

NATIONAL BANK OF SLOVAKIA

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**IMPACT OF FOREIGN
DIRECT INVESTMENT
ON THE ECONOMY
OF SLOVAKIA**

**National Bank of Slovakia
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IMPACT OF FOREIGN DIRECT INVESTMENT ON THE ECONOMY OF SLOVAKIA

According to the latest results, the inflow of foreign direct investment (FDI) to Slovakia has started to gain importance. It is therefore important to understand the impact of FDI on the economy of Slovakia, primarily on the real sector, banking, third sector, etc.

This study aims to depict the impact of FDI on selected production areas, i.e. employment, labour productivity, know-how, partnership between FDI and domestic industry, and regional distribution of FDI. The final positives (and/or negatives) boil down to the impact on the balance of trade and payments of the SR, as a result of the capitalisation of pro-export oriented organisations, which sell their output (because of the small size of the Slovak market) in foreign countries, by means of FDI.

The study presented is a summary of six years of research into the said subject, which is covered by six studies of the IMFS NBS (see References) that detail individual problem areas subject to this study.

Foreign Direct Investment

Foreign direct investment is a key form whereby foreign capital penetrates our economy. It is exactly this investment that should form a basis for upgrading production facilities, transfer of new technologies and know-how, and for the more effective integration of our economy into the international division of labour. This process results in direct investment becoming an immediate source for the production of convertible goods that sell very well in global markets, thus creating opportunities for the generation of foreign exchange funding. However, in terms of times scales, it is a process that takes longer than, for example, the inflow of foreign portfolio investment.

There are also some alternatives to foreign direct investment: borrowing capital, acquiring technology through various licensing agreements, purchasing management as well as expert knowledge, and/or their transfer on the basis of agreements. The main problem of such separate acquisition of individual resources is that it turns out to be much more expensive.

Foreign direct investment into production must initially pass through a start-up period during which these positive results do not yet show, and contrariwise, the opposite holds true: i.e. foreign exchange funds spent on purchasing modern technologies, know-how, licences, materials, semi-products and the like. When full-scale production is launched and especially when the profits generated are re-invested domestically, the positive effects of this process start to be seen. Apart from yielding products of good quality, foreign capital may also bring about the so-called multiplication effects due to the associated demand for capital expenditure.

Direct investment is understood as such disbursement of cash or other assets appreciable in cash (cash equivalents) or property rights, the purpose of which is to set up, acquire or expand the stable economic involvement by a resident investor in a business in a foreign country or by a non-resident investor in a business in Slovakia, namely in one of the following forms:

1. establishing or acquiring an exclusive interest in a business, including its expansion,
2. participating in a newly-established or existing business, where an investor owns or acquires at least a 10% interest in the share capital of a business corporation, or at least a 10% interest in its net owner's equity or 10% of voting rights,
3. an investor providing a financial loan for business purposes for a period of five or more years, where the investor participates in this business in accordance with clauses 1 or 2 above, or the loan is associated with an agreement on a share of profits to be distributed,
4. applying the proceeds from an existing direct investment to this investment¹.

In terms of time, the operation of an investment once it has entered into a particular country passes through different development stages. Several theories have been formed based on a longitudinal study of foreign direct investment. At the beginning of the eighties, J.H. Dunning, one of the most important theoreticians dealing with the subject mentioned, has elaborated the following theory or hypothesis (as reported by Pichl, C. 14).

In the first stage, the given country does not invest in other countries, since due to its low standard of development it is not able to make an effective use of its advantages via direct investment under a specific oligopoly competition. An active international co-operation will occur when the country employs exports. At the same time, foreign companies will start to make investments in the home country, initially just on a small scale, due to locally restricted specific conditions (a small market, workforce unsatisfactorily trained for industrial production, insufficient infrastructure, and the like.).

In the second stage, direct investment by foreign enterprises in the country in question gains significance. A high volume of output achieved, generating abundant supply to the local market, will start to act massively. The workforce in the recipient country gets acquainted with a high standard of labour productivity and manufacturing process, while the level of wages is still low. Direct investment is not as yet interconnected with the rest of the economy

¹ Foreign Exchange Act, NBS, 1995, § 2, clause k), p. 7

of the given country. As a result of imperfect local markets for information, goods and capital, transaction costs are usually high, and foreign direct investors therefore try to integrate a number of markets in which they perform business transactions. For the time being, a home country seldom makes foreign direct investment as yet, since domestic undertakings possess corporate advantages that can only be inappropriately utilised, and even if such investment exists, it only involves direct export investment into neighbouring countries with a similar standard of development.

In the third stage, a home country exhibits a noticeably higher proportion of foreign direct investment. Local companies have gained experience from operating in developed markets, relations with foreign companies (improved training of workforce, promotion of know-how and by this token, also promotion of specific corporate advantages), which helps them to penetrate foreign markets considerably. As a result of the level of wages rising (greater skills, higher labour productivity as a result of technology advancement, and so forth), differences between countries as to wages diminishes and the given country loses the advantages of having "cheap labour". The inflow of new foreign direct investment to the country is driven by new advantages: a high demand, the ability to develop technologies domestically, new modern infrastructure, etc. On the whole, the exported direct investment however still develops at a lower pace than the imported one, although they gradually come closer to each other. FDI gets interconnected with the local industry.

In the fourth stage, the given country finally becomes a significant direct investor in other countries.

What is referred to as **the fifth stage** of this process of development by Dunning is the development of international trade between industrial branches based on intra-industry division of labour in production itself. As a rule, decisions on where to locate corporate branches to be founded are less driven by the country's specific features, and the dynamic effect of the development of international division of labour is taken into account to a greater extent. On the other hand, imported direct investment begins to increase, but for reasons other than those which held true for the initial stages, for example, in order to make the product line more varied/diversify the assortment. Imported and exported investment converge.

Based on the results of our own research into the FDI issues, it is possible to note that the aforementioned breakdown of the development of FDI into stages is also applicable to Slovakia. The first, and partly also the second stage, passed relatively quickly in our country, i.e. approximately during the years 1990 – 1995, depending on the particular conditions in individual undertakings, but also depending upon the regional environment.

At the present time, we are approximately at the level of the second stage (of Dunning's scheme), but a certain portion of organisation with foreign capital participation already operates at the third stage. This means that resident organisations with foreign capital involvement are partnering with domestic industry and are establishing links between sectors and branches, with highly positive effects showing on the volume of production, regional

distribution, employment, and above all, foreign trade. The third stage will be very important and a transition to it will be more complex than reaching the first two stages. It is exactly in this stage where the most important preconditions for economic development are achieved, and, apart from FDI, the ability to develop technologies domestically in such branches or sectors for which we have the best conditions, should matter in this respect. Although the verification of the impact of FDI on the economy of Slovakia made so far has practically confirmed the validity of the first two stages under the Slovak conditions as well, this does not still mean that the hypothesis presented will show to hold true in our environment without any changes also in the future. Not every country must undergo such development, as it may also stagnate at a certain stage.

1. Foreign Direct Investment in Slovakia

1.1. Inflow of Foreign Direct Investment

Until the year 2000, the development of FDI flowing into Slovakia had an upward trend, but its volume and pace lagged far behind the needs of our economy, as well as in comparison with neighbouring countries undergoing restructuring.

Comparison of the inflow of FDI in 2000 and in the previous years clearly shows that its development has started to gain in intensity. Large investments into the telecommunications, petrochemical and metal working industries have materialised and this positive development can be expected to still continue in the near future. Privatisation of the gas industry and several large banks is in the pipeline, together with investments into individual industrial branches.

Table 1

Development of inflow of foreign direct investment (FDI) * in SKK million

Year	Position as at 1.1.	Net change	F/X rate differences	Position as at 31.12.	Position as at 31.12. in %**
1994	15 342	8 744	246	24 332	-
1995	24 332	7 683	1 035	33 050	135.8
1996	34 345	10 956	467	45 768	138.5
1997	50 781	6 867	-272	57 376	125.4
1998	57 376	17 783	1 879	77 038	134.3
1999	77 038	15 128	781	92 947	120.6
2000	92 947	91 795	-19 056	165 686	178.3

Source: NBS

1996 – a change in the methodology – inclusion of CZK among convertible currencies

1997 – a change in the methodology – inclusion of equity capital also in SKK

(in 1994 -1996 only in foreign currencies)

* FDI – equity interest, designation in this sense of the word applies to the whole document

** 100 % is always taken to be the previous year

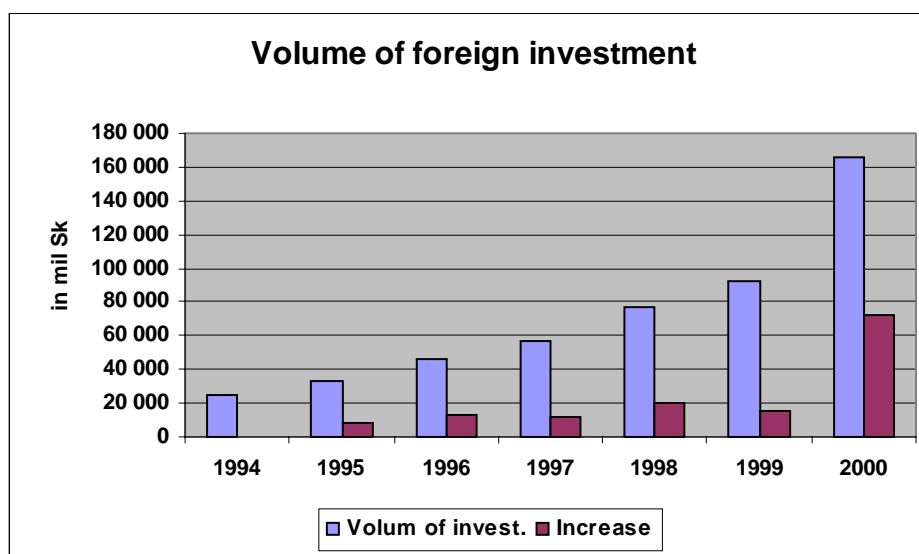


Figure 1

Also, the ways in which FDI enters Slovakia were significantly broadened. Whereas in previous years FDI used to flow into the country exclusively in the form of investment made directly into individual branches within the business sector, the form of entry via shares, which due to a variety of legislative obstacles was previously used in our country to a minimum extent, has now started to be significantly more actively utilised. Nowadays, after the eligibility criteria for entry of FDI into Slovakia have been liberalised, it has become clear that quite like comparable countries (where this form of FDI inflow accounts for as much as approx. 50 %), Slovakia will also gradually attain a standard level in the given area.

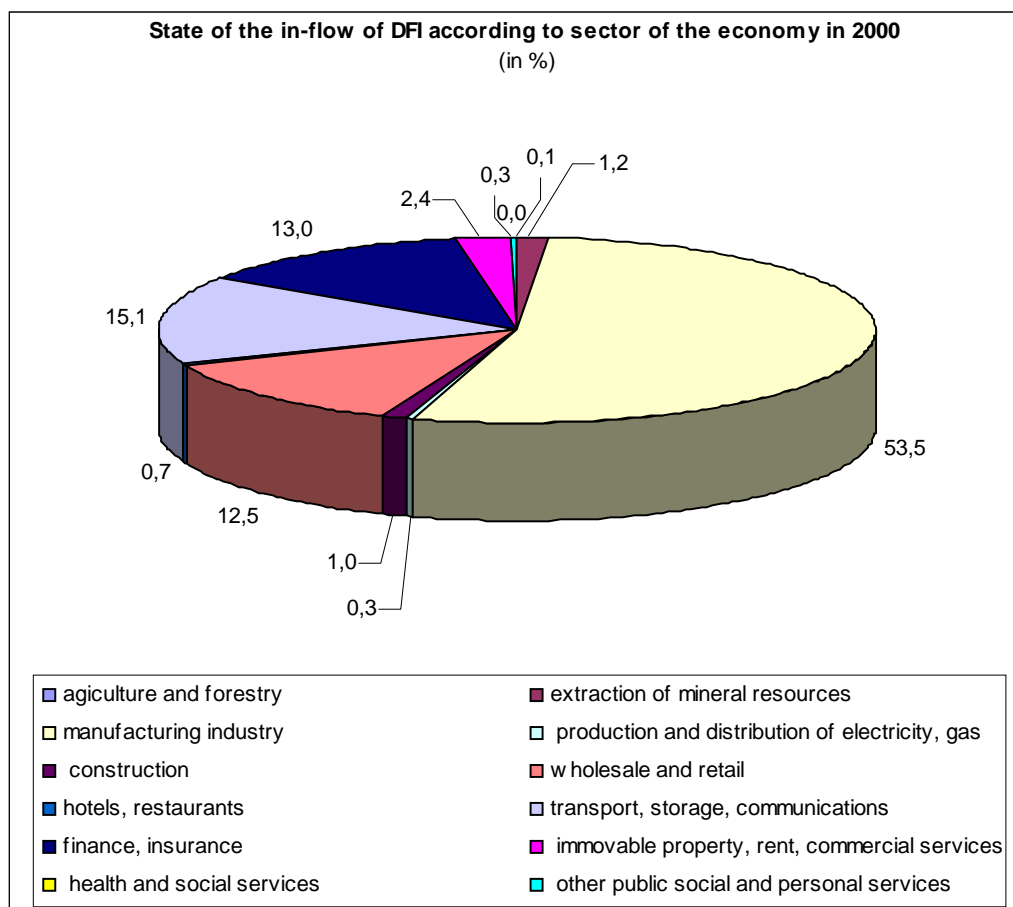
Table 2

Distribution of FDI by sectors as of 31.12.2000

Sector	Year 1998		Year 1999		Year 2000	
	SKK million	%	SKK million	%	SKK million	%
agriculture, forestry	3	0.0	146	0.2	145	0.1
extraction of raw materials	910	1.2	1 042	1.1	1 939	1.2
industrial production	38 159	49.5	46 034	49.5	88 597	53.5
electricity and gas production and distribution	429	0.6	426	0.5	434	0.3
construction	1 589	2.1	1 788	1.9	1 658	1.0
wholesale and retail trade	13 111	17.0	17 466	18.8	20 632	12.5
hotels and restaurants	667	0.9	1 059	1.1	1 125	0.7
transport, warehousing and communications	2 431	3.2	2 854	3.1	25 057	15.1
banking and insurance industry	16 816	21.8	17 775	19.1	21 562	13.0
real estate, leasing and trade services	2 531	3.3	3 822	4.1	3 964	2.4
health care and social welfare	19	0.0	18	0.0	68	0.0
other public, social and personal services	373	0.5	517	0.6	505	0.3
Total	77 038	100.0	92 947	100.0	165 686	100.0

Source: NBS

Figure 2



Whilst in 1998 and 1999 a relatively balanced development was recorded, in 2000 the shares of individual sectors were shifted. Privatisation of telecommunications most markedly impacted upon the item transport, warehousing and communications, increasing its share from approx. 3% to 15.1%, due to which the shares of wholesale and retail trade and banking sectors were reduced. Other items have been developing without any big fluctuations.

In the forthcoming period, major changes can be expected in the banking and insurance sectors and in the production and distribution of electricity and gas.

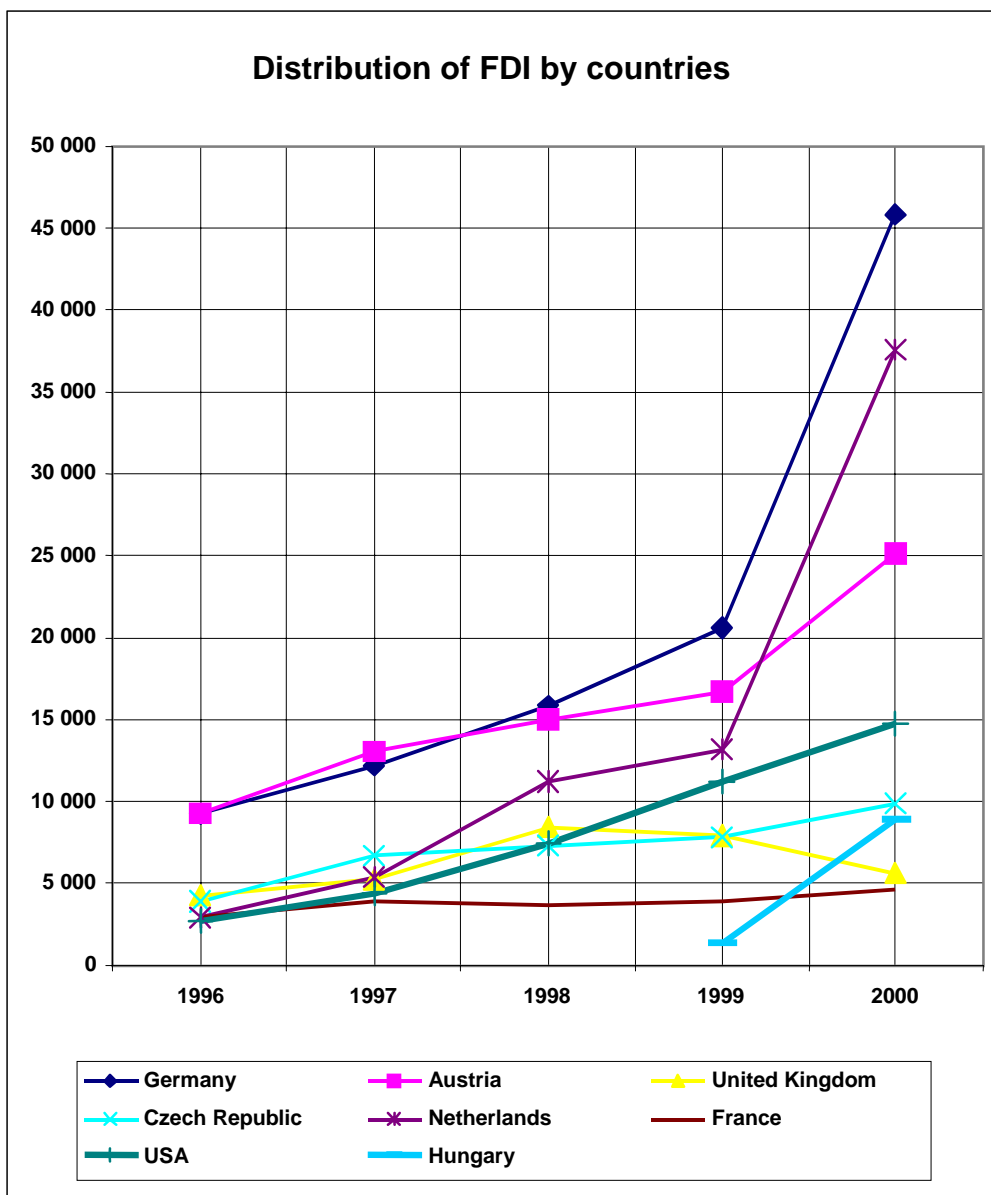
Table 3

Distribution of FDI by countries in SKK million

	1996	1997	1998	1999	2000
Germany	9 300	12 146	15 840	20 639	45 821
Austria	9 243	13 039	15 027	16 741	25 088
United Kingdom	4 248	5 210	8 453	7 942	5 595
Czech Republic	3 865	6 737	7 288	7 789	9 853
Netherlands	2 925	5 333	11 188	13 143	37 554
France	2 916	3 952	3 681	3 960	4 600
USA	2 686	4 374	7 481	11 187	14 750
Hungary				1 373	8 900

Source: NBS

Figure 3



Over the long run, the distribution of FDI by countries has not exhibited any significant changes as to the order, but rather as to the share of the total FDI entered in Slovakia. Exemptions are represented by the Netherlands, which at the end of 2000 invested large volumes in Slovakia and likewise into Hungary.

Because of confidentiality of data, we are not able to conduct any in-depth analysis.

Table 4

Distribution by regions as of 31.12.2000

Branch	Year 1999		Year 2000	
	SKK million	%	SKK million	%
Bratislava region	55 777	60.0	91 820	55.4
Trnava region	8 482	9.1	9 457	5.7
Trenčín region	5 795	6.2	6 092	3.7
Nitriansky kraj	3 630	3.9	4 456	2.7
Žilina region	2 676	2.9	7 241	4.4
Banská Bystrica region	4 708	5.1	5 275	3.2
Prešov region	4 023	4.3	4 448	2.7
Košické region	7 856	8.5	36 897	22.3
Total	92 947	100.0	165 686	100.0

Source: NBS

Statistics on the distribution by eight regions has only been made over the last two years. In terms of volume, the Bratislava region has steadily achieved the largest share of investment, coupled by the Košice region in the year 2000. The volume of investment grew in other regions as well, but to a lesser extent. In 2000, the shares were also changed accordingly. These changes were caused by the already listed entries of FDI in the year 2000.

1.2. Outflow of Foreign Direct Investment

FDI flowing out of Slovakia has exhibited an uneven development and low values, which is a reflection of the lack of disposable funds on the part of our enterprises. No striking changes can be expected in the nearest period.

Table 5

Development of FDI outflow as of 31.12.2000 in SKK million

Year	Position as at 1. 1.	Net change	F/X rate differences	Position as at 31. 12.
1993	3 467	393	14	3 874
1994	3 874	567	-5	4 436
1995	4 436	-1 230	18	3 224
1996	3 285	1 733	30	5 048
1997	5 048	3 170	-817	7 401
1998	7 401	4 876	1 644	13 921
1999	13 921	-16 405	15 183	12 699
2000*	12 699	615	1 287	14 601

Source: NBS

1996 – a change in the methodology – inclusion of CZK among convertible currencies

1997 – a change in the methodology – inclusion of capital also in SKK (in 1993 – 1996 only capital in foreign currencies included)

* Data as of 31. 12. 2000

Table 6

Distribution of FDI outflow by sectors as of 31.12. of the respective year

Sector	Year 1998		Year 1999		Year 2000	
	SKK million	%	SKK million	%	SKK million	%
agriculture, forestry	2	0.0	166	1.3	20	0.1
fishing, pisciculture	0	0.0	0	0.0	2	0.0
extraction of minerals	719	5.2	983	7.7	1 125	7.7
industrial production	4 787	34.4	3 765	29.6	4 783	32.8
electricity and gas production and distribution	1 722	12.4	1 640	12.9	1 489	10.2
construction	40	0.3	44	0.3	576	3.9
wholesale and retail trade	1 643	11.8	1 210	9.5	1 339	9.2
hotels and restaurants	8	0.1	8	0.1	0	0.0
transport, warehousing and communications	163	1.2	163	1.3	163	1.1
banking and insurance industry	4 644	33.4	4 201	33.1	4 573	31.3
real estate, leasing and trade services	171	1.2	344	2.7	506	3.5
health care and welfare	21	0.2	22	0.2	25	0.2
other public, social and personal services	1	0.0	153	1.2	0	0.0
Total	13 921	100.0	12 699	100,0	14 601	100,0

Source: NBS

As to the outflow of FDI, no significant changes have occurred compared to the last year and no further developments can be expected in the near future either.

A more interesting development has been reported for applied forms of FDI outflow from Slovakia.

The most frequent form is represented by the classical export of goods to subsidiaries located abroad, or the provision of services abroad.

Gradually, most frequently in addition to trade organisations, also production or maintenance services are starting to be set up, but only on a small scale for the time being, which does, however have potential for future growth.

Purely Slovak companies (numbering 1787) carry on activities in foreign countries, with 44 of them exporting commodities from Slovakia to their subsidiary undertakings. Also, combined joint organisations have started to operate in markets in neighbouring countries. Table 6 indicates that FDI from Slovakia is being less and less channelled into trade activities and construction, and contrariwise, the highest share is held by industrial production and banking, which can be considered a positive development.

2. Impact on Balance of Trade and Payments

Impact of FDI on the trade balance and balance of payments is significant, considering the small market in Slovakia. Our calculations draw upon the statistical return DEV 1-12 NBS.

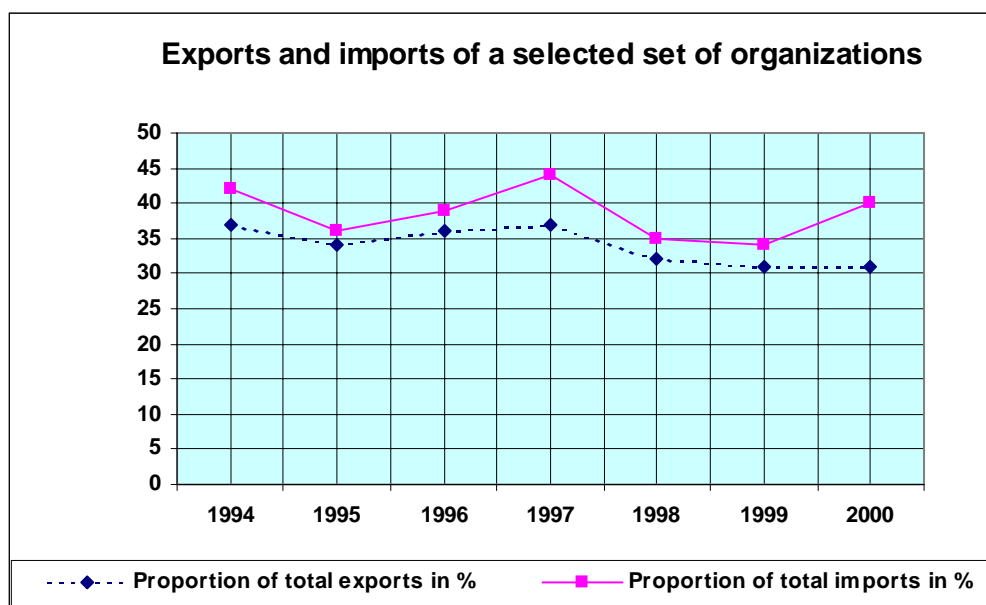
Table 7

Exports and imports for a selected population of organisations (SKK million)

Year	Join ventures				Total for Slovakia	
	Exports	Share of total exports in %	Imports	Share of total imports in %	Exports	Imports
1994	63 649	37	65 703	42	171 972	156 042
1995	85 564	34	89 953	36	254 099	252 311
1996	96 523	36	131 700	39	270 628	335 165
1997	108 229	37	152 821	44	295 574	345 049
1998	120 671	32	158 554	35	375 921	456 713
1999	131 933	31	157 440	34	422 344	468 031
2000	168 339	31	237 478	40	548 372	590 728

Source: NBS + Bulletin of the Statistics Office of the SR Bratislava

Figure 4



Compared to the previous year, imports by joint organisations have increased more markedly, with exports remaining at the original level.

This can be attributed to an increase in global oil prices and thus an increased volume of imports for the petrochemical industry on the one hand, and, on top of that, to a more significant increase in imports by large trade companies, which, apart from other goods, also

import machinery and raw materials for the Slovak industry, and to the third important imported article, which is parts for the automotive industry (excluding transfers).

The above mentioned clearly shows that the prevalence of imports is not due to activities conducted by foreign organisations established in Slovakia not being fairly effective.

As mentioned in an earlier study, there has been a new element introduced in our surveys of exports and imports by joint ventures, that being intra-company transactions between parent and subsidiary undertakings as expressed in quantitative terms (under the earlier methodology, it was not possible to separate out the imports and exports of transfer flows of materials to be processed), the exports of which amounted to SKK 170 219 million in 2000 and the imports of which amounted to SKK 176 679 million. The share of joint ventures in exports and imports has therefore changed for the SR, being 62% for exports and 70% for imports.

The results given above confirm our conclusions from the previous year, which is, that the best performing undertakings recruit from those that are either partly or wholly owned by foreign capital. In principle, this concerns several large undertakings that by and large influence the given results. When it comes to intracompany transactions, it is companies engaged in the automotive industry, electronics and telecommunications, chemical and metal working industries.

We shall obtain a more precise overview of the performance of joint organisations in Slovakia when subtracting trade organisations from the total volume of exports and imports by companies with FDI, thus getting the volume of exports and imports by such joint ventures that carry out production activities in our country and resell their products in global markets. This reflects the ability of joint ventures to meet one of their main goals (considering our small market), that is, pro-export orientation.

Netting of Trade Organisations

In this section we have taken out any foreign trade activities by trade organisations as reported under No. NACE 50 – trading in motor vehicles, No. 51 – wholesale trade and No. 52 – retail trade from exports and imports.

Table 8**Year 2000**

NACE	Trade organisation	Imports SKK million	Exports SKK million
50	Motor vehicles	4 667	311
51	Wholesale trade	53 728	2 743
52	Retail trade	3 006	310
	Total	61 401	3 364

Table 9**Total imports by undertakings with FDI**

Imports	Excluding intracompany transactions in SKK million	Including intracompany transactions in SKK million
year 2000	237 499	414 157
of which: trade organisations	61 401	61 401
difference excluding trade organisations	176 097	352 756

Table 10**Total exports by undertakings with FDI**

Exports	Excluding intracompany transactions in SKK million	Including intracompany transactions in SKK million
year 2000	168 339	338 558
of which: trade organisations	3 364	3 364
difference excluding trade organisations	164 975	335 194

Generalisation of Results:

- It is possible to state that in 2000, as in the preceding two years, trade organisations have influenced the balance of foreign trade exchange by joint ventures to a relatively significant extent, especially when it comes to imports. Contrary to imports, exports by joint ventures can be considered as positive, since they add to the assets, including all the associated advantages (employment, foreign exchange reserves, expanding markets, etceteras).
- Exports and imports by trade organisations concentrate on the group of goods No. 51 – wholesale trade.
 - a) The share of trade organisations in total imports by undertakings with FDI in 2000 amounts to (with this figure excluding intracompany transactions) 26% and the share of undertakings with FDI in total exports amounts to 2%. (Source data: Table 8 to go with the data from Table 7).
 - b) The proportion of imports by other undertakings with FDI (excluding trade organisations and intracompany transactions) to total imports by undertakings with FDI stands at 74%

and the proportion of their exports to total exports by undertakings with FDI stands at 98%. (Source data: Tables 9 and 10 to go with the data from Table 7).

- c) The proportion of imports by other undertakings with FDI (excluding trade organisations and intracompany transactions) to total imports for the SR stands at 29.8% and the proportion of their exports to total exports for the SR at 30.1% respectively. (Source data: Tables 9 and 10 to go with the data from Table 7).
- d) The proportion of imports by other undertakings with FDI (excluding trade organisations and including intracompany transactions) to total imports and exports for the SR is 59.7% for imports and 61.1% for exports. (Source data: Tables 9 and 10 to go with the data from Table 7).

The results set forth in c) and d) clearly indicate the impact trade organisations have on imports ratios. The netted data on foreign trade activities of undertakings with FDI yield balanced results with a mild predominance of exports, which is a positive trend.

3. Regional Aspects of FDI and Slovakia

In regional terms, FDI impact upon the country's economy on two levels:

- multinational
- national.

Distribution by supranational regions

Political and economic stability is considered as one of the most important criteria in discussions on driving forces for FDI into countries of Eastern Europe. Associated with it are also the questions of repatriation of profits, and/or capital invested. Another important incentive is the size of the market and legislative conditions for investment.

In 1993, a survey was conducted among potential investors from developed countries in order to determine the most important preconditions for investment in the region of Central Europe. Each respondent was to rate three factors by 3, 2, and 1, which yielded the following results:

Table 11

Determining factors for FDI in states of Eastern Europe

Rating	Factor	Number of points
1.	Political stability	115
2.	Relevant domestic market	71
3.	Financial stability	47
4.	Skilled labour	40
5.	Potential profitability	35
6.	Geographic location	33
7.	Competitive costs	28
8.	Currency convertibility	15
9.	Transport network / Infrastructure	10
10.	Legislation	6
11.	Potential export basis	5
12.	Favourable taxation system	2

Source: Stankowsky, J.: *Direktinvestitionen in Oseuropa*. Vienna, Bank Austria / WIFO 1996, pp. 26-27

The importance of political and economic stability and the size of the market has been confirmed also in this instance.

The next section outlines the development of ratings as published in Euromoney.

Assessment of countries of Eastern Europe by the Euromoney overall rating

Table 12

September 1994

Country	Overall position	Political risk	Economic performance	Debt	Credit rating	Availability of international financing	Total
Maximum rating	-	25	25	20	10	20	100.00
Czech Republic	40	17.5	16.0	19.5	3.9	9.4	66.2
Hungary	44	15.6	14.8	18.5	2.3	9.5	60.7
Slovakia	64	12.1	9.3	19.5	0.0	5.5	46.3
Slovenia	73	14.9	12.2	10.0	0.0	6.0	43.1
Poland	80	11.5	13.2	9.2	0.0	8.0	41.8

Source: *Euromoney*, 1994, No. 3

Table 13

March 1999

Country	Overall position	Political risk	Economic performance	Debt	Credit rating	Availability of international financing	Total
Maximum rating	-	25	25	20	10	20	100.00
Slovenia	32	16.62	12.07	19.94	6.46	14.97	70.06
Hungary	39	17.39	10.74	19.51	5.00	13.10	65.74
Poland	42	15.99	10.54	19.56	4.79	11.19	62.07
Czech Republic	43	16.58	9.97	19.65	5.83	9.93	61.96
Slovakia	66	10.91	8.51	19.54	3.75	5.62	48.33

Source: *Euromoney*, March 1999

Table 14

March 2000

Country	Overall position	Political risk	Economic performance	Debt	Credit rating	Availability of international financing	Total
Maximum rating	-	25	25	20	10	20	100.00
Slovenia	33	16.76	12.10	20.00	6.67	15.76	71.29
Hungary	39	16.58	10.45	18.48	5.63	10.71	61.85
Poland	42	16.37	9.84	19.38	5.42	10.66	61.67
Czech Republic	45	16.80	8.90	19.03	5.83	9.63	60.19
Slovakia	64	11.80	7.33	18.95	3.75	6.61	48.44

Source: Euromoney, March 2000

Table 15

March 2001

Country	Overall position	Political risk	Economic performance	Debt	Credit rating	Availability of international financing	Total
Maximum rating	-	25	25	20	10	20	100.00
Hungary	32	18.45	11.76	18.95	6.67	16.26	72.07
Slovenia	33	17.72	13.73	19.73	7.71	12.94	71.83
Czech Republic	41	17.58	10.78	19.43	6.46	9.96	64.20
Poland	45	17.50	10.97	19.26	6.25	9.42	63.40
Slovakia	53	13.73	9.88	19.29	4.38	9.63	56.90

Source: Euromoney, March 2001

On individual criteria:²

- Political risk – is defined as the risk of a failure to pay for services, loans, dividends or prevention of capital repatriation; it does not reflect the credibility of individual business partners in the country.
- Economic performance – takes into account economic growth, currency stability, development of the current account of the balance of payments, public finances and unemployment rate.
- Debt – the rating obtained reflects the assessment of the country with regard to the ratio of debt service to exports, the current account balance to GDP and the ratio of foreign debt to GDP; the rescheduling of the country's foreign debt is also taken into account.
- Credit rating – an average of the country's rating as assessed by Moody's, Standard & Poor's and IBCA.

² BRUCHÁČOVÁ, A.: Porovnanie hospodárskeho a menového vývoja v SR, ČR, Maďarsku, Poľsku a Slovinsku. Štúdiá IMFŠ NBS. (Comparison of Economic and Monetary Development in the SR, CR, Hungary, Poland and Slovenia. A study by IMFS NBS). 1995, pp. 5-6

- Availability of international financing – reflects the ability of the country to quickly access international capital markets.

The data given in Tables 12-15, which covers a time span of more than five years, evidence the shifts between individual countries assessed in different directions.

Whilst other countries recorded a relatively steady growth, from 1994 onwards, Slovakia (ranking third among the countries compared at that time) gradually started to lose its position and in 1997 it took the last – fifth position, with a negative gap from other countries steadily growing over the following years. Only in the second half of 2000 did the situation start to improve for Slovakia, but still we lag behind comparable countries.

In the period 1994-2000, the greatest progress was made by Slovenia, which shifted by 40 points, and kept the first position among the countries compared all along. Only in the latest March rating (2001) did it drop to the second position. Highly positive results in the said period were recorded by Poland, which made an advance of 35 points until today. However, other countries too have improved their position, but starting from March 1999, the position of the Czech Republic and Slovakia started to degrade. A mild decline occurred in the case of the Czech Republic and, in March 2001, there was a mild rise for the Czech Republic and a more substantial rise for Slovakia, which was also signalled by improved ratings by all reputed rating agencies at the end of 2000.

Political risk, which **together with economic performance** are believed to be the principal eligibility criteria for entry by foreign investors into a country, have also been changing since 1994. The rating increased more significantly in the cases of Slovenia and Poland (1997 and 1998) and more mildly in the case of Hungary. A mild decline was recorded for the Czech Republic. Slovakia attained a mild rise in 1997 and 1998; nevertheless, at the beginning of 1999 it recorded a rather sharp decline. This tendency for Slovakia was discontinued in March 2000, when a mild rise concurrently occurred for the political risk. As for economic performance, the Czech Republic and Slovakia continue in the negative trend, with a decrease in ratings for both of the countries being less than one point.

The positive trend continued in March 2001, when the political risk rating improved significantly for all the countries, with Slovakia still ranking last, but having improved its

rating by almost 2 points. The same applies to the economic performance indicator, on which all the countries did better, with Slovakia advancing by 2.55 points. Performance on all the other indicators has been improving, in particular for Slovakia, with the rating on availability of international financing rising by 3.02 points over the previous year.

Conclusions for Slovakia

The results have confirmed a potential dependency between the level of FDI flowing into Slovakia and Slovakia's rating by eminent rating institutions and, following that, also the wait-and-see tactics pursued by major Western investors. It is above all large investors who need sufficient certainty, whether in political or economic terms, in order to get rooted in the economy for a long term.

Quite naturally, the said eligibility criteria also matter to smaller companies, but for all that, the issue of long term investment is not so predominant to them and therefore they are more interested in various motivation schemes in the country. The results for March 2001 also indicate a one-off revival in the inflow of FDI in Slovakia.

International comparison of inflow of FDI to selected countries

Table 16

Annual inflow of FDI to selected countries in USD million

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	654	869	2 562	1 428	1 300	2 720	5 108	4 000
Hungary	2 339	1 147	4 453	2 275	2 173	2 036	1 944	1 800
Poland	1 715	1 875	3 659	4 498	4 908	6 365	7 270	9 000
Slovakia	168	250	202	330	177	566	356	1 300
Slovenia	113	128	177	194	375	248	181	100

Source: G. Hunya, J. Stankowsky: *WIIW– WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

**= all the data have been converted on an annual basis at the exchange rate at the end of the period, otherwise an average rate is used. This applies to any tables taken from materials of WIIW, Vienna

Table 17

Situation with regard to the inflow of FDI to selected countries in USD million

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	3 423	4 547	7 350	8 572	9 234	14 375	16 246	18 000
Hungary	5 585	7 095	11 926	14 958	16 086	18 517	19 276	19 000
Poland	2 307	3 789	7 843	11 463	14 587	22 479	26 075	32 000
Slovakia	-	897	1 268	2 000	2 025	2 787	2 817	3 700
Slovenia	-	1 326	1 763	2 063	2 448	2 904	2 684	3 000

Source: G. Hunya, J. Stankowsky: *WIIW – WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

Although when judged by its yearly inflow of FDI as compared to the preceding period, Slovakia starts to come closer to the countries dominating the arena so far, of whom Hungary is currently closest to us, in terms of the up-to-date cumulative balance we are still at the periphery of the ranking subject to assessment.

The performance with regard to relative figures is a bit better, especially when it comes to the inflow for the year 2000, in which case we reached the average level, but not yet in terms of cumulative inflow:

Table 18

Per capita yearly inflow of FDI in selected countries in USD

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	63	84	248	138	126	264	497	389
Hungary	228	112	438	224	214	202	194	180
Poland	45	49	95	116	127	165	188	233
Slovakia	31	47	38	61	33	105	66	241
Slovenia	57	64	89	97	189	125	91	50

Source: G. Hunya, J. Stankowsky: *WIIW – WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

Table 19

Situation as to the per capita inflow of FDI in selected countries in USD

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	331	440	711	831	896	1 396	1 580	1 752
Hungary	543	692	1 168	1 470	1 587	1 835	1 919	1 900
Poland	60	98	203	297	377	581	675	828
Slovakia	.	168	236	372	376	517	522	686
Slovenia	479	667	887	1 036	1 232	1 464	1 352	1 507

Source: G. Hunya, J. Stankowsky: *WIIW – WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

We are also approximating the ratio of FDI to GDP, where we have already approached the level of Poland, but when compared with Hungary and the Czech Republic, the given ratios are still about half the value.

Table 20

Ratio of the inflow of FDI to GDP in selected countries in %

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	9.8	11.1	14.1	14.8	17.5	25.8	30.7	35.4
Hungary	14.5	17.1	26.7	33.1	35.2	39.4	40.0	40.3
Poland	2.7	4.1	6.2	8.0	10.1	14.2	16.8	19.9
Slovakia	-	6.2	6.9	10.1	9.9	13.1	14.3	19.2
Slovenia	7.5	9.2	9.4	10.9	13.4	14.8	13.4	16.1

Source: G. Hunya, J. Stankowsky: *WIIW – WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

What is interesting are the ratios of FDI to total investment in selected countries, where we have advanced by 13.5% over the previous period, which indicates that the accelerating inflow of FDI significantly enhances investment opportunities for the economy of the SR.

Table 21

% share of FDI in total investment of selected countries for the current year

Country	1993	1994	1995	1996	1997	1998	1999	2000*
Czech Republic	6.6	7.4	15.4	7.7	8.0	17.3	36.0	29.7
Hungary	32.1	13.7	49.7	23.5	21.4	18.3	17.1	17.5
Poland	12.6	12.5	15.5	15.1	14.5	16.0	18.4	24.1
Slovakia	4.3	6.1	4.2	4.9	2.4	7.0	5.9	19.4
Slovenia	4.7	4.4	4.4	4.6	8.8	5.2	3.4	2.2

Source: G. Hunya, J. Stankowsky: *WIIW – WIFO Databaza. Foreign Direct Investment in Central and East European Countries and the Former Soviet Union, WIIW - WIFO, Vienna. February 2001*

*= IV. quarter is an estimate

Strategy of Foreign Investors in Making Decisions on Investing in the Economy of a Respective Country

The numeric data from the overview of the inflow of FDI to selected countries of Central Europe unambiguously shows different volumes, which causes some countries from the same region to be attractive and others substantially less attractive for foreign investors.

The paper by J. Stankowsky³ very aptly summarises the main criteria according to which foreign investors decide on whether to invest their resources in the countries of Central and Eastern Europe.

There were several reasons behind the hitherto relatively low attractiveness of eastern states as international location for production, with the most important ones including: low rate of return on projects and unsatisfactory economic, political and legal framework conditions in host countries.

Low wages are frequently referred to as a comparative advantage of these countries, which could become a determining factor for FDI. To a foreign partner, the overall cost of production, as compared to the cost of production in the mother country or third countries, is decisive. In this context, it is the productivity of labour, cost of production, disposability of capital and infrastructure in the host country that are of principal importance.

³ STANKOWSKY, J.: *Direktinvestitionen in den MOEL: Standortattraktivität für ausländische Investoren*, WIFO, Vienna, 1998

Nevertheless, in many cases it is the calculated risk premium is decisive. It is important for an investor to feel secure about his investment, as well as to be able to expect his investment not to deteriorate. Surveys among western investors have shown that political and financial certainty in making decisions on investments in East Europe is the most important factor.

Economic and political risks in transition countries are rated to be higher than the risks in developed industrial economies. A high risk exposure represents an important barrier to investment. Estimated country risk is influenced by the progress made in transformation, and its quality and speed, which is reflected in many international ratings of these countries.

An estimated risk for a transition country may be reduced due to the admission of this country into the EU.

Support of FDI by means of different government measures is a somewhat controversial issue.

Theoretically it is frequently believed that FDI does not need to be given any special advantages, but that all business undertakings, including local ones, should be subjected to the same conditions. Different surveys have found that when making decisions on investments, Western investors ascribe only a relatively small importance to investment promotion measures.

As viewed by Western investors, barriers to East European countries reaching out to Western markets almost exclusively rest in administrative barriers to trade. In some instances, anti-dumping measures of the EU may potentially turn out to act as another obstacle.

Another barrier to access to Western markets, which will not be easy to remove in the short run, is the poor image of Eastern goods, which is still leftover from the planned economy era (with so-called cheap goods).

Nevertheless, such barriers can be gradually removed by interconnecting the production in these countries with multinational production organisations. Making East-European parts and components anonymous is therefore the simplest way for doing away with this problem, although this does not present a final solution, since it could mean that those countries place

themselves in a second-rate position. Assistance from a parent concern to a domestic producer by building up nationally affiliated products in host countries is less frequent, although possible (e.g. Škoda).

On the other hand, the existing barriers to trade in the countries of Central and East Europe do matter to Western investors.

This adverse situation will be alleviated by gradual elimination of causes, i.e. through the build-up of modern telecommunications, and interconnecting the road, and highway networks particularly, but also railway, aviation and water transport with international transit systems.

The target of redirecting foreign direct investment to more remote regions should be achieved through differentiation of a combination of concessions (taxation, financial and others) across regional lines on the basis of interest areas delineated by society-wide economic needs.

Incentives adopted in Slovakia in 1999 produced a considerable enhancement compared to the previous period, but also conditions of this kind comparable to the countries of Central Europe. One also has to bear in mind a current amendment that is pending approval by the parliament.

Of special importance for regional development is the input of large-scale foreign investments that in many instances induce other investments in the host country in local undertakings that in the majority of cases would by themselves not be able to set up international partnerships. In this case, so-called multiplication effects with a distinct impact on the regional development are involved.

It needs to be added, however, that in order for large investments to enter the country on a larger scale, more exacting eligibility criteria and guarantees will be required than in the case of small and medium-sized businesses. Large foreign organisations always have strategic interests and establish themselves in such localities that enable them to get rooted there effectively for a longer period. In the macroeconomic area, this in particular involves the creation of a favourable economic climate in combination with political and social stability. As far as other eligibility criteria go, in addition to the aforementioned demands for an

extensive infrastructure, they also include a supply of skilled (relatively cheap) labour, the ability of the domestic market to absorb a certain portion of the output, currency stability, a tolerable rate of foreign debt and a rate of inflation that is not high.

What also matters to large foreign organisations, although not as an overriding concern, is the long-term applicability of legislative and fiscal regulations, which would ensure that any calculations and considerations concerning the entry of foreign capital into our economy hold true for a longer period. In our country this principle is not as yet sufficiently effective because of frequent changes, especially in legislation.

We had the opportunity to practically validate the relevance of such a statement in organisations we visited last year. Large and medium-sized organisations induce effective follow-up co-operation with resident medium-sized and smaller companies. The impact of such partnership between FDI and the local industry is discussed in a separate section.

Distribution of FDI by National Regions

From its very beginning, the entry of FDI in Slovakia has been marked by unevenness in terms of regional distribution. Approximately 60% percent of FDI is concentrated in the vicinity of Bratislava and in some major centres, such as Košice, Banská Bystrica, Trnava and Trenčín, with the rest of it scattered in small volumes throughout the whole Slovakia. It is possible to say that the statement "the further away from an industrial centre, the less foreign investment there is" still holds true.

Reasons for such state of affairs are primarily the following:

- ✓ Concentration of FDI in major centres is driven by a good standard of transport and communications infrastructure (especially access to highways and the airport), sufficient number of skilled labour, connection to an administrative and governance centre, and so forth.
- ✓ Regions that do not possess such advantages or, if so, then only to a small extent, continue to be barely noticed. In comparison to major industrial centres, such regions also have fewer traditional business and production relations established in the past and less experience from co-operation with foreign investors who should establish a basis for deeper international co-operation.

- ✓ Recently this shortcoming has started to be removed through the establishment of internal co-operation between large joint ventures and local industry, i.e. medium-sized and smaller Slovak businesses. This issue is covered in greater detail in a separate section of this study. This co-operation has special importance for the regional development of smaller businesses in more marginal areas that without such co-operation would probably not find any opportunities for co-operation with foreign countries. The given case involves multiplication effects, with a distinct impact on regional development.

4. Impact of FDI on Employment, Labour Productivity and Know-How

The most important sources for the acceleration of economic growth include an increase in the productivity of labour and GDP development. That is why it is highly relevant whether the impact of FDI entering the Slovak economy induces a greater pace of growth than do local partners, whether they manage to better translate the favourable developments in the decisive external economic environment into growing performance and, in connection with that, also into increases or maintenance of employment.

On the basis of consultations we had in undertakings visited we can without any doubt, **from the perspective of a host country**, make the observation that there has been a clearly positive impact on employment in Slovakia as well as on the overall standard of work and workforce.

In every company visited it was noted that without a foreign partner joining them it would not be possible, because of the shortage of domestic capital resources, to upgrade the production and assortment, due to which the original production would stagnate, decline, or even cease. On these grounds it is possible to draw a conclusion that had it not been for the foreign capital involvement, the employment in respective companies would be substantially reduced, or vanished completely. Based on that it is evident that FDI has a vast impact on retaining employment. On the other hand, it may not necessarily increase it, since when conceived from a broader perspective, employment in the given companies (notably in joint ventures) is generated through modernisation, expansion of production and enhancement of the quality of products that ensures consistent sales and cost effectiveness. The above mentioned positive developments do not always have to automatically lead to increased employment, since there are also such factors as increasing productivity of labour, better organisation, etc. coming into play.

Other positive impacts of FDI on the workforce relate to enhanced skills. Foreign partners frequently make it possible for their employees to be trained in the parent company, and run examinations and reviews at regular intervals. In joint ventures, the attitude towards work and working discipline has considerably changed. Also, the so-called "multiplication effects" have been recorded in co-operation with other companies, with the parent organisation also having influence on workers of subcontractor firms so as to make them improve their skills and overall organisation of work.

Hand in hand with the aforementioned, an increase in wages in joint ventures or companies wholly owned by foreign investors has also been observed.

In the recent period, a deepening impact of the partnership between companies with FDI participation or 100% ownership and internal industry in Slovakia has been observed. This factor generates multiplication effects in many respects, one of the most important being the two forms of employment: direct and indirect ones. (The issue of partnering between FDI and the local industry is covered in a separate section.)

Based on the above mentioned, a certain differentiation of income of the population can gradually evolve also in Slovakia. On the one hand there will be employees of joint ventures who, due to superior management, pressures towards education, higher productivity of labour and discipline, will be remunerated more generously. On the other hand, there will be a strata of population employed in some local companies and not enjoying such benefits, which could potentially invoke a certain tension.

As viewed from the perspective of the parent country, Slovakia, by reason of its so far small export of capital to foreign countries, does not pose any threat to employment in these countries – since it is prevailing trade organisations that are established there. On the contrary, this can have a positive impact in reviving exports and thus promoting employment to a certain extent on the one hand, and, when it comes to capital exported by Slovakia for production purposes, the primary focus at present is on the construction business which, in Slovakia today, has constrained potential for development compared to the previous period - so in a certain respect, from the point of view of employment, this can be perceived rather as a positive than not.

Table 22

Inflow of FDI to Slovakia and unemployment rate by regions

Region	Year 1999		Year 2000	
	FDI inflow %	Unemployment rate %	FDI inflow %	Unemployment rate %
SR in total	100	19.2	100	17.9
of which region:				
Bratislava	60.0	7.2	55.4	6.4
Trnava	9.1	16.3	5.7	14.9
Trenčín	6.2	13.5	3.7	12.7
Nitra	3.9	21.5	2.7	21.7
Žilina	2.9	17.7	4.4	16.8
Banská Bystrica	5.1	23.1	3.2	21.8
Prešov	4.3	26.0	2.4	22.1
Košice	8.5	26.0	22.3	24.4

Source : *Bulletin of the SO SR – 1999 and 2000, No. 12, NBS*

When matching the level of unemployment with the distribution of foreign capital, a certain relationship can be established. Although the level of unemployment is influenced by a multitude of factors, it is possible to assume a positive effect of the entry of foreign investors on the regional demand for labour. In this sense, foreign investment may contribute towards the reduction of unemployment in hosting districts, as well as the economic equalisation of the regions in questions.

All the above said has of course to be seen in a broader context, since employment in companies concerned (and above all, in joint ventures) is generated through modernisation, expansion of production and improved quality of products, which in turn ensures consistent sales and cost effectiveness. The above mentioned positive developments do not always have to automatically lead to increased employment, since there are also such factors as increasing productivity of labour, better organisation, etc. coming into play.

Quite obviously, were it not for the entry FDI, it would not be possible to sustain employment at the original level and in no case would it be possible, in particular cases, to consider any increases in staffing over the current status.

This means that whilst the magnitude of impact of FDI upon an unemployment rate can only be determined indirectly or partially, the impact on the level of labour productivity can be established without any doubt.

Table 23

Employees and labour productivity in Slovakia, the year 2000

NACE	Number of companies	Labour productivity in SKK	Index MR = 100 %
4 Manufacturing industry	2 285	1 609 397	115,2
401 Food production	379	1 718 303	106,6
402 Textile and clothing production	246	365 496	100,3
403 Leather working	90	482 335	118,3
404 Wood working	134	805 636	123,0
405 Production of paper, printing	132	2 013 705	112,0
406 Production of oil products	4	805 636	120,7
407 Production of chemicals	59	2 171 107	115,1
408 Rubber products	101	1 663 740	114,9
409 Production of non-metallic products	127	1 213 092	107,0
410 Production of metallic products	357	1 872 476	105,4
411 Production of machinery and equipment	303	842 467	124,1
412 Production of el. and optical devices	206	1 009 765	107,2
413 Production of means of transportation	71	4 236 342	134,1

Source: SO SR – Selected Indicators for Industrial Branches, December 2000

The table above gives labour productivity indices in SKK/employee/year 2000 in individual branches of the manufacturing industry. Since we do not possess the data concerning the productivity of labour in specific local companies, for the sake of comparison with the level achieved by joint ventures, we can use the average data for the branches in question.

Concrete examples:***Henkel Slovensko, s.r.o.***

The productivity of labour achieved there per employee stands at SKK 10.0 million, whilst an average for chemical production is SKK 2.1 million/employee (including the company subject to comparison). Henkel has been reporting one of the highest levels of labour productivity in Slovakia over the long term. In terms of the product line, its operations are relatively simple and highly automated (with annual sales of SKK 1.5 billion and 150 employees in 1999).

Volkswagen Slovakia, a.s.

The productivity of labour achieved there for the years 1999 and 2000 was 9.6 million and 11.4 million SKK/employee respectively. The figure reported for branch 413, the production of means of transportation, which is 4.2 million SKK/employee, is in no case adequately comparable, since we do not have a similar production facility in Slovakia in the entire 413 branch.

According to the data provided by specialists from Volkswagen not only has the Bratislava organisation achieved the level of productivity of labour reported for the whole concern, but it has also exceeded it in certain respects.

Siemens AG

The productivity of labour there averages 2.2 million SKK/employee. The product line consists of electric and partly also metal products, with the productivity of labour achieved for the electric section being 1.0 million SKK/employee and that achieved for the metal section being 1.9 million SKK/employee.

RAJO, a.s.

The company has reached a high standard of labour productivity – 9.2 million SKK per employee, which was just 5-6 million SKK/employee three years back and has been growing at a rapid pace in the new company. The productivity of labour in the parent Austrian firm stood at 10 million SKK/employee (upon conversion), and the Bratislava firm would like to achieve this level in the near future. The productivity of labour in comparable local (Slovak) companies amounts to 2-3 million SKK/employee.

Coca Cola Beverages Slovakia

The productivity of labour there stood at 2.9 million SKK/employee in 2000. The productivity of labour as reported for the food industry in Slovakia averaged 1.7 million SKK/employee in 2000. However, the figure does not tell much because of a great variety of product lines.

All the examples given confirm that in such companies there is a higher and sometimes even very high standard of labour productivity by Slovak standards. We have not yet studied the given issue from a broader perspective, nevertheless in all the cases mentioned FDI was confirmed to have significantly intensified production.

Table 24

Comparison of productivity of labour (GDP/employee) in the countries of Central Europe (sample)

Country	'000 ECU ^{a)}				Level in CR =100 %			Level in Austria = 100 %		
	1991	1998	1999 ^{b)}	Pace of growth 1990/1999 in %	1990	1998	1999 ^{b)}	1990	1998	1999 ^{b)}
Czech Republic	19.6	25.8	26.9	137.2	100	100	100	54	50	51
Slovakia	16.0	24.6	25.9	161.9	82	95	96	44	47	49
Hungary	10.3	26.8	27.2	264.1	53	104	101	28	52	51
Poland	10.6	19.1	20.3	191.5	54	74	75	29	37	38
Slovenia	22.2	36.6	37.9	170.1	113	142	141	61	71	71

Source: Zeman, K. – Rodová, V.: *Srovnávací analýze vývoje ekonomik ČR a ostatních asociovaných zemí SVE (10) v procesu přípravy na přistoupení k EU (Comparative Analysis of the Development of Economies of the CR and other Associated Countries of the CEE – 15. Prague, ČSOB, 3/2000, p. 35*

ad ^{a)} at current prices

^{b)} preliminary data

Among the countries subject to comparison, the productivity of labour achieved by Slovakia is of an average level. The scene is dominated by Slovenia, which has achieved the highest standard. A ranking made according to the pace of growth of labour productivity will give a different picture, where in principle Slovakia again matches the average, but the dominant position is taken by Hungary and partly by Poland (because of the low level of its labour productivity in the basis year used as a reference for comparison). Quite surprisingly, the lowest rate of growth was exhibited by the Czech Republic.

All the countries compared exhibit a low level of labour productivity relative to Austria: the Czech Republic, Slovakia and Hungary a level of approximately 50 % and Poland 38 %.

Slovenia was the best performer, since it has been steadily achieving the highest standard over all the years subject to survey, both relative to the Czech Republic and Austria.

International Transfer of Technologies and Know-How

International transfer of technologies and know-how is another factor intensifying economic growth.

There is no doubt that direct investment facilitates the transfer of technologies between partnership countries, in particular between developed and developing ones. Foreign investment represents the principal vehicle for such transfer in this respect. Nevertheless it is

not the only option. Foreign direct investment impacts upon a whole range of activities subject to international co-operation such as capital, technologies, management, know-how and other expertise. This transfer can be compared to a number of market transactions. Each element within this "mix of activities" may also be pursued separately using market mechanisms. Capital may be borrowed, technologies may be acquired under different licensing agreements, and also the management can be purchased and/or transferred based on agreements and, finally, a wide range of specialist knowledge may be obtained on a fee basis. In their capacity as a vehicle for international transfer of resources, these market mechanisms are an important alternative to foreign investment.

As a result of efforts by host countries – notably developing ones – to gain some degree of control over foreign direct investment, a number of the so-called new standards for international transfer of resources has been developed. They for instance relate to joint ventures, supplies of key components, contract management, international co-operation, and the like.

Separate procurement of resources may however be too expensive (especially for poorer countries). Despite that, what appears to be ideal is a combination of the two methods, i.e. foreign direct investment combined with market transactions in a proportion generating the biggest benefit for the host country.

The implications of direct investment do not only pose problems to developing countries. Also many developed industrial countries fear that foreign investment might take over major local undertakings that primarily produce industrial technologies, thus putting the domestic technology development out of action. By this token, control measures with regard to technology transfer (in particular national supervision) will add a political dimension to foreign direct investment. National movements against the transfer of technologies are not clear and are frequently contradicting, and direct investment therefore represent just one of the ways in (means by) which technologies can be transferred. Regardless of that the importance of technology competition between undertakings and economies is growing. Implications of foreign direct investment for the technology development are attracting more and more attention on the part of politicians in the host country.

Business Objectives in Selecting and Transferring Technology

The primary goal of choosing a technology is to achieve a satisfactory cost effectiveness. There are several options for meeting this goal: a wide choice of technologies on the one hand and different performance guarantees on the other.

Besides that, there is a significant relationship between capital expenditure and running costs and the determination of the most profitable technology. At the same time, one has to realise that the level of running costs cannot be the sole criterion for selecting the technology, but in calculating the costs, the level of productivity of labour has to be also taken into account, so that a decision can be made as to the labour or capital intensity of the technology.

Technology may also be an end in itself – that is reaching the **markets for sale**. It may be used to overcome barriers to entry into a particular market. This usually applies to technologies of the highest standard that are of interest to particular countries and are by and large applied in multinationals.

The choice of a particular technology may also matter when **interdependent exports** are involved. In that case a technology is to be selected so as to be bound to certain specific materials (raw materials) that are only available in that particular country. Certain import restrictive measures of the host country may also be overcome in this way.

A decisive part in selecting a technology is played by **the human workforce factor**. The level of education of labour in the host country is the basis for determining a usable technology. In the process, the number of skilled as opposed to unskilled labour available abroad is to be assessed. In this connection, an important role is also played by the **pay levels**. What is relevant in this respect is not the absolute level of wages, but the productivity of labour. Low wages in combination with a low productivity of labour may at the end of the day be more expensive than capital intensive production in a country where there are high wages. When making a decision on the productivity of labour whereby wage costs are incurred, a company must decide as to whether to introduce either a capital- or labour-intensive production technology in a foreign country. Besides that, in countries where there is an abundance of cheap and barely skilled labour, a question arises whether the local management available would be able to handle the particular technology.

Also, the choice of a particular technology is frequently predetermined by special requirements for **ready supply of materials**. The quality of materials (raw materials) significantly influences the products made. If these materials are not available in a certain country, they must be imported. Certain restrictions on a particular technology may also occur here. In addition to quality, big importance is also attributed to the certainty that there is a regular supply. In countries where certain raw materials are not available and must be imported that at the same time have only small foreign exchange reserves, products demanding in terms of these materials may pose a serious obstacle to installing that particular technology.

One of the most important factors determining the selection of technology is **the scope of sales potential**. At the same time, the question of how to choose an adequate product for the market area in question must be answered as well. The issue of a proper product largely depends on the structure of consumers abroad. In such cases the choice of technology is co-determined by a potential pricing strategy for the given country. High tech intensive operations are only possible when there is a certain structure of customers or they depend on the volume of output produced.

Quality requirements may lead to different technologies being used in different countries. The highest requirements are usually given by the most developed countries.

Status of International Transfer of Technologies in Slovakia

Based on our visits to specific production undertakings it is possible to make unanimously positive assessment in this regard. An assessment made almost unanimously of the entry of foreign partners into joint ventures is that had it not been for the modern technology contributed by the foreign investor towards the joint venture, the existing local businesses would not be able to achieve the enhanced production parameters over a long term because of not having sufficient own resources for innovation purposes. Investments made by foreign partners take the form of cash contributions used mainly for purchasing technologies and equipment, supplies of machinery, know-how, licences, leasing, and the like.

In every instance surveyed, partnering with a foreign entity benefited local undertakings in that it enhanced the technological standard of production and concurrently improved the quality of products, as well as skills of employees. Our country prevailingly meets the

conditions for the high tech deployment, since the education of the population is of a high standard and should there be any new features associated with this technology, the staff involved could be quickly retrained. To a foreign partner, our country has an important benefit to offer, namely the possibility of combining an educated workforce with low wages, which currently is one of the most definite incentives in making a decision on investment in Slovakia.

On the other hand, however, there is a problem gradually emerging in that local research is getting reduced hand in hand with an increasing inflow of foreign investors. This notably concerns large undertakings pursuing their research centrally, usually within the parent company, which is a worldwide phenomenon. Volkswagen would make a typical example, where Slovakia's involvement in international co-operation predominantly consists of the supply of components, which is, however, becoming an increasingly sophisticated business.

Smaller joint ventures partly leave Slovak partnership organisations to carry on their own research, assessing it as being of a good standard.

5. Partnership Between FDI and Domestic Industry

So far, we were not able to study well the impact of the partnership between FDI and local industry, since it starts to come into play only when there are more developed forms of FDI in a given country. According to the Dunning scheme, this occurs at the turning point between the second and third stages of development and is further deepened in the following periods. As part of this impact, multiplication effects arise from the partnership between local medium-sized and smaller businesses in different areas of the production process: an increased volume of output of high quality, a product line that is also attractive for foreign markets, enhanced skills of workers, increased productivity of labour and wages, export opportunities, and the like.

At the present time, an enlarging impact of foreign companies being interconnected with the Slovak industry can be observed. It is in the first place large multinational companies (Volkswagen, Siemens, Henkel, Coca Cola) that dominate the scene in this respect, but also smaller companies, such as those operating in the food industry, are doing very well, although to a lesser extent.

Multinationals have great importance in the global economy both in terms of world trade and production. Even though such international co-operation in Slovakia is still in its beginning stages, certain essential common features, typical of this form of international co-operation, can already be quite clearly observed.

Survey of partnerships established between FDI and domestic industry in selected Slovak companies

There is not yet a population of organisations large enough in order for us to be able to express the impact of partnering between FDI and local industry in Slovakia in quantitative terms. For the purposes of our survey, we have selected the companies Volkswagen Slovakia, a.s., Siemens AG, Henkel Slovensko, s.r.o., Coca Cola Beverages Slovakia and RAJO, a.s. We strove to select these companies both by their size (large, medium-sized and smaller ones) and sectors they operate in, i.e. mechanical engineering in combination with electrical, chemical and food industries.

Investments made by foreign investors into organisations with FDI (according to the data supplied by respective organisations):

Year 1999	
Volkswagen	- DM 339 million
Siemens	- DM 250 million
Henkel	- SKK 870 million
Coca-Cola	- SKK 2 702 million (year 1998)
RAJO	- SKK 520 million (year 2000/midyear???)

Generalisation of Survey Results

At present, the partnership between FDI and local industry is becoming increasingly profound and intense compared to the start-up period.

This shows in:

- The build-up of subsidiary undertakings in the form of buyouts of Slovak undertakings and their subsequent reconstruction and the build-up of new undertakings.
- Subcontracting of production adjacent or more distant regions and their catchment areas, which yields positive regional effects and positive impacts on employment.

The above given intensely promotes the growth of production and its orientation towards exports both through:

- **the classical form of foreign trade (direct exports and imports) and**
- **cross-border transfers from a foreign parent to a subsidiary and vice versa.**

The consequences of such partnerships are highly positive: they lead to the revival of smaller companies that would probably never be able to establish any co-operation with other countries, which gradually makes them raise their standards to match international ones. This primarily results in a parent undertaking exerting pressure towards a high standard of skills, quality of work, know-how, and management, which in turn makes it possible to increase the volume of output, as well as exports.

a) Employment

It has become an established fact that foreign direct investment has significant influence on the maintenance of employment, or the creation of new jobs.

In this respect it is possible to make a distinction between:

- **so-called direct employment**, i.e. work positions in the parent company and its establishments in Slovakia
- **so-called indirect employment**, which is induced by the interoperation of the company and its subcontractors from other sectors and branches.

Direct employment

- All the respondents have voiced a highly positive assessment of the Slovak labour in the following respects:
 - ✓ the ability to adapt quickly
 - ✓ a high standard of graduates from professional, especially technical secondary schools and Universities
 - ✓ the deficiency of language skills from 5-10 years ago is diminishing
 - ✓ moreover, the shortage of professional managers is being eliminated.
- A problem still present in this field appears to be a shortage of middle level professionals – something between professional school and University (bachelor study) graduates.
- Greater opportunities for professional growth in large international companies, both thanks to the establishment of the companies' own professional and apprentice schools, induction training initially under the leadership of foreign trainers, now generally under the supervision of local employees and the possibility of different internships abroad.

- The reputation of the quality of Slovak specialists has started to expand quickly beyond the border of Slovakia. Nowadays they even go to induct employees in similar operations abroad.

Indirect employment

As a result of multiplication effects on subcontracted organisations, employment fans out, which gradually helps to reduce regional problems with unemployment in the given areas. In some specialisations this concerns quite considerable numbers of employees, especially in machinery production, but also in lower profile branches, such as the food industry. For example, a study elaborated by the Coca Cola company drawing upon the Polish and Romanian experience has confirmed that multiplication effects generate, per one employee in the soft drink business (the Coca Cola company), 7-9 jobs in annual operations in interconnected specialisations or branches. These are cases of indirect employment.

In addition to the partnership as such, there are some other positive sides that cannot be overlooked, namely the qualitative shifts due to the pressures exerted by the parent company, such as unanimous requirements as to the quality, skills, assortment, quantity, etc. On the other hand, in the majority of cases, this means supplies not just for the foreign partner operating locally, but also for the parent concern operating abroad, whereby the standard of workforce in the given area becomes quite high.

It is possible to say that all the managers in foreign companies we have visited in unison, as well as from other sources, very positively assess the Slovak labour possessing a solid professional background that can be refreshed or adjusted to the particular production or economic demands in a very short time. Language barriers, which initially posed a big problem, are being gradually eliminated and also the management positions in these companies are prevalingly being filled by local professionals.

b) Regional Distribution of Partnerships

The partnership between the foreign direct investors established in the country and local industry is very important in terms of the regional distribution of their operations. In this way the uneven entry of FDI in Slovakia, which has been considerably varying over a long term, is at least partially levelled out. Nevertheless, it is predominantly concentrated in the Bratislava area or other regional or district capitals.

This view is proven by the activities pursued by foreign companies in which we conducted our survey. In some cases, the partnership with local industry has nation-wide dimensions, or it only concerns individual regions:

Table 25

Regions	Participation of selected foreign companies
Bratislava	Coca Cola, Siemens, Henkel, Rajo, VW, Danone
Trnava	Siemens, Coca Cola, VW, Rajo,
Trenčín	Henkel, VW
Nitra	Siemens, VW, Rajo
Žilina	VW
Banská Bystrica	Coca Cola, VW
Prešov	VW
Košice	Coca Cola, Siemens, VW, Fromageries Bel.

By and large, the partnership with local industry may be twofold:

- Supplies from independent subcontractors operating in different sectors and branches;
- Buying out Slovak undertakings, which then operate as part of the foreign company and a combination with the first method.

Example of co-operation between independent subcontractors

Regional distribution of a production partnership is almost ideal in the case of Volkswagen Slovakia, a.s. The company is actively involved, depending on respective parts, (Table 2) in the following towns:

Table 26

Automotive industry – purchases from Slovak undertakings in the year 1999

	Parts	Turnover in the year 1999 '000 SKK
1.	Plastics, insulating materials	32 985.2
2.	Forgings, sheets, castings, pipes, powder metallurgy	5 185 537.9
3.	Cable harnesses, fuse panels, accumulators, lamps	7 944 312.5
4.	Seats, set covers, AIR bags, steering wheels, brakes, linings	2 790 081.3
5.	Instruments, tools, JUS, preparations	124 638.1
6.	Bearings, chip working, surfacing	444 832.6
7.	Axles, gearings, clutches, brakes, brackets	12 200 786.9
8.	Rubber, rubber and metal, tyres	828 268.2
9.	Compression moulded parts, springs	880 905.8
10.	Bowdens, filters, rear view mirrors	785 316.8
11.	Others	30 004.8
T o t a l		31 246 970.1
of which VW Bratislava approx.		19 000 000.0

Source: Volkswagen Slovakia, a.s.

These involve supplies for VW, Audi, Škoda Auto, Seat and others.

- ad 1. Nová Baňa, Vranov, Bratislava, Žilina, Nitra
- ad 2. Dolný Kubín, Martin, Považská Bystrica, Žiar nad Hronom, Trnava, Snina, Košice, Podbrezová
- ad 3. Banská Štiavnica, Piešťany, Topolčany, Komárno, Trenčín, Dolný Kubín, Stará Ľubovňa, Nitra, Krompachy, Michalovce, Liptovský Hrádok, Previdza, Dubnica, Dunajská Streda
- ad 4. Veľký Meder, Stupava, Bratislava, Žilina, Púchov, Senica, Považská Bystrica
- ad 5. Bratislava, Myjava, Považská Bystrica, Vrábľa, Topolčany, Dolný Kubín, Prešov, Skalica, Žilina
- ad 6. Hriňová, Michalovce, Považská Bastrica, Bytča, Nové Mesto, Zvolen, Michalovce, Prakovce, Vrábľa, Topolčany, Dolný Kubín, Prešov, Skalica, Žilina
- ad 7. Čadca, Bratislava, Veľký Meder, Detva, Trnava, Bánovce, Košice
- ad 8. Dolné Vestenice, Prievidza, Púchov, Bytča, Hnúšťa, Banská Bystrica
- ad 9. Trnava, Vrábľa, Brezová pod Bradlom, Bratislava, Malacky
- ad 10. Banská Bystrica, Hnúšťa, Vlkanová, Nové Mesto, Dolné Hámre
- ad 11. Žilina, Banská Štiavnica, Myjava, Banská Bystrica, Vlkanová, Považská Bystrica, Trnava.

Source: Škoda Auto Slovensko, s.r.o.

Association of Automotive Industry Subcontractors in Slovakia

Many foreign companies in Slovakia operate in this fashion. From among those we have consulted, it is, for example, Henkel, Volkswagen, Coca Cola, Rajo, Danone, etc.

The Volkswagen company dominates in this respect, namely in terms of such aspects as spatial, sector or branch distribution. It is possible to say that should there be more such activities, main investment, employment, export, regional and other problems would be removed for the Slovak economy.

Another option for establishing a partnership with local industry is to buy into a partial or a one-hundred percent ownership of Slovak undertakings in different regions in one go. There are advantages of its own to such partnerships in that since they immediately report to their parent companies, and any eventual problems of financial, qualitative (predominantly) or other nature thus fade away.

The Siemens company in Slovakia would make a good example of such type of partnering, where in some instances a combination with the former method has been used. Siemens Automative, s.r.o. Michalovce and Elektrické systémy, s.r.o. Nitra could be referred to for illustration.

c) Increasing exports

Increased volume of exports is one of the essential effects of partnering between foreign direct investment and local industry.

Companies with a part or one-hundred percent FDI participation pursue exports in the following forms:

- **directly**, with foreign trade being conducted directly between a local supplier and a foreign customer;
- **indirectly**, with a local subcontractor supplying their products to a local customer (subsidiary), who uses them for making their own products and then exports them to its parent company by way of a transfer. An indirect form of exports may also be involved in cases where there is own production of parts by a local subsidiary that likewise incorporates them into its own products (usually assembled also using parts imported from the parent company) and sends them via transfer channels, after having added value to them by such processing, to the parent company. A clear-cut example of this method is represented by Volkswagen Slovakia, a.s.

In the first years of FDI entering Slovakia and individual organisations, exports developed at a relatively slow pace. Since Slovakia is a small market, investors who want to get settled in the country must be predominantly pro-export oriented and this has gradually started to show in the share they have in export activities in Slovakia.

This trend could be observed in all organisations surveyed, whose exports already now amount to approx. 40-70 % of their output, and in Volkswagen, whose exports accounted for almost the whole of its yearly output. At the same time, each of the said undertakings expects its volume of output and exports to grow further.

Problems

Apart from all the positives mentioned earlier in this study, we have also come across certain problems as cited by our respondents:

In respect of workforce, representatives of the Volkswagen company noted that the qualifications structure of the new generation has not been developing in a positive direction over the past decade. Even, higher education has partly got out of control. Undue

independence of individual faculties forming part of universities resulted in an excessive increase in the number of study specialisations. Their number rose by 100 % in comparison with the CR. On the other hand, the proportion of University graduates to the general population is still low.

As for machinery plants (but this also applies to the industry in general), experts we talked to have distinguished three groups of companies. Companies such as Matador Púchov, Siemens, Volkswagen and undertakings they co-operate with have firm orders, they have managed to raise sufficient funds, thus resolving the problem of undercapitalisation and have acquired know-how. There is no overemployment in these undertakings, that is, they are getting to the normal. Then there is a second group of undertakings that in a way just keep going, struggling to survive. These companies are indeed working, but still they exhibit signs of overemployment, undercapitalisation and are seriously concerned about the future of their sales. For the third group of undertakings, bankruptcy is just a question of time. This problem must be resolved by speeding up insolvency proceedings in necessary cases and finding ways for doing away with the shortage of jobs and creating new ones. Experience from recent years shows that foreign investors cannot be expected to come to old-fashioned factories with unsettled title to assets and environmental liabilities. It would be more optimum to concentrate on individual regions, so that, in concurrence between the economic managements and local authorities, industrial parks started to be formed. Also, all necessary land should be provided and industrial infrastructure built up, so that an offer can be made to foreign investors, who may then quickly get involved. It was shown that tax holidays, customs concessions and similar incentives by themselves are too weak to motivate foreign investors. From a broader perspective, political and economic stability and general transport, energy and telecommunications infrastructure will be required.

As for local research, a rather definite reduction has been recorded in it as a result of the entry of foreign investors. In large concerns in particular the research tends to concentrate in parent companies. Nevertheless, this is a world-wide phenomenon. A typical example would be Volkswagen, which at present cannot be realistically expected to come up with a new model of “Slovak car”. There is a chance though for developing final production as part of attractive programmes there. On the other hand, there are opportunities there for developing extensively, through multiplication effects, a network of subcontractors, as well as

construction and transportation capacities, advertisement and other activities linked to the industrial branch.

On the other hand, smaller firms do make use of local research, which is the case of subsidiaries of the Siemens company operating in Slovakia, and in food plants, e.g. diaries, and so forth.

Quite importantly, the product lines of Slovak joint ventures is becoming increasingly more sophisticated.

Representatives of the RAJO undertaking are critical about the length of **time needed to get products certified**. This takes at least 6 months in Slovakia, while in developed European countries it takes 1 month at the maximum. This presents a big handicap for the food industry, since the applicant company thus loses its time lead to competition.

Representatives of almost all organisations consulted complained about enduring **bureaucracy**, but also **corruption**.

Conclusion

Analyses of international competitiveness of individual countries are based on their ability to sustain economic growth over a long term. This above all involves the growth of production (GDP), productivity of labour and the translation of these positive developments into multiplication effects domestically and also in external economic relations.

As was shown by the results of our analyses, when it comes to the entry and operation of FDI in Slovakia, all these have in principle been accomplished: **a high rate of growth of labour productivity**, and that developing at a higher pace than in the case of comparable local partners, and internationally reaching the standard of parent organisations, a **growing volume of output** of adequate **quality, maintained employment**, etc.

At the same time, the above mentioned achievements present one of effective ways for a gradual approximation to developed EU economies.

In the forthcoming period, a positive trend in the inflow of FDI to Slovakia can be expected as a result of the improved international image of Slovakia, local legislative conditions for the entry of FDI into Slovakia, and, last but not least, a relatively positive rating of the business environment in Slovakia by notable foreign investors already established there.

In the near future, in addition to a classical form of direct investment into production, banking or services, the inflow of FDI will be extended to a form so far only scarcely utilised in our country. To this end, extensive liberalisation measures were taken in 2000, which have already started to yield the first actual results.

Apart from the positive sides of the inflow of FDI, also some problems can be envisaged:

- ✓ Upon the entry of large foreign organisations into Slovakia, the stifling effect on the local research and development in progressive industrial branches has started to show. Nevertheless, this is a worldwide phenomenon for large concerns to be concentrating their research in parent companies. On the other hand it is possible to say that products made by Slovak subsidiaries as part of their manufacturing programs are becoming increasingly sophisticated.
- ✓ At the present time views have started to proliferate that should the inflow of FDI develop in the same direction as up to now, we could become a sort of "assembly workshop of Europe", which could impact upon the structure of demand in the market for labour. This would on the one hand mean stagnation – the lowering of professional requirements for specialisations down to the level of just the skills still adequate for the category in question, and, on the other hand, the increased brain drain of educated specialists to foreign countries might occur.
- ✓ The comparative advantage of "cheaper labour" that foreign investors make use of in our country is not a permanent phenomenon, that is, something on which long-term foreign investment could rely. It is therefore important to strengthen the other facet of our comparative advantage – the skilfulness of the workforce and their creative abilities. This first of all implies the need to develop the educational system, but also to promote national research and innovation activities so as to enable us to capture the interest of foreign capital with new ideas, the creative skills of people and local development projects. For that reason, the Government should have ideas of how to develop selected branches or sectors and further sophisticate Slovakia's own activities, whereby local specialists could fully utilise their potential.

- ✓ Retail trade competition was to a relatively significant degree affected by the entry of large foreign supermarkets. On the one hand their impact is positive, notably because of reductions of the prices of foodstuff, but on the other hand they are pushing out smaller local producers from their markets through competition. The latter are not able to adjust to the level of prices offered by prominent producers, particularly joint ventures. This seems to be essentially due to the high productivity of labour and superior organisation of work in joint ventures compared to local undertakings⁴.
- ✓ With a view towards resolving this problem, recommendations first made consisted of proposals to integrate these organisations into voluntary associations of retail outlets. An alternative opportunity for selling their goods outside the distribution chain would be created thereby, which could also contribute towards the elimination of economic dependence.
- ✓ However, the problem of smaller undertakings appears to rest in production activities, i.e. substantially higher production costs. For that reason we believe that individual producers should internally specialise in such products for which they have the best conditions and thus could attain a higher cost effectiveness. That is why not only distribution, but also production associations should be engaged.

⁴ The RAJO, a.s. joint venture can be given as an example, where the productivity of labour achieved was 9.2 million SKK/employee/year 2000 (and 10 million SKK/employee/year in the parent company). Three years ago it was 5-6 million SKK/employee/year and in comparable milk plants approx. 2-3 million SKK/employee/year.

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