

CONTRIBUTION OF FOREIGN DIRECT INVESTMENT FOR THE REGION DEVELOPMENT

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Abstract

Foreign direct investments contribute to the important solving of the economical growth and regional development and it presents part of the state's effort to increase living level of the state. Slovakia government is motivated to support any foreign investment and it competes for such investments with other transforming countries. Goal of the contribution is to provide idea about main factors that influence inflow of the foreign investments to the individual regions of Slovakia and to evaluate their contribution through characteristics and main determinants of the foreign investments. Only through careful choice can Slovakia obtain successfully investors that would come to the country with production, research and development since in modern economy we cannot be competitive without such activities, neither in regional, nor in the international level.

Keywords: foreign direct investment, region development, regional policy, international business

Clasification JEL : M40, M41

1. Introduction

Foreign investments are considered as a tool for unemployment decreasing, but also consumption of great volume of finances that are provided for the state and inhabitants. Over national corporations invest in certain country milliard of monetary means, but this country is pushed to invest other investments that include mainly purchase of the land, construction of approaching ways – infrastructure, state donations, etc. Such costs are many times enormous. But there are existing also cases, when costs for support of foreign direct investment are higher then revenues. And loss of finances that results from the taxes remission during several years that accompany construction of such firms at the given region, is not interest of the state. Fact is that several firms after this period are moving to the region of other state, where they can have also tax holiday. There is a question if such foreign investment are really profitable for the given region and country, since reality is many times given out of focus, there are given only positive reports, as for example invested volume, number of created working posts, positive balance of foreign sale, etc. But public does not receive presented cost that are connected with given foreign investment. [1]

Foreign direct investments (FDI) contribute really to the unemployment decreasing, since through building of vast companies they can create also several thousands of working positions. But neither in the world exist economy that could be successfully developing due to the foreign investments. Foreign capital is welcomed, but it presents only part of the effort that state as well as inhabitants of the state must make for increasing of living level of the state. Real long time capital has to be drawn by the help of tax holiday. [3]

Goal of the contribution is to provide picture about main factors that influence inflow of foreign investments to the region and to evaluate their contribution through characteristics of foreign direct investments, main determinants of the foreign investment inflow. [2]

2. Present state of the foreign direct investments

National bank of Slovakia defines foreign direct investment as category of international investment that expresses aim of the subject that is resident of one economy (direct investor) to obtain permanent rate in the firm with residence in other economy (firm of direct investment). Permanent rate expresses existence of long term relation between direct investor and firm of direct investment and considerable level of influence to the management of the firm. [6]

During stating of the direct relation existence there can be some of the following forms:

- Rising or obtaining of 100% rate on the business

- Participation at the business, when investor owns or obtain less then 10% rate at the basic equity of the business company or less then 10% rate at the net business equity of the business company, or less then 10% of right to vote
- Acceptation or rejection of the financial credit to the investors for business, when investor has on this business participation according first and second article or when financial credit is connected with the influence to the company management that is comparable with the influence to the rate according article one and two
- Using of the contribution from the existed direct investment to this investment. [5]

Conference UNO for business and development UNCTAD defines foreign direct investment as a investment that are based on the long term relation of the firm and that reflect permanent interest about control of the resident subject from the one country (foreign investor or parent company) in the firm of resident of other country - firms with foreign direct investments, affiliated branch or affiliated firm. [8]

As for the portfolio investments foreign direct investment is investment, when there is minimal 10% decisive owner ratio of foreign investor (for example in Slovakia).

Government of Slovak republic stated in its national „Strategy of competitiveness development till 2010“ except of others also priority to support creation of working posts with high value added, and to support education at the job market. Blind orientation to the car industry, where value added, research and development and using of new technologies are disputable.

From the short term view of political cycle – 4 years – any foreign direct investment appears to many politics as an optimal solution, but in spite of this fact government of Slovakia should to access to the future choice of supported foreign investors by state more responsibly. Priority should be given to the foreign investment, placed mainly to the regions with high measure of unemployment and low measure of economical activity. Better linking between education and job market should be priority not only in the documents of the action plans, but also sufficiently used in real life.

Foreign investments are one of the main forms of foreign capital obtaining. In present time they belong to the one of the most effective way for competitiveness increasing in the frame of given region, where foreign capital permeates to the economy of host country and through movement and installment of new technologies there is increased also production potential of the given region. [11]

In this connection we can distinguish two basic forms of capital:

- Foreign direct investment - purchase of the rate in the company that enables full control of the company, or so-called “green” investment. Decisive characteristics of the foreign direct investment are control of the property, obtained in abroad. An investor firm provides as a counter balance to foreign country financial, managerial, and technical and other sources. [9]
- Portfolio investments – present export and import of securities, shares, obligations or other financial assets and tradable securities from foreign firms with goal to obtain certain revenue. Such investments are therefore different from foreign direct investment passively; investor is not trying to have control, management of the firm, but only participation at the property.

Biggest difference between portfolio and direct investment is the fact that direct investment include effective control by the way of capital, portfolio investment does not include control.

For limitation of ownership rate during foreign direct investment there is very significant definition of International monetary fund, according which foreign direct investments are such investments that provide effective control with minimal 25% rate of capital. Control can be obtained by following:

- By new firm establishment
- By grating of ratio from yet existed firm
- By reinvesting of the profit and natural increasing of the rate in yet established firm. [10]

Direct investments many times do not include movement of the capital, that means certain subject can invest in abroad also with borrowed capital in residence country. By this way it can be participating at the creation of joint ventures, or it can purchase 100% ownership of the firm, but mainly foreign investment must provide control.

Foreign direct investments are most important way of capital involvement that are realized as capital involvement in joint ventures, as for example foundation of the individual firms, affiliated company and sub company without involvement of domestic capital or as foreign capital involvement during privatization process. Joint ventures are certain form of foreign direct investments realization.

Effects of foreign direct investments to the economy „authorize providing the stimulus during assumption that their economical convenience is equal at least resulting social benefit. “ [2]

3. Foreign direct investment in Slovakia

As for the foreign direct investment in Slovakia development in the individual regions had been as follows (table no.1).

Table 1. Development of FDI in Slovakian regions

| year/ region | 2003 | | 2004 | | 2005 | | 2006 | | 2007 | | 2008 | | 2009 | |
|-----------------|---------|------|---------|------|---------|------|---------|------|---------|------|---------|------|--------|------|
| | mil.€ | % | mil.€ | % | mil.€ | % | mil.€ | % | mil.€ | % | mil.€ | % | mil.€ | % |
| Bratislava | 9 502 | 68,7 | 11 529 | 68,2 | 10 988 | 66,5 | 16 021 | 66,8 | 17 912 | 67,7 | 18 722 | 62,4 | 19 340 | 62,7 |
| Trnava | 968 | 5,1 | 1 583 | 6,0 | 3 369 | 5,9 | 2 804 | 5,3 | 2 960 | 6,9 | 2 971 | 9,9 | 3 035 | 9,8 |
| Trenčín | 344 | 4,1 | 434 | 4,4 | 550 | 5,0 | 624 | 4,8 | 1 073 | 4,6 | 1 433 | 4,8 | 1 447 | 4,7 |
| Nitra | 438,6 | 3,2 | 523,0 | 3,0 | 511,9 | 2,7 | 1 025,1 | 4,0 | 1 165,2 | 4,0 | 1 399,1 | 3,9 | 104,87 | 1,25 |
| Žilina | 660 | 4,4 | 799 | 5,1 | 973 | 6,2 | 1 434 | 7,4 | 1 073 | 6,1 | 1 992 | 6,7 | 1 958 | 6,3 |
| Košice | 1 115,9 | 8,0 | 1 697,6 | 9,6 | 1 686,3 | 8,9 | 2 405,7 | 9,4 | 2 646,5 | 9,1 | 2 632,9 | 7,3 | 2 696 | 8,7 |
| Prešov | 204,3 | 1,5 | 252,5 | 1,4 | 226,6 | 1,2 | 246,0 | 1,0 | 223,3 | 0,8 | 363,9 | 1,0 | 370,9 | 1,0 |

Through comparing of macro economical indexes by the help of statistical analysis we are finding answer to the problem, if foreign investments are contribution for regions, or if their negative predominate over positive, or if they do not influence them considerably.

From the view of regional discrepancies easing there is significant that foreign direct investments would come in highest possible volume to the region, where there is high measure of unemployment, lowest gross domestic product and average monthly wage per inhabitant (table no.2).

Table 2. Contribution of foreign investments for region of Košice country

| KOŠICE COUNTRY | | | | | | |
|----------------|--------------------------|-------------------|--------------|--|--------------------------|--|
| Year | VOLUME OF FDI - mil. EUR | Unemployment | | Average monthly wage of employee in SR economy (EUR) | Regional GDP in mil. EUR | |
| | | Thousands persons | % | | | |
| 2003 | 1 115,9 | 83,1 | 18,1 | 469,3 | 5 154 | |
| 2004 | 1 697,6 | 91,3 | 19,0 | 512,5 | 5 693 | |
| 2005 | 1 686,3 | 87,0 | 20,4 | 556,6 | 5 955 | |
| 2006 | 2 405,7 | 71,3 | 20,2 | 595,2 | 6 650 | |
| 2007 | 2 646,5 | 54,7 | 18,7 | 626,8 | 7 251 | |
| 2008 | 2 632,9 | 47,2 | 18,3 | 671,9 | 7 895 | |
| 2009 | | 55,8 | 17,2 | 684,0 | | |
| 2010 | | 65,8 | 18,3 | 719,0 | | |
| Sum | 12 184,9 | 556,2 | 150,2 | 4 835,3 | 38 598,0 | |

Source: NBS, SARIO

Statistical institute of Slovakia publishes data about regional structure of GDP in Slovakia every second year. Majority of statistical data are most of all from whole republic and lately there are calculated also regional data. During GDP this process is very sophisticated and many calculations, consultation and approving must be made also in the frame of Eurostat. Regional data of GDP are not ideal index of living level. It is distorted for example due to the fact that several firms with whole Slovakian action have their Centrum in Bratislava and value added that they produced, is totally calculated to the Bratislava country.

Next fact that distorts this index is migrated employees. Except of the mentioned Bratislava forwardness connects also with high concentration of the inhabitants, more educated working power or geographical closeness to the Austria or Czech Republic.

According mutual connection with chosen indexes by the way of regression analysis and Pearson correlation coefficient we can deduce relation of foreign direct investment to the regional GDP, to the employment and level of average monthly wage according region. [4]

Calculation of correlation coefficient

$$\rho_{X,Y} = \frac{Cov(X,Y)}{\sigma_X \cdot \sigma_Y}$$

Pears correlation coefficient

$$r = \frac{\sum(x-\bar{x})(y-\bar{y})}{\sqrt{\sum(x-\bar{x})^2 \sum(y-\bar{y})^2}} \quad (1)$$

Pears correlation coefficient has a value from interval -1,0 (for totally negative correlation) till 1,0 (for totally positive correlation) and it expresses measure of linear relation among two groups of data. Calculation had been made through Microsoft Office 20047, statistical function and Correl and Pearson. It serves for calculation of relation existence among two indexes.

Interpretation of correlation coefficient connects with the context. Value 0,8 during proving of physical law through using of exact measuring tools is very low, but in social science it is very high. Cohen (1988) created simple instrument for interpretation of correlation coefficient during psychological research: correlation (numerical value) under 0,1 is trivial, 0,1-0,3 small, 0,3-0,5 middle and over 0,5 high.

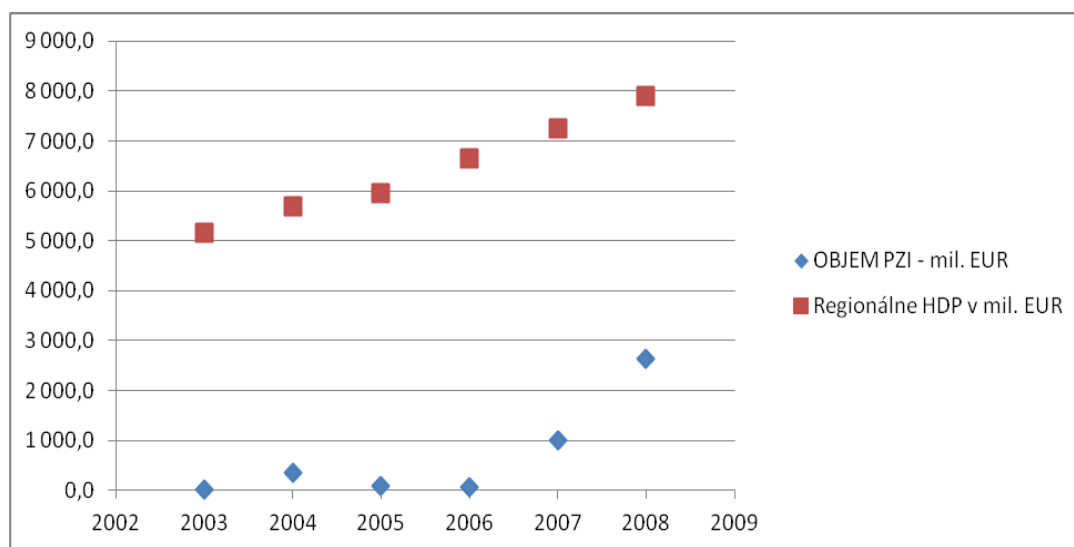


Figure 1. Volume of FDI and regional GDP (Correlation index: 0,95105522)

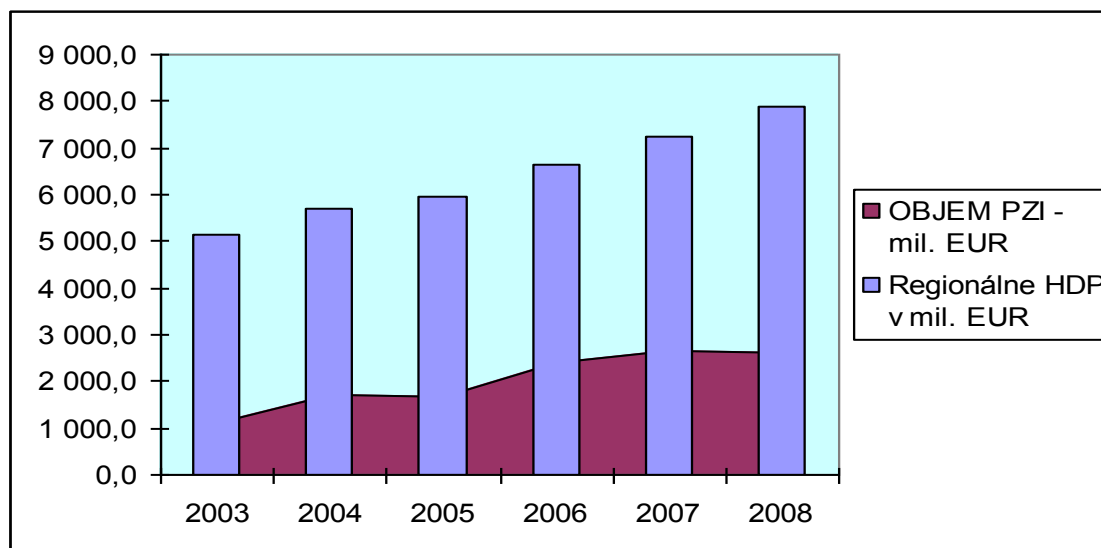


Figure 2. Development of FDI and regional GDP

That means there is not existing connection in this context between inflow of foreign direct investment and regional GDP, volume of foreign investments in the region does not have influence to the index of regional GDP, Pearson correlation coefficient has value 0,95105522. (fig.no.1,2)

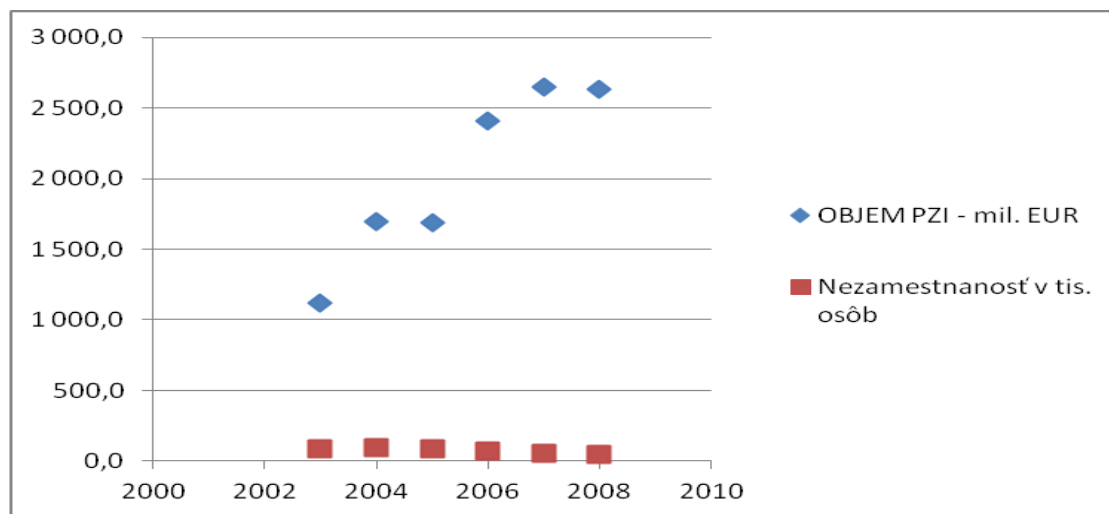


Figure 3. Volume of FDI and unemployment in thousand persons (Correlation index: -0,84339608)

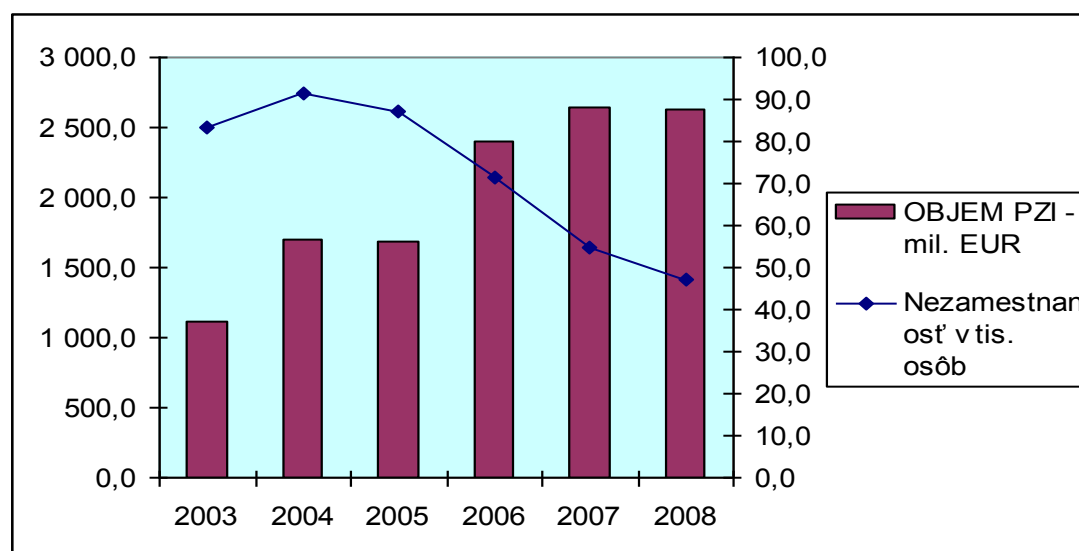


Figure 4. Development of FDI and unemployment in thousand persons

We can see from the graphs (fig. no. 3,4) that foreign direct investment does not influence unemployment in the given region. From the allocation of the individual points in graph and Pearson correlation coefficient (- 0,84339608) that is closed to the negative correlation we can determine that neither this relativity does not have considerable economical influence.

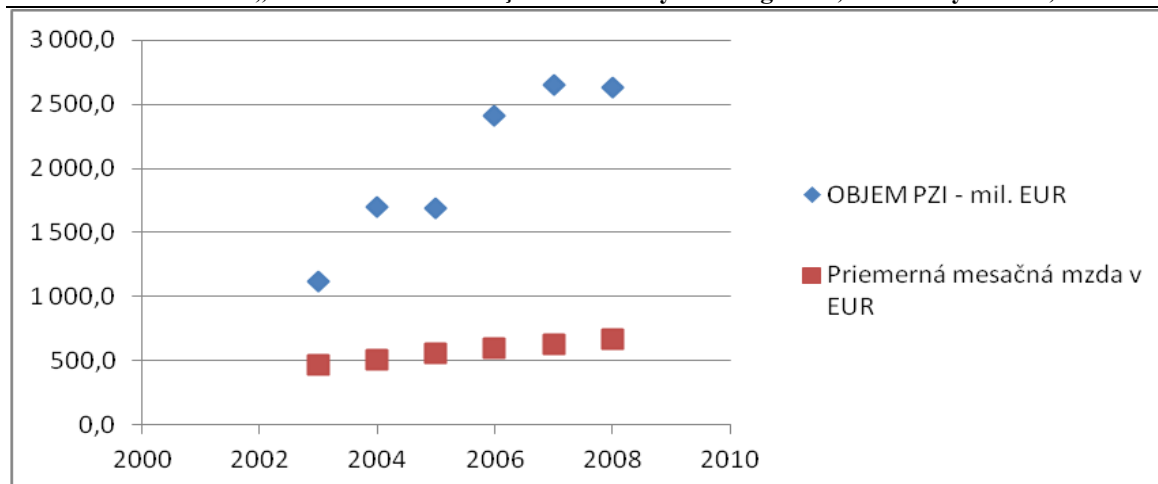


Figure 5: Volume of FDI and average monthly wage in EUR (Correlation index: 0,951584762)

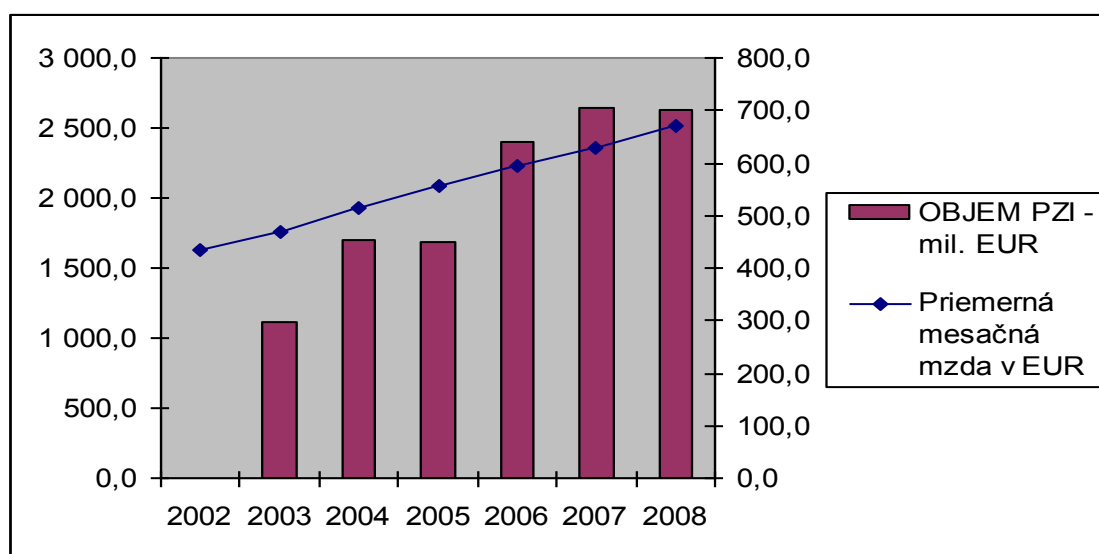


Figure 6: Development of FDI and average monthly wage in EUR

Indexes during following period have been increasing, but strong mutual dependence of FDI volume and average monthly wage per worker in economy did not similarly prove. Value of Pearson correlation coefficient is 0,951584762.

Mutual dependence can be searched from various other points of view, but also in the frame of provided invested stimulus for the individual regions.

From the available data we cannot estimate reliably every contribution that foreign investments bring for the given region. Many investors after exhausting of conveniences are moving to other country, they move their companies to country with better condition. Contribution as for the creation of working posts, wages increasing, creation of GDP, cannot be really calculated.

On the other hand foreign direct investments can cause also negative impacts mainly through competitiveness increasing for domestic businessmen; therefore they can cause indirectly further unemployment increasing due to the bankruptcy of domestic subjects at the market. As for the average monthly wage, in eastern part of the region foreign investors give to their employees' wages mostly at the minimal level, therefore in this case they do not contribute to the increase of average wages in the frame of spotted regions.

4. Discussion

When we consider previous findings, inflow of foreign direct investments is not sufficiently effective tool in relation to the remission of regional discrepancies and to the improving of macro economical indexes. Increasing of effectiveness of regional policy demands considerable system changes. [7]

Problems of stagnating regions should be solved mainly by increasing of quality for their functional assumptions and social and economical potential through building of infrastructure, more effective providing of public

services. Development and support of conditions for small and middle business, where there should be regarded needs of the given region and specific characteristics is not possible to make without creating of effective linking of state administration, business sphere and autonomy. It leads to the creation and activating of business and creative potential of economical subjects directly in the given region.

We have evaluated weaknesses and strengths by the help of SWOT analysis, where we ranked individual indexes and evaluated them by three levels: 1 – very important, 0 – insignificant, 0,5 – middle important index. It is obvious that there is necessary to orientate to the chosen factors of weaknesses and strengths, where weights were the highest. Strengths of the regions are as follows (tab. no.3):

Table 3. Strengths in the region

| strengths | Rate on branch | Stocks of raw materials | Assumptions of agriculture | Terminal of combined transport | Natural and cultural heritage | International airport | Sufficiency of qualified working power | sum | Weight |
|------------|----------------|-------------------------|----------------------------|--------------------------------|-------------------------------|-----------------------|--|------|-------------|
| S1 | X | 0,5 | 0,5 | 1 | 0,5 | 1 | 1 | 4,5 | 19,8 |
| S2 | 1 | X | 0 | 1 | 0 | 1 | 1 | 4 | 17,6 |
| S3 | 0,5 | 0 | X | 1 | 0 | 1 | 1 | 3,5 | 15,4 |
| S4 | 1 | 1 | 0 | X | 0 | 1 | 1 | 4 | 17,6 |
| S5 | 0 | 0 | 0 | 0 | X | 1 | 1 | 2 | 8,8 |
| S6 | 0 | 0 | 0 | 1 | 1 | X | 1 | 3 | 13,2 |
| S7 | 0,5 | 0 | 0 | 0,5 | 0,5 | 0 | X | 1,5 | 6,6 |
| sum | | | | | | | | 22,5 | 100 |

Strengths:

- S1 – industrial character with representation of every branch
- S2 – raw material with over regional importance (talc, magnesite, salt, calcite)
- S3 – high soil and climatic potential together with technical assumptions for agriculture
- S4 – Terminal of combined transport and broad gauge line, enabling without transshipment to the Eastern Europe
- S5 – broad space natural complexes, cultural heritage
- S6 – International airport Košice
- S7 – sufficiency of qualified working power

As for the strengths of the branch, results from the table show to the possible consideration during evaluation of further development possibilities in the region and its consequent orientation.

It means that stock of raw materials, their using, assumption of agriculture and possibilities of transport by the way of broad-gauge line to Eastern Europe present undoubtedly factors that show to the further development of the county and its regions.

Weaknesses, as for example not sufficient transport infrastructure and not sufficient research base are factors that belong in long time to the blacklist of not solved problems, with which previous government was dealing as well as regional representatives, but till present time there is no considerable improving of the situation in the mentioned area (tab.no. 4).

Table 4. Weaknesses in the region

| weaknesses | Not sufficient transport availability | Technological and technical backwardness | Prevail of prime production over finalization | Not sufficient research base in perspective branches | Not sufficient using of tourist travel potential | Low level of water and sewerage system | Energetic and material demanding industrial production structure | sum | Weights |
|------------|---------------------------------------|--|---|--|--|--|--|------|-------------|
| W1 | X | 1 | 0,5 | 0 | 1 | 0 | 1 | 3,5 | 18,9 |
| W2 | 0 | X | 0 | 0,5 | 0 | 1 | 0 | 1,5 | 8,1 |
| W3 | 0,5 | 1 | X | 1 | 0 | 0,5 | 1 | 3,5 | 18,9 |
| W4 | 0 | 1 | 0 | X | 1 | 1 | 0,5 | 3,5 | 18,9 |
| W5 | 1 | 1 | 0 | 0 | X | 1 | 0 | 2 | 10,8 |
| W6 | 0 | 0 | 0 | 0 | 1 | X | 0 | 1 | 5,4 |
| W7 | 1 | 1 | 1 | 1 | 0 | 0,5 | X | 3,5 | 18,9 |
| sum | | | | | | | | 18,5 | 100 |

Weaknesses:

- W1 – not sufficient transport availability of the territory
- W2 – technological and technical backwardness of the agricultural sector

W3 – prevailing of the prime production over final production

W4 – Not sufficient research base and its absence in the branches that are perspective, for example from the view of the economy development

W5 – not sufficient using of potential for tourist traffic, lack of material and technical equipment of centers for tourist traffic

W6 – low level of inhabitants’ connection to the water and sewerage system

W7 – energetic and material demanding structure of the industrial production (metallurgy, chemical industry, which demands imported raw material and which decrease quality of living environment

Regional unemployment should to be solved by the way of long term increasing of the working power qualification through whole life education and requalification. Qualified working power is one of the factors that draw near investors to the individual regions, but also increase individual applying at the job market, but on the other hand it would be also competition advantage in relation to the investments.

As for the measurements from the job market:

- To increase quality of prequalified programs,
- To identify and monitor risk groups of unemployed,
- To accept measurements for increasing of their flexibility and adaptability in the working environment,
- To increase effectiveness of the active policy tools for employment and development of the self employment possibility of the inhabitants directly in the regions.

In the condition of Slovak republic it seems that application of foreign investments as a tool for development of regional policy is not sufficient. Neither by help of investing stimulus can we influence foreign direct investment in the frame of regions. Factors that belong among problems of stagnant regions are also territory equipment, lacking infrastructure, technology, raw material base and lack of qualified people on job market. According mentioned facts investors are placing their services to the regions with higher economic level and equipments that is source of further increasing of regional disparities.

Regional development demands except of others following:

- Finishing of the basic infrastructure building
- Support of the business environment
- Regarding of the specific characteristics.

Programs of the economical and social development of the regions are weak. Mainly local administration is not very active, many times they deform business environment by frivolous high taxes. Mainly local administrations should use in the frame of their competences economical potential of the correspondent region, mainly in area of service and tourist traffic development.

5. Conclusion

Foreign direct investment presents for economy of Slovakia unchangeable sources. Although they are important accelerator of the economical growth and regional development, they are also bearer of the regional disparities rising.

During initial phase of foreign direct investment drawing our government is motivated to support any foreign investment and it competes about these investments with other transforming economies. Some authors are speaking about theory “race to the bottom”, in which frame countries are heavily compete with each other. It is important to know, when there is proper time for changing of such zeal for wise economical consideration.

From the view of economists foreign direct investment are more positive then negative, but we must not forget also threats that result from the entering of the big over national companies to the economy of such small country Slovakia. As main threats we can consider using of cheap working power and departure to the other more convenient locality after some time, as well as end of traditional, historically given branches that are gradually disappearing since they do not know how to compete with strong foreign companies.

State should not forget support of domestic subjects that also profit indirectly from the foreign investors as for the experiences, skills, knowledge and technologies.

Slovakia should not to be orientated only by the influence of over national companies from the view of some branches development, but it should improve also conditions for business for domestic companies. We speak still about support of small and middle business, but in case financial means would not be divided to the support and development of infrastructure, improving of business environment of domestic subjects, overcoming of bureaucracy, improving and simplifying of tax system and mainly rights reclamation, we are not able to draw more foreign investors and at the same time development of local business will stagnate.

It is also very important that every investment, except of Austria Zizala Lichtsysteme in Krušovice near Topoľčany, is orientated to the production sphere. Foreign investors are totally renouncing possibility to realize research at the Slovakia. But at the same time many qualified experts are leaving abroad mainly due to the difficulty to find out in Slovakia exercise for reward, which could be proper to their contribution for employer or society as a whole.

But if we want to go forward as a state, we must try to attract investors that are dealing with research and development. Mainly such activities are source of high value added that is consequently contribution for the economy of the country.

Only through careful choice Slovakia can obtain successfully investors that would begin in the country except of the single production also with research and development. In the modern economy we cannot be competitive without such activities, neither in regional, nor in international measure. One of the governmental priorities should to be creation of business environment that would draw investors with knowledge economy and high proficiency.

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