

THE INSURANCE IN THE FORMATION OF AN INVESTMENT ENVIRONMENT

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ABSTRACT

The article discusses the role of insurance in the formation of an investment environment. It is known that no country in the world has been able to secure economic growth without developing investment activity, this is also the case in the Republic of Armenia. The share of foreign direct investment in GDP in different countries varies from 100 to 11-13 %. In Armenia the highest level was in 2011-66,3 %, in 2016 it complied 5,4 % (GDP-10572,3 million US dollars, foreign direct investments – 567,99 million US dollars). The aim of the study is to justify the importance of insurance of investment risks for attracting foreign investments in Armenia.

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Investments play an important role in the development of the economy of any country, strengthening the country's defense, solving social problems. In essence, they determine the future of the whole country as well as individual economic entities. Implementation of investment programs allows to improve production, increase the quality of sales, increase the number of jobs, increase the employment level of the population, and, ultimately, contribute to raising the living standards of the population. That's why one of the most important issues in the current stage of Armenia's economic development is the activation of the investment process in the country, the solution of which is an important precondition for the stability of the economy and the subsequent economic growth.

No country in the world has been able to secure economic growth without developing investment activity. That is why a large-scale investment policy is being implemented in a variety of economic activities in modern conditions [5].

Foreign investment is realized through the organization of new production, acquisition of existing enterprises, creation of joint ventures, lending through financial institutions, purchase and sale of securities and other forms. Acting as long-term investment, they have a significant impact on the country's economic growth, its sustainable development and economic security. Foreign investment stimulates economic growth, just as with direct impacts (with the introduction of newest techniques and technology, transfer of management experience, increasing the volume of economic resources in the economy) and positive external effects [7]. Therefore, in the development of foreign economic policy in the Government of the Republic of Armenia should take into account the impact of foreign investment on employment, to improve the investment environment in every way, to increase the flow of investments, the flow of technology, encourage the competition between domestic and foreign companies.

It should be noted that direct investments are crucial in foreign investment. They make up more than a quarter of total investment. Their role in the financing of production is growing in both developing and developed countries. The share of foreign direct investment in GDP in different countries varies from 100 to 11-13 %. In Armenia (see table 1) in 2016 it complied 5,4 % (GDP-10572,3 million US dollars, foreign direct investments – 567,99 million US dollars) [2]: In this regard, direct foreign investment can have a significant impact on the social and economic development of the country, which forces the country's government to take account of its policies. At the same time, as some scientists say, foreign direct investments in developing countries are more stable during the financial crises [6].

Table 1. Foreign Direct Investments (FDI) and GDP Indicators for 2007-2016 in Armenia [3]
million US dollars

Years	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
FDI	2089,66	3470,01	4076,95	5676,41	6718,58	352,69	292,7	310,77	495,85	567,99
GDP	9206,3	11662,0	8648,0	9260,3	10138,1	10619,4	11121,3	11609,5	10553,2	10572,3
FDI's share in GDP, %	22,7	29,8	47,1	61,3	66,3	3,3	2,6	2,7	4,7	5,4

As it is seen from the table, foreign direct investment from 2007 to 2011 had a tendency to grow every year, and in 2012 there was a sharp decline, and the share of FDI in GDP decreased by 63 %. A trend of growth is observed in 2014-2016.

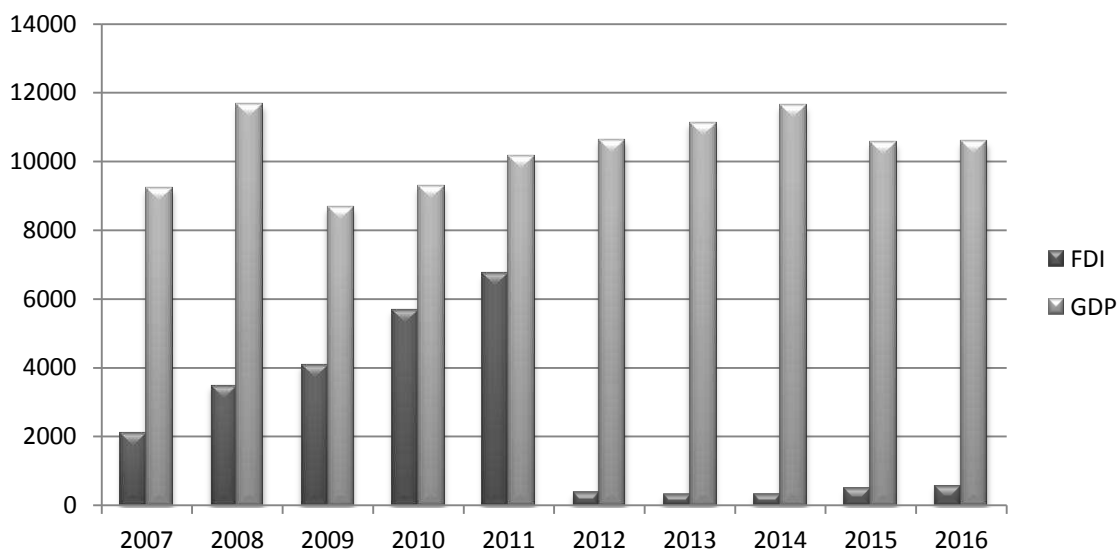


Fig. 1. Dynamics of Foreign Direct Investment and GDP in Armenia [3]

The interaction between foreign direct and domestic direct investment often involves the form of replenishment and replacement, which in economic models reflects their influence on economic growth. Evaluation of the impact on exclusion and filling of these two investments is important especially for investments in innovations. The impact of filling domestic investment with foreign investments means that if foreign direct investment brings innovations, the return on old technology can grow. In such a case, foreign direct capital investment increases the amount of capital available for industry development, and just as some scientists say, foreign direct investment expands the investment constraint [4].

The impact of the new foreign direct investment on the overall productivity of the economy, and hence on the productivity of domestic companies, can contribute to the emergence of new, up-to-date technologies that will complement the previously attracted technology through foreign direct investment.

The extent and effectiveness of foreign direct investment on economic growth depends on the level of economic development. There is a dependency on the foreign direct investment inflow and the level of qualification of working resources. In other words, the positive external effects of foreign direct investment in economic growth are that salaries in enterprises with foreign capital are higher than the enterprises with foreign capital are higher than the average salary of the country. This circumstance contributes to the formation of solvent demand, which is accompanied by expansion of consumer goods production.

Foreign direct investments has also had a positive impact on the increase in labor productivity, which is driven by the size of the enterprise, that share of managers in the total employer, and the costs of new technology per employee. Foreign direct investment contributes to the restructuring of domestic economy and raising competition in economic sector.

The degree of human capital and technology replenishment, taking into account the peculiarities of the country and its branches, is considered to be one of the main factors in the inflow of technology with foreign direct investment. The positive external effects of foreign direct investment

also include the inflow of new technologies accompanying them, which increases the overall productivity of factors in the host country. As a result of rapid technological changes, high moral depreciation of capital takes place in foreign direct investment sectors. Technological changes lead to accelerated depreciation, the net capital stocks decreases, but overall productivity increases.

The high level of technology available in technically advanced countries indicates that technologies accompanying direct foreign investment are effective in the world.

The particular importance for foreign investors are the investment risks associated with the danger of loss of ownership with the retention of ownership. As a first example related to these risks, one can consider an example with economic activity, where within the occurrence of possible negative impact the reason is the shortcomings in the organization of the production process. The number of losses arising from these risks includes, lost profits, losses, violation of the established period of the repayment of the loan by the debtor, etc. The next type is the technical risks that arise from fire, explosion, flood, accidents and other possible similar cataclysms of the 21st century or in case of technical malfunctions. To obtain possible guarantees for the above two risks, foreign investors use the services of insurance companies.

For the Republic of Armenia, since the 90s of the XX century, the existence of so-called political risks and their research are relevant, since such risks are specific for each individual country. Political risks include the possibility of confiscating the property of a foreign depositor for political reasons, the possibility of destroying or losing the property of foreign investor because of political unrest or war, changes in relation to foreign investors due to internal political changes and worries.

As shown by the analysis of the literature by different authors, the presence of political risks for foreign investors is classified in different ways. In a number of cases, a part of political risks is considered as a phenomenon of political instability, which manifests itself in political upheavals, anti-state strikes, civil war and other solemn manifestations. However, they happen very rarely and do not belong to the most important factors that worry foreign investors. This is mainly related to foreign investor who has already deployed his investment activities in a given country.

For potential foreign investors political instability appears in the form, at least, an unattractive reality and, moreover, in the form of a limiting reality. Thus, a survey of managers of companies willing to deploy their investment activities in Eastern Europe shows that foreign investors imply the main three total factors, giving priority to political stability (78 % of the respondents). As the next most important factor is the factor of the volume of the internal market (52 %), the availability of an experienced workforce (29 %), geographical location (24 %), level of infrastructure development (7 %) and only 2 % pay attention to the availability of tax incentives.

The emergence of political instability for both – active and potential investors is a concern, especially when internal and external tensions arise due to such events, to overcome which the government changes “the rules of the game” for foreign investors (political risks pertaining to the government). The above risks include risks arising from changes in the taxation system of foreign enterprises, in the export of profits, exchange of currency, the possibility of changes in the regulation of property ownership rules as evidenced by the results of interviews conducted among investors and experts operating in Republic of Armenia.

The specificity of Armenia is that, despite certain difficulties within the political life of the country, the political risks are largely related to regional political instability. In Armenia, under the existing conditions of unstable external political risks are connected with the economic blockade imposed by Azerbaijan and Turkey. Without mentioning the fact of regional instability to the most important factors that have an impact on foreign investments, we note that it has a negative impact primarily on those who do not have the experience of working for investors and those who are preparing to export the product to the foreign market, not limited to Armenian – a fairly compact market. However, in general, the preservation of regional stability is an area that requires an immediate solution.

From the point of view of assessing foreign policy risks we must positively assess the quality of bilateral relations between Armenia and its main partner countries (Russia, the United States of America, European Union countries, Iran, Arab countries, etc.).

There is no need to prove that for foreign investors the level of these bilateral ties, their stability or at the best, development is of fundamental importance. Deterioration or weakening of these ties may become another reason for the fluctuations of foreign investors. Thus, deterioration of relations between states can lead to the establishment of an embargo or a bilateral economic boycott, to restricting the movement of capital or its suspension.

Political risks are, to a certain extent, associated with social risks (which in some cases act as socio-cultural risks). Underlying this kind of risks lies a special (often negative) perception population of the host country of a portion of foreign investors because of previous or current historical, political contradictions, acute conflicts, wars, differences in customs, culture, etc. Although in the case of Armenia, the society as a whole is fairly liberal about almost all foreign investors, and as the facts show, foreign investors (regardless of what countries they represent) are mostly positively perceived by the population of the republic and are generally satisfied with their attitude towards themselves. This does not apply only to a number of natural monopolies (communication, energy distribution networks) and traditional industries (Cognac production) of trading activity, the population of the Republic of Armenia.

To reduce the possible negative impact of political risks in Armenia it is necessary to develop a number of rules on the application of insurance measures at the private and government level, at the domestic and interstate level. At the heart of this process is, of course, the creation of a legal framework that protect the rights of investors.

As already formulated proposals on the normative-legal base of Armenia, and, first of all, in connection with the law of the Republic of Armenia "On Foreign Investments", the regime established by the domestic legislation to protect foreign investors from political risks is not the last absolute guarantee.

The State, in fact, itself "gives" guarantees in relation to the economic activities of the owners, and the state itself (and not the third independent part) controls the quality of the provided guarantees. A more productive method at the intergovernmental bilateral level is the conclusion of agreements to protect and stimulate deposits. Another productive method of minimizing political risks is the existence of independent judicial systems. To reduce the risks for foreign investors it is important to provide them accurate information.

The aim (purpose) of the study is to justify the importance of insurance of investment risks for attracting foreign investments in Armenia.

To reduce the degree of political risks of foreign investors, it is important and their correct information support. (As practice shows, regardless of the real state of the investment situation is this country, foreign investors are inclined to view as the country with the highest degree of risk, the one about which they have a minimum information.) For the future this fact is extremely important for Armenia. And since the Republic of Armenia is a "Young" country (starting with the receipt of the independence in the early 1990s) with a limited space, a small population, located in an unstable region with folded political relations with two neighboring countries (Azerbaijan and Turkey), then Armenia is not always properly presented to a foreign investors in terms of political, economic, social and cultural.

The next, more productive method of protecting foreign investors from political risks is the method of using insurance companies. However, ordinary insurance contracts concluded by private insurance companies consider political risks under "force majeure" circumstance, and risks are not compensated in most cases. Only in recent years there has been an increase in activity by private insurance companies in the case of protection against political risks. In the territory of the former Soviet Union, the British insurance company "Lloyd's", American "Hermes" and "ALG" are engaged in insurance against small-scale political risks. In Armenia, the French insurance company "Coface", which practices foreign trade insurance, in 2007 insured "Alcatel" in communications sector for 40 million US dollars.

A fruitful method of insurance of investment activity, along with private insurance companies, is the creation of large firms under the auspices of the State or its direct participation.

Support of investment programs involving foreign companies can be the participation of the State or an international financial institution in this project. Such participation, not including the immediate elements inherent in insurance, as international practice shows, at the same time is a convincing guarantor for a foreign investor. For a foreign investor, the fact of participation State in the investment project is guarantee that the State itself is interested in the successful implementation of the project, and the participation of an international organization in any project allows us to assume that these organizations, if necessary, use all the levers and methods available to influence the government of the country, implying the removal of all obstacles.

In the United States and in a number of other countries, specialized agencies have been set up, the so-called "State Guarantee Agencies", whose main purpose is to coordinate the State's investment activities, in which public funds are also attracted to one degree or another. State participation in investment programs can be manifested as follows:

- As an owner, that is, a part of the company's shares is owned by the State,
- Loans on preferential terms,

- Subsidizing investment programs.

It seems that in Armenia the time of creation of such an agency has already come, but for this it is first necessary to ensure the appropriate legal and regulatory framework.

A number of states, in an effort to protect national companies making deposits abroad, themselves insure exported capital. An example is the US Overseas Private Investment Corporation (OPIC), which assists American entrepreneurs in investing abroad. Assistance is shown when insuring property rights from political influences, providing consulting services, financing long-term and short-term investment programs. OPIC also includes the Republic of Armenia, where a number of programs have already been insured with the participation of the American side. To implement insurance against non-trade (political) risks, in 1985 the Multilateral Investment Guarantee Agency (MIGA) was established, whose members are currently over 181 countries, including Armenia. The main activity of MIGA is connected with the proposals of long-term services on insurance against political risks, provision of consulting and marketing services. Over the years of activity of MIGA, the number of member countries of this Agency has increased dramatically, as well as the volume of insurance transactions [8].

In 2000, MIGA received a large number of guarantees from member countries in the United States and the Caribbean, which involved 45 % of the total insurance coverage, 24-25 % of the countries in Central and Eastern Europe and the Republic of the former Soviet Union. The largest in terms of insurance cooperation with MIGA from the neighboring countries and partners of the Republic of Armenia was Russia (insurance for \$340 million) and Turkey (\$230 million). In Azerbaijan (\$19 million) and Georgia (\$2 million) MIGA also carried out insurance programs. In Armenia, any insurance program was not implemented by MIGA, and only recently have begun work in this direction, which, of course, need to be promoted.

Thus, the insurance system against investment activity risks is an important part of the country's investment climate, which will create favorable conditions for attracting foreign investments to Armenia.

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