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REGIONAL DIFFERENCES IN THE INFLOW OF DIRECT FOREIGN INVESTMENT INTO THE CZECH REPUBLIC

Summary: This article analyses the inflow of foreign direct investment into the Czech Republic on the regional level. Their inflow shows a dynamic change. The early 1990s were represented by their low inflow and on the contrary, from the late 1990s to the time before the global economic crisis there was significant growth in direct foreign investment. From the regional point of view, Prague and the metropolitan regions of the Czech Republic with taking Mladá Boleslav region into special consideration dominate other Czech and Moravian regions in the context of direct foreign investment absorption.

Key words: direct foreign investments, metropolitan area, region.

1. Introduction

After 1989, in the course of the transformation of the Czech economy from a centrally-managed economic system to a market economy, many problems surfaced. One of the burning economic issues, which has ultimately survived from the early 1990's up to the present day, is the wrong sector composition and low performance associated with the very low competitiveness of Czech businesses resulting from not standing up to global competition and forcing it out of the market. In the 1980's and 90's, both central and local government began to implement tools for attracting direct foreign investment. To attract foreign investors, investment incentives have been used covering tax holidays, subsidies for creating jobs, reimbursement of costs paid for staff re-qualification, provision of land for business etc. In the pursuit of winning investment and creating job opportunities, the public sector has waived part of its income in favour of NNS and is thereby locked into an unequal position where NNS rules must be accepted instead of determining the rules to ensure the accession of a foreign investor on the domestic market. The result provides NNS with advantages that are far more beneficial for business compared to the those provided to local companies [Sýkora 2000].

The inflow of direct foreign investment has substantially influenced the course of the structural changes with a substantial improvement in the quality and

competitiveness of the raw material processing industry. However, on the other hand, it has contributed to a further increase in industrial activities in the gross domestic product (in European comparison); this can be an impulse for investors in the service sector and for developing symbiosis conditions between intensely industrialised economic activities and service activities, e.g. focusing on leisure time and tourism. Supranational companies play a more prominent role in research and development in the host countries. Direct foreign investment is crucial for parent companies because it results in more efficient production, access to new markets and enables them to keep abreast of new technologies. The vast majority of direct foreign investment originating from EU member countries goes to the OECD countries although we can see that a growing share goes to developing economies. The difference in direct foreign investment is also obvious within the EU where the majority of the original member countries have recorded a drop in investment activities in favour of the new members [Kadeřábková 2006].

2. Positive and negative effects of direct foreign investment

The most important benefits from foreign companies are that they directly and indirectly contribute to a higher employment rate and have a huge share in industrial production exports. The management of the vast majority of companies also indicate that the expansion of existing production, incorporation of research and development departments and customer care centres in individual regions of the Czech Republic are assumed to take place within the next two years. Direct foreign investment brings modern technologies into the country, foreign investors support both technical and technological progress, aim to increase production efficiency and establish research centres. At the same time in terms of human resources management, they allow knowledge, skills and experience sharing in the affiliate companies in the host country, especially in the fields of research and development, know-how, production organization and sales and in the field of management skills. Direct foreign investment also contributes to the development of domestic companies because increased investment by supranational companies can help local companies through subcontracting relationships. Supranational companies can aid access to foreign markets that would otherwise be difficult for local companies, resulting in new export opportunities. Generally speaking, they contribute to a change in the institutional environment, help to improve the efficiency and competitiveness of the host company and increase the pressure to improve adherence, protection and enforceability of intellectual property rights. A further effect is the structure or industrial composition of newly attracted foreign investors. I have assessed the consequences on employment from the point of view that although these companies contribute to employment growth, the dominant share of employment remains with small and medium-sized enterprises. These supranational corporations are given intensively preferential treatment and in smaller enterprises with limited lobbying

potential (e.g. in negotiations for granting state subsidies) unemployment can rise significantly in those regions with a small inflow of direct foreign investment.

Direct foreign investment can also indicate some negative points. Direct foreign investment negatively affects Czech enterprises, particularly small and medium sized enterprises that are an important part of the economy of each country. Foreign investors can liquidate and displace local competing enterprises, particularly when focusing on the local market. In practice, the hostile acquisition of companies can take place in order to attenuate competing production so that the foreign investor need not compete with competitors and therefore floods the market with its products. This inflow of the foreign investors can also be reflected in the increased unemployment level in the case of the development of capital-demanding production at the expense of work-demanding production. In association with the restructuralization of production, streamlining of operations and the introduction of new technologies, the staff count is reduced in many industries. The increased unemployment level especially applies to acquisitions (i.e. purchase of ownership interest in local companies) while on the contrary, direct foreign investment in the form of green field investment increases the employment level. Higher salaries in companies with foreign capital involvement, which are a logical consequence of greater working productivity (due to restructuralization, new technologies, know-how, management style and others), are poured into local companies with a slower pace of working productivity growth and finally, an increase in unemployment as well as a fall in the competitiveness of the local companies can be observed. The emergence of the so-called dual economy, which is a consequence of the lower economic performance of local companies compared to the segment of foreign companies, is often mentioned and can result in the displacement of local companies from the labour market.

In the interest of winning new foreign investors, the state administration may either limit or neglect support for local companies that are associated with excessive optimistic expectations and concessions to foreign investors. All comparisons of the business performance confirm that companies with direct foreign investment are much more technically developed and out perform local companies. After all, it is true that in each country and industry, exporters are more productive than other companies and companies investing abroad are more productive than exporters without foreign investment. This is the origin of the usual argument in support of direct foreign investment from public resources – it is expected that exceptionally productive foreign companies will positively influence the operation of local companies after their arrival and that these local companies will learn better technologies through subcontracting relationships. However, the consequences can also be negative; the accession of a developed company in the industry can result in the decline or termination of local competitors. A negative phenomenon is also transfer pricing or price handling in supranational companies that try to elude high taxes and reduce tax revenues by transferring otherwise taxable amounts between countries with different taxation levels.

In addition, the system of investment incentives distorts the economic environment and disadvantages domestic companies compared to foreign companies. Governments in different countries approach investment support in different ways and different levels of intensity. Therefore, there are differing opinions on this subject. Theoretically, it is again a long-term dispute of liberal and interventional-based ideas and it is impossible to precisely define which approach is more effective and beneficial for the development of the regions of the Czech Republic.

3. Differences in the inflow of direct foreign investment in the Czech Republic

Deployment of direct foreign investment in the Czech Republic can be regarded as fragmented because rather substantial regional disproportions can be observed (see fig. 1). The regional factors, which influence the location of direct foreign investment, include, among others, quality and availability of human resources, economic structure, transport infrastructure and especially the effect of agglomeration savings strongly interrelated with the metropolitan areas of the Czech Republic. Following Prague, Mladá Boleslav holds a very strong position due to the highly concentrated level of investment associated with investment by Volkswagen in the automotive industry and the Škoda company.

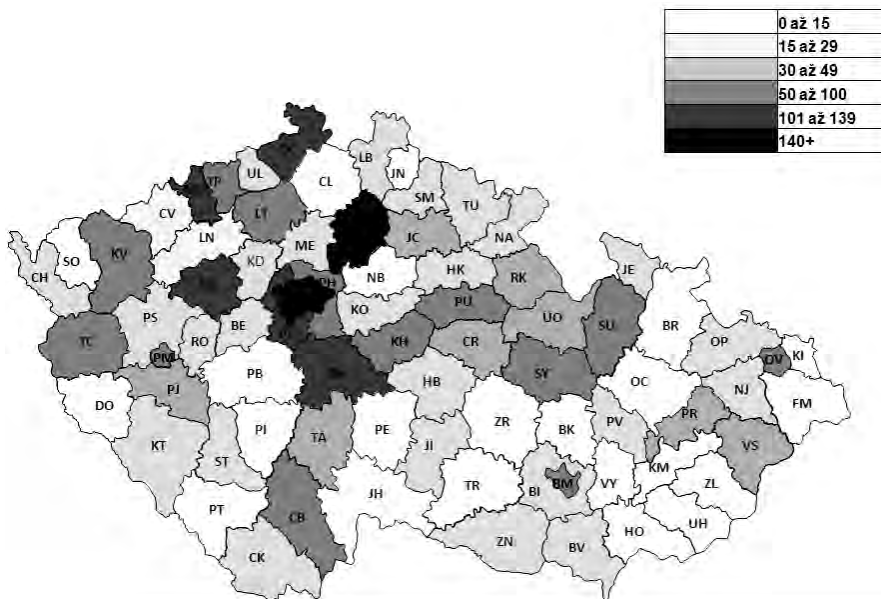


Fig. 1. Regional differences in the inflow of direct foreign investment in 1999-2008, converted per one inhabitant (in Thousand CZK)

Source: internal processing based on the Czech National Bank database.

In addition to the concentration in the metropolitan areas, the diagram shows a surprisingly high concentration of direct foreign investment in the north-west region of Bohemia. Reinforcement of the north-west in addition to the north-east regions is the result of investment both into existing industrial companies and into the prime location of the so-called incentive investors due to the investment incentives system which is primarily focused on regions with above average unemployment.

In addition to cities and metropolitan areas, territories in the border areas were attractive from the point of view of foreign investors. Therefore, the geographical location factor plays an important role, however not just from the number of foreign companies but also from the amounts of capital invested. Nevertheless, the Czech Republic shows some polarity between the eastern and western parts; more precisely between Bohemia and Moravia with a higher inflow of direct foreign investment into the western regions of the country.

However, it can be seen that direct foreign investment in the Czech Republic is concentrated extremely unevenly, especially in the more developed regions with a higher economic level with long-term differences and supports growth in the regional differences between the metropolitan areas and the other regions of the country.

It is impossible to draw any conclusions regarding the success of the economic transformation based on regional differences in the inflow of direct foreign investment. For example, the Ústí Region cannot be regarded as unattractive to investors from the point of view of the volume of the inflow of direct foreign investment because the direct foreign investment level per capita reaches values identical to other regions (except for Prague). At the district level, Most is an “attractive to investor“ district not only within the Ústí Region but at a national level as well. Direct foreign investment per capita from 1998 to 2006 amounted to a level that significantly exceeded the average for the Czech Republic (without Prague). The district of Most followed by Teplice and Litoměřice also saw the highest volume of direct foreign investment in the period in question. Quantitatively, the Ústí Region does not differ as much from other regions (except for Prague) as far as direct foreign investment is concerned. However, this interpretation is highly simplified because it does not include any quality parameters. Monitoring the quality aspects of direct foreign investment is a rather difficult discipline due to the lack of relevant data and therefore, partial indicators are used for this purpose, e.g. the database of completed foreign investment (Czechinvest), captures projects by foreign investors included by institution and therefore can be interpreted as a representative sample of foreign investors. A further quality indicator is the presence of direct foreign investment focused on developing innovations and research & development. From this point of view, the Ústí Region belongs among the least attractive regions for innovation businesses. The number of technological centres for similarly focused development projects is very low in the Ústí Region.

The uneven deployment of direct foreign investment for higher investment demand and higher quality (e.g. research and development investment) further

supports the regional differences and highlights the markedly successful “adaption” of the regions to new economic conditions. It can be assumed that the differences will further deepen, especially by the type of investment. It is expected that for countries in Central Europe, these regions will welcome the growing number of investors in industries with higher added value and strategic services that are much more demanding on quality human resources and the general business environment. Therefore, it can be assumed that this investment will be especially directed to the most developed regions, i.e. direct foreign investment will further act as a factor for differentiating the regions.

Investment incentives should be more focused on the service sector (including strategic services) and hi-tech technologies: telecommunications, new technologies and innovations, information systems etc. Also, a greater diversification within the industries as well as the structure of the economy is important together with the support of SME Czech and foreign businesses. Should the Czech Republic want to attract foreign investors promising an inflow of new technologies, better organization of work, know-how, improved employment level and improved productivity of the economy, it must create better investment conditions than its competitors, in this case the other Eastern European countries.

4. Conclusion

The inflow of direct foreign investment in the Czech Republic has seen quite a dynamic change. The early 1990’s were represented by a low inflow of direct foreign investment and on the contrary, the late 1990’s reported a significant growth in direct foreign investment. It is obvious that, in terms of the districts in the Czech Republic, investment has been located very unevenly. From the long-term point of view, Prague and the metropolitan regions of the Czech Republic and the economically stronger regions (with the specific position of Mladá Boleslav due to the above-average inflow of direct foreign investment when compared to other regions in the Czech Republic) dominate. Direct foreign investment includes many positives and negatives, whereas as far as the Czech Republic is concerned, the positive impacts on the Czech economy and society prevail. Despite the fact the investment incentives are just one of many criteria for selection of a country by a foreign investor, the Czech Republic should continue with the incentive process following appropriate changes, reviews, and the reorganization of the investment incentive system in order to increase quality-oriented direct foreign investment to reinforce the long-term growth of the competitiveness of the Czech economy.

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REGIONALNE ZRÓŻNICOWANIE NAPŁYWU BEZPOŚREDNICH INWESTYCJI ZAGRANICZNYCH W REPUBLICE CZESKIEJ

Streszczenie: W artykule przedstawiono analizę napływu bezpośrednich inwestycji zagranicznych w Republice Czeskiej, na regionalnym poziomie. Napływ bezpośrednich inwestycji zagranicznych dowodzi dynamicznych zmian. W pierwszej połowie lat 90. odnotowano niewielki napływ inwestycji, w przeciwieństwie do późniejszego okresu dekady, w którym bezpośrednie inwestycje zagraniczne charakteryzowały się znacznym wzrostem. Taka sytuacja utrzymywała się do czasu globalnego kryzysu gospodarczego. Z regionalnego punktu widzenia Praga oraz metropolitalne obszary Republiki Czeskiej, ze szczególnym uwzględnieniem regionu Mladá Boleslav, zdominowały pozostałe regiony Czech i Moraw w kontekście absorpcji bezpośrednich inwestycji zagranicznych.