyond the scope of this paper and remain for future research. Second, by exploring the connection between privatization and foreign portfolio flows, we might supplement our analysis of the bidirectional relationship between the privatizations and FDI. Nonetheless, the sale of shareholdings available for foreign investors is expected to depress global capital flows too. Similarly, countries with more developed local capital markets that attract foreign investment flows are expected to privatize further. A thorough examination also needs to be performed on the bi-directional link between privatization and foreign portfolio flows.

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