Inward foreign direct investments to Serbia – investigating motives in the past and prospects for the future

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Abstract. Our research tackles inward foreign direct investments to Serbia. In the introduction we explain the reasons why the Republic of Serbia is a latecomer in the transition process and why foreign direct investments passed by Serbia until the 2000s. The first part of the paper investigates what the motives are for inward foreign direct investments to the Republic of Serbia. Secondly we discuss factography of the dynamics of inward direct investments to Serbia and analyze how those affected other macroeconomic indicators, primarily the balance of payment and the exchange rate. Thirdly other implications, as well as their causes, are analyzed in detail, including the quality of inward foreign direct investments to Serbia (greenfield vs. grayfield investments). The fourth part of the paper discusses future prospects of the Serbian economy regarding the quantity and quality of foreign direct investments until the year 2020.

Keywords: foreign direct investments, balance of payment, current account deficit, exchange rates, Serbia

JEL Codes: F21, F32

1. Introduction

Serbia is a latecomer in transition. There are many reasons for this. The breakdown of former Yugoslavia was destructive for the Serbian economy. Governments of Serbia in the 1990s made an unsuccessful attempt to prevent the dissolution of Yugoslavia. They materially and politically supported Serbs from other newly formed states, former Yugoslav Republics that were respectable minorities in Croatia and Bosnia & Herzegovina to oppose independence. This was the cause of war with ethnic conflicts that resulted in many victims and huge material destructions as well as a massive number of refugees. That material support to Serbs outside of Serbia was a trigger for a catastrophic situation in Serbia that already had economic problems accompanied with the second biggest hyperinflation in economic history. On top of this, the international community imposed economic sanctions to Serbia that lasted for five years. As a final stage, In 1999 NATO-pact launched an 11-week bombing campaign called “The Angel of Mercy” killing hundreds Serbian civilians and many infrastructure and production premises suffered physical destruction. The decade of the 1990s was not only a lost decade for the Serbian economy, but it was a period that tragically regressed.

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As an indication of the degree of calamities, in 2012 Serbia reached only 70% of the industrial production of 1990, despite the acceptable rate of its growth in the last decade.

Even though some authors (See f.e. Uvalic, 2012, p.25) consider 1989 as the starting year of transition in Serbia (and the rest of Yugoslavia), no major reforms were made until the end of 2000, when Slobodan Milosevic lost presidential and parliamentary elections, which was a breakthrough. International blockade was banned, Serbia became a member of the IMF\(^1\), World Bank group and regional organizations, signed the Treaty on Succession with other former Yugoslav republics, and received massive international donations. The Level of FDI, which is the topic of this paper, was negligible until the year 2000 (except the year 1997, when privatization of Telecom was made).

2. **Motives for inward foreign direct investments to the Republic of Serbia**

In the beginning of this section it is important to present the formal definition of FDI and certain terms that will be used throughout this paper. Foreign direct investment (FDI) is defined as a long-term investment by a foreign investor in an enterprise resident in another economy. FDI can be observed and analyzed from an investor’s perspective or from a host’s perspective. These two perspectives are reported separately as:

- Inward FDI (or FDI in the reporting economy) represents investments made by foreigners in enterprises resident in the reporting economy.
- Outward FDI (or FDI abroad) represents investments by entities in affiliated enterprises abroad.

There are several statistics which are used for FDI description. According to Eurostat\(^2\) the most important statistics for FDI measure are the following\(^3\):

- FDI flows denote the new investment made during the period,
- FDI stocks (or positions) denote the value of the investment at the end of the period,
- FDI income is the income accruing to direct investors during the period,
- FDI intensity is mainly measured as a percentage of GDP. If this index increases over time, then the country/zone is becoming more integrated with the international economy.

Inward FDI attracts new and advanced foreign technology, know how, and the possibility for accession to the network of international production and trade. Besides, FDI is the best resource for covering the balance of payments deficit, since there are no liabilities abroad. This is the reason for transition countries, since they have balance of payments deficits, to continuously make conditions for attracting inward FDI. According to the UNCTAD assessment, as well as others, foreign direct investment inflow to Southeastern Europe in the next three years will deteriorate. Despite this general trend, good projects will always find foreign investors.

That general view of FDI as a quality source of balance of payments deficit financing especially makes sense in Serbia as a transition economy of the region of Southeastern Europe, where all economies suffer from balance of payments deficit, not only in early years of transition, but also today. As a consequence of respectable FDI stock in the time of structural production changes in combination of huge public spending in countries of the region, deficit of current account remains. FDI level in aforementioned countries should be higher, especially in the years after privatization in order to create a condition for sustainable development. In conclusion, creating a favorable condition for foreign capital in Serbia, as well as in other countries of

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1 Socialistic Federative Republic of Yugoslavia was a founding member of the Breton-Woods International Conference where both the International Monetary Fund and International Bank for Reconstruction and Development were formed.


Southeastern Europe is an important factor that will contribute to increase motives of foreign investors to invest in the Serbian economy. Many researches proved that FDI are the best form of foreign investments. Two possible scenarios are for the Serbian economy in the near future due to the current world financial and economic crises – is either a higher rate of foreign loans or a forcedly driven decrease of current account deficit. The most possible scenario is, in fact, a combination of both. 

Foreign capital inflow depends on two groups of factors. The first one is related to the favorable global economic conditions and satisfactory global liquidity. However, during the time of global prosperity there was a rise in FID stock, it was a time of foreign investments growth. The second group includes internal factors within the national economy such as: structural reform progress, financial integration etc. Therefore, even in the time of global recession, certain (but much lower) quantum of capital is available, but only economies with better performances are able to attract it. Aside from positive effects of foreign capital inflows, there are also threats and dangers, like overheating of economic activity competitiveness decline (if monetary reserves sterilization policy is consistent – it implies appreciation of national currency that causes loses of competitiveness and an increase of reserves, as the side effect of the process). IMF team researchers (IMF, 2007, p. 106. Also see: Cardarelli, 2007, p. 203) point out four main lessons related to big capital inflow:

- First, countries that experience more volatile macroeconomic fluctuations – including a sharp reversal of inflows – tend to have higher current account deficits and experience stronger increases in both aggregate demand and the real value of the currency during the period of capital inflows.
- Second, episodes during which the decline in GDP growth following the surge in inflows was a more moderate trend than those in which the authorities exercised greater fiscal restraint during the inflow period, which helped contain aggregate demand and limit real appreciation.
- Third, countries resisting nominal exchange rate appreciation through intervention were generally not able to moderate real appreciation in the face of a persistent surge in capital inflows and faced more serious adverse macroeconomic consequences when the surge eventually stopped.
- Fourth, tightening capital controls has not, in general, been associated with either lower real appreciation nor with reduced vulnerability to a sharp reversal of inflows.

One study (Marinkovic, Ljumovic and Zivkovic, 2011) was investigating motives of inward FDI to the Serbian banking industry. Their findings (based on a survey) are that the category of “searching for new markets” dominates. Also important are location, conditions in the domestic market as well as a degree of risk and state regulation, rather than financial parameters.

3. Inward foreign direct investments in Serbia and other macroeconomic aggregates

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Free trade zone launching was an important step toward the attraction of foreign capital as a factor of improving current account. According to UNCTAD World Investment Report, Serbia held the fourth position in cumulative 2000-2008 foreign capital inflow. Only the United Arab Emirates, Libya and Bulgaria were ranked better than Serbia, while neighboring countries Croatia and Albania were ranked in 8th and 9th position respectively. Cumulative foreign capital inflow in Serbia was 16.4 billion dollars, which is a 16 time increase to very moderate conditions in 2000. At the moment, Serbia's situation is such that it has to attract at least 3 billion dollars of foreign capital per year in order not to have obstacles in achieving high rates of economic growth with the current account equilibrium.

Very poor infrastructure quality and overregulated economy are two major obstacles for foreign direct investments income to Serbia. In general, a very important factor for this region is also political stability improvement. Countries of this region are still a ways from a satisfied level of law security and corruption control, which is a serious obstacle for more intensive foreign direct investments inflow. Eastern European transition countries experience shows that these factors are important for integration in global trade and financial flows. The fact that foreign direct investments are much more than simple inflow of capital – the overall investment package also contains transfer of know-how and technology.

The most common type of investments in Serbia are investments for securing the market. One of the major motives of such investments is servicing local market, or eventually regional market. Investments in financial intermediation, trade, properties, traffic, housing, etc. make up a huge part of the overall stock of foreign direct investments in Serbia. The problem with the investments in the aforementioned industries is that, as exclusively market-motivated, they are in non-tradable sector. Sachs and Larrain under tradable goods consider agricultural-related goods, mining-related goods, and those goods related to processing industry, while all other goods are considered non-tradable goods. If we analyze foreign direct investment stock in Serbia, only 23.7% of them are investments in tradable sector (20% processing industries; 3% mining; 0.7% agriculture), while the rest of the stock (76.3%) goes to non-tradable goods, which is much more than average for Central and Eastern European countries (where as much as 66% of total foreign direct industry stock goes to non-tradable goods).

Foreign direct investments not only have direct negative impact on the balance-of-payments, but also generate consumption, both directly and indirectly, which results in import increase. Among the twelve biggest foreign direct investments in Serbia in 2000-2011 (see Table 1) there were only two greenfield investments. At the same time this is an essential difference between foreign direct investments in Central and Eastern European economies in the 1990s and in Southeastern Europe (including Serbia) in the 2000s.

Table 1: Twelve biggest inward foreign direct investments in Serbia 2000-2011

<table>
<thead>
<tr>
<th>Company</th>
<th>Investment (€)</th>
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<tbody>
<tr>
<td>Telenor</td>
<td>1,602 million</td>
</tr>
<tr>
<td>Gazprom</td>
<td>947 million</td>
</tr>
<tr>
<td>Intesa Sanpaolo</td>
<td>944 million</td>
</tr>
<tr>
<td>Delhaize</td>
<td>932 million</td>
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<tr>
<td>Stada</td>
<td>650 million</td>
</tr>
<tr>
<td>Mobilkom Austria</td>
<td>570 million</td>
</tr>
</tbody>
</table>

An interesting question arises in so-called supporting measures by the Government in order to attract inward foreign investments. For the biggest foreign direct investments the Government of Serbia negotiated directly with the foreign investors and granted them 10-25% of investing value. Those supporting measures raise many controversial opinions. For example, Nobel prize winner Joseph Stiglitz made a statement that those measures flourished often due to the fact special privileges cadged by investors were granted by the Government.

Most economic analysts have a similar attitude towards the supporting measures: by introducing supporting measures we admit existence of a bad investment climate. At the same time foreign investors are in a better position in comparison with domestic investors, while the price is paid from the state’s budget.

Supporting measures are widely used in the region of Southeastern Europe. In Bulgaria certain inward FDI are paying as much as 50% lower taxes in a period of ten years if investment is bigger than a certain amount and if investment is made in a particular region. In Romania tax release of 20% of the purchasing value of the investment amount, plus additional profit tax releases are possible to achieve from foreign investors. In FYR Macedonia it is possible to be granted three-years tax reduction if the investment share is bigger than 20% of the investment. In conclusion, serious competition in the region of Central and Southeastern Europe is recorded concerning the attraction of inward FDIs, including supporting measures. This competition can easily be tracked in the car-manufacturing industry. Ford invested in Romania, Mercedes and Suzuki in Hungary, Kia in Slovakia, and Fiat in Serbia.

4. Other implications of inward foreign direct investments in Serbia

The dominant share of Serbian export comes from „low“ and „moderate low“ technology intensive industries. Keeping in mind the present situation in the Serbian economy, this is no surprise, but also the fact that solid growth of exports was achieved mainly by the processing industry and primary products, where Serbia enjoys comparative advantages. In 2009 only 26.7% of Serbian export originated from industries with „high“ and „moderate high“ technology, which is just too mild of an improvement in comparison with 2001, when that share was 23.3%. The total share of „high“ and „moderate high“ technology industries is high, for example, Slovenian (43.9%), and the Czech Republic (57.5%), are almost 2.5 times lower than the average of that in the Western economies. Technology improvements are playing a key role in overcoming poor competitiveness, but also utilizing imported modern technologies without so-called technology training could be inefficient. Since Southeastern European economies are not able to independently encourage development of strategically technology-advanced industries, incorporating large international projects and

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Source: SIEPA

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount</th>
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<tr>
<td>ABInBev</td>
<td>530 million €</td>
</tr>
<tr>
<td>Eurobank EFG</td>
<td>500 million €</td>
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<tr>
<td>US Steel</td>
<td>280 million €</td>
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<tr>
<td>Carlsberg</td>
<td>160 million €</td>
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<tr>
<td>Michelin</td>
<td>150 million €</td>
</tr>
<tr>
<td>Heineken</td>
<td>67 million €</td>
</tr>
</tbody>
</table>

Source: SIEPA

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development programs of powerful transnational corporations is one of the possible strategies to encourage macroeconomic restructuring in order to develop technology-intensive industries.

Regional integrations; i.e., foreign trade liberalization, expanding market through reducing tariff and non-tariff barriers are important for foreign direct investments. One of the most important factors that attracts foreign direct investments is the size of the national market (economy of scale). From that point of view, benefits of a free market are the same as benefits of a bigger market: by multiplication of the number of potential business partners it also multiplies the possibility to increase wealth. The importance of foreign direct investments today is huge, both for developed and developing economies. Foreign direct investments also brings with them a transfer of knowledge and technology through diffusion of innovations, increase of productivity, increase of competitiveness, improved access to foreign markets, increase of employment, etc. Besides, keep in mind that foreign direct investments do not generate loans, it is the most wanted form for financing current account deficit, which are common for developed economies.

Table 2: Foreign direct investment inflows in Eastern, Central and Southeastern Europe countries 2002-2011 (in billion US dollars)

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</thead>
<tbody>
<tr>
<td>Azerbaijan</td>
<td>1.4</td>
<td>3.3</td>
<td>3.6</td>
<td>1.7</td>
<td>-0.7</td>
<td>1.5</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
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<tr>
<td>Bulgaria</td>
<td>0.9</td>
<td>2.1</td>
<td>3.5</td>
<td>3.9</td>
<td>5.2</td>
<td>3.5</td>
<td>2.3</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Croatia</td>
<td>1.1</td>
<td>2.0</td>
<td>1.2</td>
<td>1.8</td>
<td>3.6</td>
<td>2.5</td>
<td>2.7</td>
<td>2.5</td>
<td>2.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1.1</td>
<td>0.9</td>
<td>1.1</td>
<td>1.2</td>
<td>1.5</td>
<td>1.8</td>
<td>1.5</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>8.5</td>
<td>2.0</td>
<td>5.0</td>
<td>11.6</td>
<td>6.0</td>
<td>6.5</td>
<td>6.0</td>
<td>4.5</td>
<td>4.8</td>
<td>5.1</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.3</td>
<td>0.9</td>
<td>1.0</td>
<td>3.0</td>
<td>1.6</td>
<td>1.4</td>
<td>1.3</td>
<td>1.4</td>
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<tr>
<td>Hungary</td>
<td>3.0</td>
<td>2.2</td>
<td>4.5</td>
<td>7.5</td>
<td>6.1</td>
<td>4.8</td>
<td>4.8</td>
<td>5.9</td>
<td>5.4</td>
<td>4.8</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2.6</td>
<td>2.1</td>
<td>4.2</td>
<td>2.0</td>
<td>6.1</td>
<td>6.2</td>
<td>7.0</td>
<td>8.0</td>
<td>6.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Latvia</td>
<td>0.3</td>
<td>0.3</td>
<td>0.6</td>
<td>0.7</td>
<td>1.6</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Lithuania</td>
<td>0.7</td>
<td>0.2</td>
<td>0.8</td>
<td>1.0</td>
<td>1.8</td>
<td>1.0</td>
<td>1.1</td>
<td>1.2</td>
<td>1.4</td>
<td>1.5</td>
</tr>
<tr>
<td>Poland</td>
<td>4.1</td>
<td>4.6</td>
<td>12.9</td>
<td>9.6</td>
<td>14.5</td>
<td>12.5</td>
<td>12.0</td>
<td>12.6</td>
<td>12.9</td>
<td>13.1</td>
</tr>
<tr>
<td>Romania</td>
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<td>1.8</td>
<td>6.4</td>
<td>6.5</td>
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<td>7.3</td>
<td>7.0</td>
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<tr>
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<td>8.0</td>
<td>15.4</td>
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<td>31.0</td>
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<td>0.5</td>
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<td>1.7</td>
<td>5.6</td>
<td>3.2</td>
<td>4.5</td>
<td>4.5</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Slovakia</td>
<td>4.1</td>
<td>0.7</td>
<td>1.1</td>
<td>1.9</td>
<td>4.2</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.2</td>
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</tr>
<tr>
<td>Slovenia</td>
<td>1.7</td>
<td>0.3</td>
<td>0.8</td>
<td>0.5</td>
<td>0.4</td>
<td>0.8</td>
<td>1.4</td>
<td>0.8</td>
<td>0.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Ukraine</td>
<td>0.7</td>
<td>1.4</td>
<td>1.7</td>
<td>7.8</td>
<td>5.2</td>
<td>5.2</td>
<td>4.8</td>
<td>4.6</td>
<td>4.8</td>
<td>5.3</td>
</tr>
</tbody>
</table>


Contrary to the beginning of the transition period (1990s) when negative influence of FDIs were outlined, together with a loss of national sovereignty and addiction to foreign capital inflow, today FDIs are seen as a leverage of export and technological development. It is a long-term interest of every export-oriented economy to attract foreign greenfield investments. Thanks to a relatively stable political and judicial environment Central European economies were far more attractive for foreign investors than Southeastern European ones. But progress in legislative adjustment to the EU standards, which is confirmed by adding
Serbia, Macedonia and Montenegro to the “White Shengen list” in 2009, made Southeastern European countries presently more attractive than they were in the past. Not to mention the free trade area establishment, which could be an important factor in attracting foreign investments to the Balkan countries.

FDI inflow to the CEFTA agreement countries could help increase their export capacity, reducing their balance of payment deficit and improve their overall economic characteristics. It is indicative that all CEFTA agreement member countries are faced with a high deficit of current account, as a result of a large foreign trade deficit. In the first quarter of 2009 global recession is visible, which redirects funds that use to inflow from developed countries to others, to developed countries itself, which makes those funds more expensive or even non-reachable to countries of our region. FDI inflow to the region will certainly influence economic growth in the future, but only if they contribute to the processing industries and tradable goods, which will support export expansion. This scenario could happen if a stable political and institutional environment is in place, as well as an appropriate economic growth strategy. The main common characteristic of the CEFTA agreement countries is uncompetitive export; i.e., lack of competitiveness in the world market, which is a consequence of inherited economic structure during centrally planned economies. Therefore, the need to increase the volume of export is among the most important goals of an economic policy.

5. Prospects for the future

In order to maximize utilization of a free trade agreement, Serbia has to improve export. In the period of 2000-2008 Serbia had a respectable rate of foreign trade yearly increase (an average of 19%), which was accompanied with a much more moderate rate of yearly increase of GDP (an average of 5.4%). Since economic structure generates export, it is important to emphasize that even though Serbian economic growth in the last several years had been relatively high, it was mainly based on only three economic sectors (financial intermediation, retail and wholesale, and transport and telecommunications), that are accountable for almost 3/4 of the overall economic growth in the period of 2002-2008. The three mentioned sectors are non-tradables (their products mainly cannot be exported); i.e., they rely mainly on expansion of domestic demand. Economic growth had not been accompanied with appropriate expansion of production, mainly in the tradable sector. This is the reason why Serbian economic growth was accompanied with a relatively high trade deficit, as well as current account deficit. The new model of economic growth has to be significantly based on the tradable sector. Foreign capital inflows, that were mainly used to finance domestic demand, will not be the same as in the past due to the economic crisis in the EU and USA. It could be considered that sectors that had been pillars of the growth had already reached a relatively high level (15% per year). Therefore their growth in the future will surely be diminished. We should keep in mind that the rest of the economy had a relatively moderate growth of 2% yearly, and that it is important to increase productivity of those sectors in the near future. In order for Serbia to achieve sustainable economic growth; i.e., to stop further growth of unemployment, as well as an increase in poverty with all accompanied problems, the average growth of industrial production (especially tradable goods) should be 6.9% yearly. Such an increase should make a yearly increase of Serbian export of 13.5 % possible , as well as an increase of its share in the GDP up to 65%. With the yearly growth of 5.8% (as in 2008), in the year of 2020 Serbia would reach a GDP level of 8,000 euro per capita.

Expected inward foreign investments to Serbia could be in the range of 2-6 billion dollars per year if Serbia improves its position on the list of the countries with the world’s best economic conditions (presently at 140th position). The new government of Serbia (formed after general elections in May 2012) is expected take necessary steps for this.
Until the year 2020 it is expected that major inward foreign direct investments in Serbia could be in the energy sector. The state owned Electric company (Elektroprivreda Srbija) has already signed a two billion dollar contract with one consortium from China on building one new electric plant (the 3rd one in thermo-electric plant “Nikola Tesla” in Obrenovac), as well as for investments in renewable sources utilization. At this moment there are also ongoing negotiations with an Italian investor for several new hydro-electric plants on Serbian rivers worth 1.5 million dollars. It is a joint venture investment, with a joint enterprise already formed. In addition the contract is already signed for a 0.3 billion dollar solar panel production plant that will be built in Southern Serbia (in Vranje), which will be the biggest investment in that particular region of Serbia.

6. Conclusion

In this paper we have discussed the importance of inward foreign direct investments to Serbia that are necessary to overcome balance-of-payment deficit problems that all countries in the region are faced with. After the introduction we presented why Serbia is a latecomer in transition process, we discussed motives for inward foreign investments to Serbia. We then analyzed inward FDI and other macroeconomic aggregates in Serbia, as well as other implications of inward FDI to Serbia. Finally, we have considered prospects for the future.

Most of inward FDI to Serbia after 2000 (as well as in other transition economies) arrived thanks to the privatization of enterprises in certain sectors – primarily cement plants, the tobacco industry and based metal production firms. Later banking and telecommunication industries joined, while greenfield investments were lacking, especially in the industrial sector.

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