INTERNATIONAL COMPETITIVENESS VERSUS LOCATION ATTRACTIVENESS FOR FDI. A THEORETICAL APPROACH

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Abstract
The aim of this paper is to assess the similarities and the differences in the theoretical frameworks that deal with international competitiveness and location attractiveness for FDI. We provide some insights in the evolution of definitions regarding the international competitiveness and emphasize its newest characteristics stated by scholars that resemble with the ones proposed for increasing the attractiveness of a location for FDI. We then assess whether the particularities and impact of FDI inflows in the host country could overlap the performance required for that a country to be considered internationally competitive. We investigate both the literature and the empirical evidence as regards the impact of FDI on host countries and we debate the role FDI could play in increasing the international competitiveness of economies. Finally, we provide some public policies measures that could be taken in order to enhance a country’s attractiveness for FDI and increase its international competitiveness.

Keywords: foreign direct investment, international competitiveness, public policies

JEL Classification: F23, M21, O11

1. Introduction
We are interested in finding if the conditions required for attracting FDI in host countries could be assimilated to the ones necessary for increasing the international competitiveness of those countries. If this is true, then inward FDI flows could be considered a measure of competitiveness.

The problem is not as simple as it sounds, given that the difficulty in defining national or international competitiveness is as common today as in the 1990s. The theory of countries’ international competitiveness is not valid according to the school of economic thought, but only under the auspices of the management school (Smit 2010). At the beginning of the 1990, Daniels (apud Smit, 2010) indicated that the notion of competitiveness is elusive and both the measurement and the explanations used for competitiveness were lacking consensus. Until today, the term of international competitiveness of a country is considered to be one of the most abusive terms used in both the press and the literature (Smit, 2010). For Siggel (2006), macroeconomic competitiveness is preferred in the public speeches, but it is the least grounded in the economic theory. Aiginger et al. (2013, p.4) even argues that the term is “rarely derived from theory”. Even more, Paul Krugman (1994, 1996) strongly disagree over the notion of countries’ competitiveness and criticizes the concept when expressed as the success on the foreign markets or as the “competition” between states.

However, Fougner (2006) considers that international competitiveness is a reference point that must guide the constitution of all public policies and the resolution of all the problems that the governments are facing. The hurdle in dealing with competitiveness is that theoreticians consider that the macro concept of competitiveness is not a simple extension or aggregation of the micro meaning of competitiveness. The new approaches in the literature that will be exposed hereunder try to reconcile this view.

In a very simple definition, FDI concerns the activity of companies in another economy than the one of origin. In a more detailed definition, FDI could be seen as an inflow of capital, technology and knowledge, therefore the interest of governments in creating an attractive location for enhancing FDI inflows. An extensive introduction in the FDI theory of location advantages and therefore the role of the governments in creating an attractive environment for business is presented in Popovici and Calin (2014). In this respect, efforts in improving the domestic macroeconomic conditions for increasing the international competitiveness could be seen as similar with the ones needed for developing an attractive location for foreign investors. Due to the fact that the results of increasing competitiveness are favourable for the business environment, competitiveness could also represent a determinant for FDI (Popovici and Calin, 2012a).

The paper starts with the presentation of international competitiveness definitions and continues with the assessment of similarities between the newest theories corresponding to the two notions. Finally, studies in the literature will be used for drawing several conclusions regarding the impact of FDI in the host country. We will
2. Issues in defining international competitiveness

Where do the international competitiveness and the FDI notion intersect? In the following, we will present the attempts in the literature made for defining international competitiveness of the countries, in order to emphasize the similarities with the necessary framework for attracting FDI.

For OECD, competitiveness is “the degree to which, under open market conditions, a country can produce goods and services that meet the test of foreign competition while simultaneously maintaining and expanding domestic real income” (OECD, 1992). For Schwab (2009) and in the World Economic Forum’s vision, competitiveness is determined by the institutions, policies and factors responsible for increasing the productivity of a country; in turn, productivity helps to obtaining a sustainable level of prosperity that enhance the citizens’ revenue and the economic growth in the long term. Narula and Wakelin (1995) see the competitiveness of a country in terms of competition on the international markets. The authors put the performance of a country on is results as regard trade and inward and outward FDI.

Buckley et al. (1988) consider that a fair measurement of competitiveness should include, firstly, the mentioning of the level of analysis (national, industrial or the company or product level) and secondly, three other aspects: the performance that competitiveness generates, the sustainability over the entire process in which competitiveness is generated and the management of the competitiveness’ process.

The most frequent difficulties are found when defining national or international competitiveness, given the fact that competitiveness is rather a concept applicable only to companies. The simple extension of the concept from the micro level to the macro level is not a solution to clarify the concept of competitiveness at the macroeconomic level (Siggel, 2006). There are several changes in defining competitiveness (Fougner, 2006):

- The change of the subject, from companies competing at the global level to states that compete. As the states become more competitive, competitiveness is seen in terms of attractiveness of countries.
- The change in the mode of action, from aggressiveness to attractiveness. Aggressiveness is more a trait of companies, which compete for increasing their profits or the market share.
- The need to also consider the satisfaction of residents. A low satisfaction level will lead to riots or resistance to change. Therefore, the government not only has to be attractive for foreign investors, but also must integrate the social logic in its strategy of creating attractiveness. This could be a basis for defining competitiveness based on the citizens’ welfare.

Recent research points to a wider framework for defining international competitiveness. For example, for Mitschke (2008), this notion is equivalent with the countries’ capacity to promote successful businesses by attracting new investors, mobile capital and human capital. International competitiveness is set in the framework limited by the international competition regarding the location and the attractiveness of an area for inputs characterized by mobility and high international demand. As the location factors gain in importance at the global level, the governments’ role is to create an attractive macroeconomic environment for these factors of production; hence the notion of competitiveness is placed in the macroeconomic sphere. Moreover, the concept of international competitiveness can also be used regarding the public policy efforts to increase the international competitiveness of companies. The role of governments is not only to attract foreign investors, but also to enhance the activity of national firms that are involved in international trade. Therefore, international competitiveness could be considered as the aggregated international competitiveness of the national companies. In this context, not only companies are responsible for achieving competitiveness, but also the governments through the public policy measures and the appropriate institutional framework for the development of the business environment. Such an approach reconciles the microeconomic and the macroeconomic dimension of the competitiveness and facilitates the connection with the efforts in attracting FDI.

Also, Delgado et al. (2012) notice two issues in defining international competitiveness. On the one hand, competitiveness is associated with a series of characteristics which contribute to a higher standard of living. On the other hand, competitiveness is associated with localization features that enhance economic growth. By increasing attractiveness, the investment inflows will increase the prosperity of a region on the long term.

3. The theoretical framework concerning international competitiveness and FDI attractiveness

a) Foundational competitiveness and the global attractiveness for investments

Delgado et al. (2012) propose a new approach on competitiveness and create the concept of foundational competitiveness. A mere definition of foundational competitiveness is „the expected level of output per working-age
individual given the overall quality of a country as a place to do business” (Delgado et al., 2012, p.2). The term is mostly connected with the notion of prosperity, thus outperforming the criticism towards the older proposal of productivity as a measure of competitiveness. Also, related to this term, the authors propose the concept of the global investment attractiveness, defined as „the gap between a country’s foundational competitiveness and its current factor costs” (Delgado et al., 2012, p.3). This approach transfers the competitiveness’ perspective into the location attractiveness for foreign investors. An attractive location would be the one that offers low-cost inputs compared to the potential productivity.

The foundational competitiveness could be influenced by both micro and macro competitiveness. For the authors, macroeconomic competitiveness refers to the social infrastructure (such as the health and educational system), the political institutions, the fiscal and monetary policy that adjust the economic activity in the short and medium term, the quality of institutions and the rule of law. In brief, the governments’ actions heavily influence and create the general framework for enhancing productivity. Microeconomic competitiveness is related to the specific factors that determine the national business environment, the organization and structure of economic activity and the use of sophisticated management practices.

Mitsche (2008) subscribes to a similar approach in terms of international competitiveness, stating that it is influenced by both the microeconomic factors, as well as the macroeconomic ones, so that both the state and the national enterprises are responsible for the international competitiveness of the economy.

The authors test their hypotheses using an empirical analysis on 130 countries during 2001-2008 with over 120 micro and macroeconomic indicators meant to capture the influence of the microeconomic competitiveness, the social infrastructure and political institutions and the monetary and fiscal policies over the output per potential worker and finally over the national prosperity.

After identifying the fundamental factors influencing competitiveness, the authors comprise a global competitiveness index for each of the countries surveyed, for each year. The relationship between the estimated level of competitiveness and the labour costs provides a measure of the overall attractiveness of countries as an investment location.

The countries scoring a high global attractiveness of investments, therefore with low factor costs (low labour costs in the authors’ example), are growing faster (such as China and Singapore). Actually, these types of countries (China, India, Singapore) are attractive for investors not because their low labour cost, but because their labour cost is low as compared to their foundational competitiveness. In 2008, Romania registered a labour cost close to that of Taiwan or Hong Kong, but below Singapore. Still, Romania has a lower performance in foundational competitiveness, therefore is less attractive for investments.

The analysis also confirms that the labour costs are relevant only when they are compared to the foundational competitiveness. The countries with high labour costs have a better social infrastructure and are more prosperous. The external balance of countries is neither a good estimator for the notion of competitiveness that encompasses prosperity. In their study, the external balance is influenced only by the monetary and fiscal policies; the microeconomic competitiveness, the quality of the social infrastructure and political institutions and the output per capita have no influence. Also, the export performance is positively determined by the microeconomic competitiveness, but not by the social infrastructure and political institutions.

b) Outcome competitiveness

Aiginger et al. (2013) are disputing the limited and obsolete framework for the analysis of competitiveness, enclosed by the use of the trade balance and current account. The authors consider that the ultimate goal of a society is not focused on the external balance, but on the wealth of its citizens, seen in the high level and increased revenues, the opportunities for employment and the improvement of the living conditions. The notion of competitiveness used by Aiginger et al. (2013) is expanded to encompass the Europe 2020 objectives.

The GDP per capita is not sufficient for expressing the wealth of a country in a manner that takes into account the new perspectives on competitiveness. There are several “beyond-GDP goals” that a nation must achieve for ensuring the wealth of its citizens. Therefore, the outcome competitiveness under new perspectives allows capturing the road of an economy towards a socially inclusive and ecologically growth, in order to create high-income industrialized regions.

c) International competitiveness as nations’ attractiveness

Fougner (2006) places the concept of competitiveness in the wider framework of the competition between states. In this context, the competitiveness of a country or an economic actor cannot be assessed than on the basis of competition and rivalry with another competitor in providing a good or service. Subsequently, considering the influences of globalization, the author's purpose is to demonstrate the transition from competitiveness as rivalry between locations to competitiveness expressed as attractiveness of a location.

Mitsche (2008) also subscribe to this approach. In his effort of defining the national competitiveness, the author draws the attention on the attractiveness of a country for foreign investors, suggesting that the notion of macroeconomic competitiveness should be built in the same way, without simply aggregating the microeconomic
competitiveness of domestic companies. In the centre of the competitiveness’ notion is the ability to attract mobile production factors, such as the qualified work force, capital and innovative entrepreneurs, as these factors contribute to obtaining positive spillovers, which further stimulates the development of a region.

The effects of globalization and economic integration (as is the case of the European Union) made that the location of the productive activity to become utterly important for public policy makers (Dembour, 2008). This is due to the fact that the location of the production becomes increasingly disconnected from the final destination of the products. In this light, local authorities have two choices: either to be fiscally attractive or to develop a favourable economic environment.

Still, there are critics regarding this approach for competitiveness that mainly concern the compromises that could be done for improving attractiveness. If the incentives granted to attract FDI lead to reduced revenues for the host location or the motivation of the investors is the exploitation of resources, FDI inflows cannot be a measure of competitiveness.

d) FDI theories regarding attractiveness of host location

John H. Dunning provides a milestone in the explanation of transnational companies’ activity by proposing the eclectic paradigm (or the OLI model). In this context, the location advantages in the host country gain a growing interest for policy makers. The particular advantages in the host country not only are attractive for foreign investors, but also influence the quality and the dimension of the investments’ inflows.

Starting from this theory, the recent approach of Dunning and Zhang (2008) divides the location of FDI in a physical and human environment. The physical environment is composed by resources (both the natural resources, including the unqualified labour force and the created resources, such as the technological capabilities and the endowment with machinery and buildings), the capabilities (composed by the intangible assets related to the human capital and governance) and the markets (characterized by openness, the ability to meet the needs, the cooperation and exploitation potential). The human environment is composed by institutions and the system of values and beliefs, which establish the rules of the game. According to the empirical analysis of the authors, the institutional development, followed by the markets efficiency, the incentives, the technological infrastructure and the innovation capacity are the main elements responsible for the investors’ location decision.

4. FDI impact on host countries

a) Different impact depending on FDI types

The FDI typology based on the investors’ motivation allows the classification of FDI into “desired” and “less desired” or, slightly forcing the meaning of the term, into “competitive” and “not competitive” FDI.

According to the theory, based on the investors’ motivation, FDI could be grouped into resource-seeking FDI, new market seeking FDI, FDI for restructuring the actual foreign production and new strategic assets FDI. This classification allows the identification of further externalities. For Lall and Narula (2004), the first two types of FDI are resource exploiting investments that use the specific assets of the company and are more often found in developing countries. The last two types of FDI are investments made for increasing the assets of the companies – made in order to protect or to increase the existing ones.

Resource-seeking FDI are one of the most spread types of investments, usually being focused on the exploitation of the natural resources in a given area. In the absence of government measures to support long-term interests of the country, these types of FDI may prove damaging for the area. The aim of the governmental measures is to defend the country’s interests against the interests of the foreign investment company whose objective is to make profit. Central and Eastern European (CEE) countries and the Commonwealth of Independent States (CIS) were attractive for foreign investors at the beginning of the transition to a market economy precisely due to the abundance of natural resources (Kinoshita and Campos, 2006).

Therefore, the first two types of FDI are exploiting the advantages of a location (for example, once the labour force costs are increasing, the companies can relocate to other countries) and are made for primarily answer to their own needs. The last two types of FDI represent a win-win situation for both the companies and the economic wealth of the host country. Large foreign companies often abuse of their dominant market position and succeed to obtain concessions from governments in exchange for their investments (Demekas et al., 2007). Moreover, as the income of the host country is growing, the FDI composition will change; horizontal FDI will replace vertical FDI, and thus the host country will attract more sophisticated investments, with a higher added value, while the investors initially attracted by the lower costs will relocate their investment.

A similar evolution is presented in the model of the “flying geese”, firstly developed in Japan. This model suggests that, with the industrialization of the host country, the type of FDI will change: investors will sought these types of countries due to their increase in skills and abilities, while the less complex investment activities will move from the more advanced countries to the countries newly opened investors (Kalotay, 2004).

b) Reasons for why FDI cannot be a measure of competitiveness
The lack of overlapping between the goals of transnational companies and those of the host countries’ governments

The role of governments is to boost economic development, while companies’ aim is to increase their profit and competitiveness. Lall (2001) notices that, despite some similar objectives, the differences are also important. The effects of FDI are difficult to estimate due to the delicate assessment of a scenario where the economic development is not influenced by FDI inflows. The results of the studies in the literature supply a composite impact of FDI on host countries. The role of governments is to enhance the positive effects and minimise the negative ones. Lall (2001) considers that policies regarding FDI should correct the information and coordination failures of the markets in the countries where FDI inflows are poor and to conciliate the aims of investors with the ones of the host location for avoiding the negative impact of FDI.

The need of endowment with “absorptive capacity”

Complex and qualitative investments are attracted by high levels of abilities, such as advanced skills of human capital, clusters and institutions dedicated to supporting this type of activities (Lall, 2001).

If we refer to the FDI definition that regards the inflows as a transfer of technology, it is certainly necessary for the host country to be endowed with the ability to use this technology. In this respect, Lall and Narula (2004) relate to the concept of absorptive capacity of a country, consisting of four components: the absorptive capacity of the industrial sector, the basic infrastructure, the advanced infrastructure and the formal and informal institutions. Companies depend on the provision of public goods. Also, the endowment with technological capacities has the role of customizing the location advantages in order to restrict their generality (Lall and Narula, 2004).

5. Conclusions and measures for enhancing international competitiveness and FDI inflows

Although FDI inflows could not be proposed as a measure for international competitiveness, the framework for both increasing the international competitiveness of a country and attracting FDI is submitted to similar measures.

As regards FDI, there is a need for permanently improving the attractiveness of a location for foreign investors (Paul et al., 2014), either the countries are developed, developing or in transition (Popovici and Calin, 2012b) or less developed (Makoni, 2015). The same is available for increasing the international competitiveness. More and more countries that compete for mobile resources are offering low labour costs, while the technological changes erode the competitive advantage of low labour cost that is one of the main determinants of FDI (Lall, 2002). Therefore, it is for the quality of the local capacities and institutions to become the main advantages for attracting foreign investments. In this respect, there is a need for governments to have a proactive attitude in creating international competitive capacities. The behaviour of the transnational companies is to locate in areas that provide the most suited immobile resources (such as abilities, infrastructure, services, manufacturers’ networks, institutions) for their mobile assets (Lall, 2000). For example, the high added values’ activities are increasingly depending on the knowledge-intensive assets or information, not only in high-technology sectors but in other sectors, previously regarded as a resource or labour intensive (Narula and Dunning, 1998).

Mitschke (2008) considers that competitiveness has two dimensions: the attractiveness of a country and the international competitiveness of domestic companies; therefore, the international competitiveness of nations is based on two factors: the governments and the national companies. For the governments, the instruments that impact both the attractiveness of the country and the competitiveness of national companies are the fiscal policy, the monetary policy (through maintain a low level of inflation and interest rates), the capital market’ regulations, the public infrastructure, the social and environmental standards, the trade and competition policy, the education system and the research and development policy. At the same time, the governments could create special economic areas for increasing the attractiveness of a location for foreign investors or could develop industrial policies for national companies, thus enhancing their competitiveness.

As regards the national companies, the involvement in developing industrial clusters, the competitive behaviour or the research and development cooperation have impact on the whole country attractiveness, while the disposition towards innovation, the productivity, the business strategy, the management capabilities and export orientation directly affects their international competitiveness.

Kozlak et al. (2013) state that the determinants of competitiveness are sensitive to policy instruments at different levels and therefore they could be influenced by either the EU, either the national or regional policies. The authors divide the determinants into three categories: the infrastructure endowment and accessibility, the human resources, and the environment productivity. Some areas may be influenced by all the three levels of policies, such as basic infrastructure, internationalization and innovation (as a result of the specific EU policies in these areas), while others are more difficult to influence and require a long-term intervention, such as the demographic trends or the management skills. The national policies have a strong impact on the factors determining competitiveness in all the three categories mentioned above and overlap the policies needed to attract foreign investment.

The development of new sources of competitive advantage is able to ensure a sustainable growth; therefore, a policy framework to facilitate and accelerate this process, considered the essence of competitiveness strategy (Lall,
6. References


