REGIONAL ASPECTS OF THE EFFECT OF FOREIGN DIRECT INVESTMENT

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The completion of economic transformation is bringing to the fore issues concerning the quantity and quality of capital necessary for this process. As a consequence of the shortage of Slovakia's own sources foreign capital plays an indispensable role. The aim of this article is to analyse the development of the inflow of foreign direct investment to Slovakia and its role in the development of regions.

Foreign direct investment capital represents an indispensable source of capital for the Slovak economy. The Ministry of the Economy of the Slovak Republic (SR) has estimated that the forecast investment intensity of the process of restructuring and renewal of industry in the years 1996 to 2000 totals SKK 216.9 bn, of which own sources of the business sector represent SKK 150.7 bn (69.5 %). The remaining non-covered part gives room for other sources, where foreign capital supplemented by bank loans should play a significant role.

Foreign capital enters the economy in three main forms: as foreign direct investment (FDI), portfolio investment, or foreign loans and others. These capital flows are concentrated in the capital account of the balance of payments, goods flows of already established joint businesses in the country, i.e. jointly owned domestic and foreign partners, or in the full ownership of foreign investors and can be found in the current account of the balance of payments.

Table No. 1: Foreign direct investment inflow [1] to the SR 1993 – 2000

	SKK mill.			
	Balance as at 1. 1.	Net change	Exchange ratedifferences	Balance as at 31. 12.[4]
1994	15 342	8 744	246	24 332
1995	24 332	6 932	1 035	32 299
1996[2]	33 594	10 555	467	44 616
1997[3]	49 629	6 656	-272	56 013
1998	56 013	16 981	1 879	74 873
1999	74 873	14 081	781	89 735
2000	89 735	6 578	1 050	97 363

1) Asset capital + reinvested profit
2) Change in methodology – introduction of CZK as a convertible currency
3) Change in methodology – introduction of capital also in SKK (1994 –1996 only capital in foreign currency.
4) In 2000, balance as at 30. 6.

Foreign direct investments have various influences on the recipient – host economy, as well as the parent country. The following influences may be considered as the most significant:

- the effect on the balance of trade and the balance of payments,
- effects on the rate of employment,
- effects on economic structure,
- regional effects at a business's location,

ther countries the international transfer of technologies and know-how.

The aim of this article is to draw attention to the fact that, besides the development of FDI inflows into Slovakia, the business operations of foreign investors in Slovakia can play a positive role also in the field of regional policy.

Foreign direct investment inflows

The development of foreign direct investment inflows into Slovakia, although taking a growing curve is one, the growth of which however remains unsatisfactory. More significant growth in 1996 was caused only indirectly as a consequence of an additional regulation: NBS Decree No. 4 of 27. 5. 1996, pursuant to which branches of foreign banks must have funds of a long-term liability nature in respect of the parent bank and in the amount of at least SKK 500 million, which for all branches represented a total of 5 SKK 880.0 million. In 1998 and 1999 development in this field was more favourable than that documented in table no. 1.

In comparison with Slovakia's neighbouring countries, the level of FDI inflow to the country remains low. From the aspect of foreign direct investors' decision making on whether to invest in a specific country, the most significant assessment criteria are economic efficiency, political risk, foreign indebtedness, the country's credit rating and access to international finance.

In the framework of an economic assessment the following factors are taken into account: economic growth, currency stability, development of the current account in the balance of payments, public finances and the rate of unemployment. Political risk is defined as the risk of non-payment for goods and services provided, the non-payment of loans, dividends or the

Table No. 2: Foreign direct investment balance as at 30 6 . 2000 – grouping by sector

Exchange rate used SKK/USD 45.416	SKK mill.	USD mill.	%
Total FDI balance	97 363	2 143.8	100
Agriculture	145	3.2	0.1
Miningn	1 119	24.6	1.1
Industrial production	47 862	1 053.9	49.2
Electricity and gas prod. and distr.	433	9.5	0.4
Construction	1 811	39.9	1.9
Retail	18 966	417.6	19.5
Hotels and restaurants	1 127	24.8	1.2
Transport and communications	3 105	68.4	3.2
Finance and insurance	19 131	421.2	19.6
Property and rental	3 168	69.8	3.3
Health and social care	18	0.4	0.0
Other public services	478	10.5	0.5

prevention of capital repatriation. The category does not reflect the trustworthiness of individual trading partners in the country. The category of foreign indebtedness reflects the ratio of debt servicing to exports, the ratio of the current account balance relative to GDP and the ratio of foreign debt to GDP. The credit rating is the average rating assessment of a country by Moody's, Standard and Poor's and the IBCA. Access to international finance is evaluated by the country's ability to quickly access international capital markets.

An evaluation of the indicators mentioned is stated twice yearly also by Euromoney. According to this the creditworthiness of East European countries in March 1994 was recorded in the following ranking: the Czech Republic 40, Hungary 44, Slovakia 64, Slovenia 73, Poland 80 (the number represents the assigned ranking from a world-wide viewpoint). In March 1997 the ranking was follows: the Czech Republic 37, Slovenia 38, Hungary 46, Slovakia 53, Poland 62 and in December 1997: Slovenia 37, the Czech Republic 44, Hungary 45, Poland 48 and Slovakia 61.

On the basis of the stated data from specific countries Slovakia has registered a definite declining trend in its assessment. Poland and Slovenia on the contrary have reported significant improvements and the Czech Republic and Hungary just partial improvements in their assessments.

The level of FDI inflow into individual sectors is in terms of their structure relatively stable as documented by the figures in Table no. 2. Approximately 50% of FDI goes into industrial production and the other half into services. It is also necessary to mention the low inflow of FDI into the fields of tourism, transport and communications.

Regional structure of foreign direct investment

Influences which result from FDI are always dependent on the type of investment and socio-economic conditions in the host and domestic country. We can observe three types of FDI:

- market oriented,

Table No. 3: Foreign direct investment balance as at 30. 6. 2000 – grouping by investor's country

Exchange rate used SKK/USD 45.416	mill. SKK	mill. USD	%
Total FDI balance	97 363	2 143.8	100
Germany	21 524	473.9	22.1
Austria	19 757	435.0	20.3
Holland	14 451	318.2	14.8
USA	11 982	263.8	12.3
Czech Republic	8 017	176.5	8.2
Great Britain	5 819	1281	6.0
France	3 874	85.3	4.0
Italy	2 079	45.8	2.1
Hungary	1 382	30.4	1.4
Cyprus	1 299	28.6	1.3
Other countries	7 179	158.1	7.4

- expense oriented,
- raw materials oriented.

Market oriented FDI can be differentiated on the basis of its target market. Exports from the host country maybe directed either to the parent country or a third country. In the case of market oriented FDI the essential reason is the size of the market from which the investor directly profits. The larger the market, the longer-term is the certainty of sales and vice versa. Market orientation is usually combined with expense orientation, since transport and production expenses have a fundamental influence on the economic efficiency of an FDI operation in a given field. In this way a certain role is also played by markets structure. Market oriented FDI comprises an own as well as export motivation. FDI investments with this focus produce goods with the aim of their sales export abroad. These investments are not directed at one market, but use a whole range of sales options. In implementing FDI of this nature low expenses play a fundamental role - as the main comparative advantage, where in Slovakia's case it is primarily low wage levels that prevail. A further role in the framework of market oriented FDI can be comprised of such elements as: market presentation, consumer requirements, the image of the producing country, and to no small extent also its political economic stability.

In the case of expense oriented FDI expense motivations are often combined with other motivations. The level of wages is often combined with the level of work productivity achieved. In the case of production oriented FDI, there contribute also other requirements, as for example energy availability and its prices, production technology, environmental and trade union policies.

Raw materials oriented FDI is motivated by the acquisition of raw materials abroad for the parent country. A further important motive in this case is that in the framework of a firm's own production a greater certainty in the smoothness of supply is ensured than by means of ordinary foreign trade; as well as there being the further possibility for lowering expenses and to take advantage of various benefits in the host country.

In certain cases access to raw materials is otherwise not possible.

Host countries gain through the creation of joint or 100% owned foreign organisation the possibility to obtain modern technology, know-how, which they themselves would be unable to acquire from their own resources, they also gain jobs and in many cases also there follows also an improvement in the social conditions etc of the given area.

Slovakia as a host country, given its shortage of raw material supplies and small market is attractive for expense oriented FDI, where the country's low wages represent a significant incentive. Often this concerns a combination of FDI with export motivation, with Slovakia's strategic location and with the use of introduced traditional trading relations with surrounding central European countries.

In developed economies on the basis of long-term development of FDI, generalisations have been drawn from experience of its inflow into individual regions of a given country and its influence on specific regional development. The choice of a specific region for FDI may be random or selected in advance. From the regional aspect the following types of direct investment are recognised in economic literature: targeted, incidental and domestic.

In the framework of targeted FDI, this is directly intended for a specific region and the investor has not invested in the given area until this time. In the framework of incidental FDI the investor usually takes over a specific firm that is already in operation. The primary interest of the investor is the firm in question and not the specific region. Domestic investments represent an input and the establishment of a foreign firm having as its aim expansion in the market of the host country.

The theory of the regional distribution of FDI presumes that besides general location specific advantages there must exist for FDI specific regional advantages, which are more attractive for foreign investors than the others. It can generally be said that FDI selects less developed regions in the host country. They have several reasons for this:

• foreign investors need permission from the government of the host country for conducting business and this permission is in many cases conditional upon ensuring the development of the specific region in the country,

• foreign investors try to build an image of being good corporate citizens and precisely their choice of placing their business in a given region contributes to the firm's good name,

• in certain regions foreign businesses may be the only local employer which exerts an influence on the level of wage expenses,

• foreign investors concentrate mainly on industrial sectors, which are relatively independent in terms of their location, therefore they may direct that investment to the desired region.

Table No. 4: Foreign direct investment balance as at 30. 6. 2000 – grouping by region country

Exchange rate used SKK/USD 45.416	SKK mill.	USD mill.	%
Total FDI balance	97 363	2 143.8	100
Bratislava region	58 762	1 293.9	60.4
Trnava region	9 229	203.2	9.5
Trenčin region	5 935	130.7	6.1
Nitra region	3 716	81.8	3.8
Žilina region	2 912	64.1	3.0
Banská Bystrica region	4 361	96.0	4.5
Prešov region	3 324	73.2	3.4
Košice region	9 124	200.9	9.4

The host country may in this way greatly influence its regional development.

The Slovak Republic for the monitored period of FDI inflow has recorded in the regional field almost the opposite trends than those which we stated in the introductory part of the regional aspects in a host country. This divergent trend is a consequence of the fact that foreign capital is entering a country with an insufficiently built up complex infrastructure and from that point of view of a foreign investors, having insufficiently appropriate industrial structure.

The extent of foreign capital distribution in Slovakia is very imbalanced in terms of the country's regions. Approximately 60% is concentrated in the Bratislava region.

The redirecting of FDI into the more outlying regions could bring a differentiation of tax, financial and other combined benefits from the regional aspect, on the basis of areas of interests resulting from the societal needs of the economy. The inflow of large foreign investments has especial significance for regional development as these in many cases induce further investments in the host country, which are created by domestic businesses in the region. In this case this concerns so-called multiplier effects with a significant influence on regional development. As regards a greater inflow of large foreign investments it is necessary to add that these require more demanding conditions and guarantees than small and medium-sized businesses. Large foreign organisations always have the character of a strategic interest and are located in those regions that enable their long term and efficient functioning. From the macro-economic point of view this concerns the creation of a favourable economic climate in combination with political and social stability. Other conditions – besides the mentioned demands for a complex infrastructure – are also the supply of a qualified (relatively cheap) workforce and the ability of the domestic market to absorb a part of the production. Another significant factor for large foreign investments is also that legislative regulation is of a long-term nature. For the time being this condition is not sufficiently reliable in Slovakia's case.

Conclusion

It may be stated that the scope of foreign investments in Slovakia does not currently fulfil expectations, not only in the country's business sector, but also in economic-political bodies. Slovakia needs to create a highly competitive investment climate in order to attract FDI of the type that it could and should wish for. Since the domestic market is small, Slovakia must remain an export oriented economy. In accordance with this it must attract also export oriented investors. In this field Slovakia faces tough competition. The countries competing with Slovakia – the Czech Republic and Hungary are considered as the best places for investment among the transforming economies. Poland provides a large domestic market and similarly is considered as a good place for creating export bases.

On the other hand also the small amount of FDI that has so far entered the Slovak economy has been primarily in the production sector, and may be evaluated positively relative to previous experience. This is clearly true for Slovak businesses that have chosen their foreign partner following a thorough search. In these cases a significant shift towards improving the efficiency of production in question has occurred.

Sources used:

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