FOREIGN DIRECT INVESTMENT INFLOWS AND EFFECTS IN THE CZECH ECONOMY IN THE LIGHT OF ECONOMIC CRISIS

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Abstract

Economic crisis coming to the Czech Republic as a globalized factor affected many areas of economic life. One of them is the investment process the sources of which come from domestic investment capital, but also from foreign capital inflows in many forms. One of them is foreign direct investment. The Czech Republic was an attractive country for foreign direct investment inflows in 90-ies, going from short-run to long-run investment, through investment incentives to structural changes of the Czech economy. The aim of the paper is to analyze the changes in FDI inflows coming from the beginning of the 21st century, affected by global financial crisis and stagnation of the Czech economy. The paper deals with the FDI effects assessment on the Czech economy (particularly concentrated on Moravian-Silesian region cases) and a glimpse of comparison to the situation in neighbouring countries. Moravian-Silesian region is the third most successful receiver of FDI in the Czech Republic. Some projects are perspective, although some others did not succeed. Nevertheless, no country today can exist without foreign capital; in spite it brings not only positive effects.

Key words: foreign direct investment, global financial crisis, investment incentives, equity capital, reinvested profit

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Introduction

In globalized, deeply integrated world flows of goods, services and production factors move across the boundaries of countries not seeing at what continent and what level of development they exist on. The important part of such flows is represented by foreign capital with its outward and inward movement. Investors seek not only for new markets (as they did originally), but also for higher efficiency, profit opportunities, sharing risks and stronger economic stability.

The decision where to allocate capital is based on capacities and objectives of particular investors, and can also be given by host country conditions. Effects on host country connected with industry and firms characteristics are broadly analyzed and evaluated (see e.g. Rasciute et al., 2014).

There are several forms of foreign capital flows as foreign direct investment (FDI) (on brownfields or on greenfields), portfolio investment, and joint venture, acquisition of 100 % of shares or privatization from the state ownership to private hands. The aim of the paper is to deal particularly with FDI inflows.

FDI according to characteristics given by the Czech National Bank in FDI statistics methodology (see CNB) represents directly or indirectly owned affiliations that are divided into three groups according to investor’s percentage share on equity capital and votes stock. In a filial (daughter company) the investor’s share is above 50 % of equity, in a related company the investor’s share is between 10 and 50 %, and the branch is in 100 % owned by the investor. An important part of FDI (besides equity capital) is also reinvested profit and other capital including credit relations to the direct investor, it means credit and debit relations among affiliated firms, and other firms in a group.

The FDI inflow is expressed in market prices, the stock of FDI is shown in accounting value (equity and reinvested profits). Besides that the benchmark definition of FDI given by OECD (2008, 2014) is a recommended basis for FDI.

The Czech Republic is traditionally an attractive space for foreign capital inflows, as analyzed by institutions (CNB, OECD, World Bank, Eurostat), and many authors (Cedidlova, 2013), who bring not only necessary statistics, but also assessment of positive and negative effects of FDI on host country, and also on domestic countries (Brash, 2012, Vaknin, 2014). The history of FDI is rather long as shown in Kozenkow (2014). Besides that, Czech investors started increasing their activities abroad since 90-ies, and in spite they come from a small-size economy, their success in some cases can be taken as remarkable (Zemplinerova, 2012).

The aim of the paper is to find whether the link exists between economic development in the Czech Republic under depression, and FDI inflows in the period of 2008 – 2013.

1 Macroeconomic figures in the Czech economy in 2008 - 2013

The Czech economy went through the period of financial crisis in 2008 – 2013. The consequences of depression can be seen till now especially in the form of relatively high unemployment.

After dynamic economic growth in 2005 and 2006 (6.8 %, resp. 7 %) there was a slight decrease in 2007, and the deepest decline came in 2009. In 2010 a recovery occurred, followed by decrease of -1.0 % in 2012 and -0.9 % in 2013 as the consequence of tough restrictive fiscal policy. Such volatility of economic activity does not correspond with the development of the rate of unemployment, which culminated in 2004, decreased to 2008, and then faced the steady increase to 8.2 % in 2013.

The rate of inflation was the lowest in 2003 (0.1 %), and then very mild till 2008 when it reached 6.3 %. In following three years inflation was again so mild that there was a threat if deflation, then a moderate growth of 3.3 % in 2012, and in 2013 again decreased to 1.4 %.

Tab. 1: Macroeconomic figures of the Czech economy in the period 2008 – 2013

		2008	2009	2010	2011	2012	2013
Economic growth	%	3.1	- 4.5	2.5	1.8	- 1.0	- 0.9
Rate of unemployment	%	4.4	6.7	7.3	6.7	7.0	8.2
Growth of exports of goods and services	%	3.9	- 10.9	15.5	9.5	4.4	0.1
Rate of inflation	%	6.3	1.0	1.5	1.9	3.3	1.4

Source: Own calculation on CZSO data

The growth of goods and services exports is closely linked to activities of foreign entities in the Czech economy, because export performance of foreign capital is usually higher than that one of domestic firms. The growth of exports reached its peak in 2006, when it was 14 %. From 2008 there was a decrease to 3.8 %. 2009 year was critical in many aspects, exports fell down for 10.9 % followed by swift movement up in 2010, and from this moment exports steadily decrease; in 2013 they in fact stagnated compared to 2012.

So we can say that economic development in period 2008 – 2013 was on one hand affected by global financial crisis, and on the other hand it had its own logic given not only by external growth factors, but also by economic policy and practice in the Czech Republic.

2 Statistics of FDI inflows to the Czech Republic in 2008 - 2013

The Czech Republic is traditionally an attractive space for foreign investors. Taken as a stable economy with good geographic position, big industrial tradition, highly skilled labour, market and profit opportunities, and some investment incentives, the Czech Republic has now the stock of foreign investment of about 2 600 billion CZK (95 billion EUR). The process of taking foreign investment went from scepticism given by the view that the Czech Republic did not need foreign investment at the beginning of 90-ies because of its advantages compared to other Central and Eastern European countries under transition. Then the view was gradually changed within the process of privatization and structural changes, and the lack of capital for upgrading technologies and productions.

The process of FDI inflow is shown in Table 2. We can see that there are big changes in the volume of invested capital among individual years, and the link to global financial crisis is not so visible. The main reason is that the Czech Economy is a small size economy and so one big investment project changes not only year-to-year values, but it is also impossible to follow some trend.

Tab. 2: FDI inflows to the Czech economy in the period 2008 – 2013 (mil. EUR)

		2008	2009	2010	2011	2012	2013*
Equity capital	mil. EUR	788.0	722.0	1785.0	- 780.2	2565.4	2321.1
Reinvested profits	mil. EUR	1652.5	2559.9	3002.1	1545.9	3103.1	3669.2
Other capital	mil. EUR	1975.0	- 1172.1	- 149.9	902.3	548.3	- 2230.2
Total	mil. EUR	4415.4	2109.8	4637.2	1668.1	6216.8	3760.1
Economic growth	%	3.1	- 4.5	2.5	1.8	- 1.0	- 0.9

* Preliminary data

Source: Own calculation on CZSO and CNB data

Nevertheless it is interesting to look at all three parts of FDI and their different development. Each of them has its own dynamics. In spite the most critical year according to macroeconomics figures was 2009, FDI inflows have the most critical period in 2011, when even the equity capital decreased. A strong modification is given by “Other capital” (credit and debit relations among firms within the group) – there is a wide volatility year-to-year, and so the total amount of FDI is strongly affected by this.

On the other hand, the most stable in trend are reinvested profits, with the exception of 2011 year.

3 Characteristics of FDI inflows in 2008 - 2013

The FDI inflows show some long-term tendencies. On the other hand, FDI inflow in the Czech economy had some peak periods in the short history from the 90-ies, after which the decline came. The first peak was in 2002 where FDI inflow represented 9 bill EUR, which was for a half more than 6.2 bill EUR in the previous year. But then, 2003 there was a dramatic fall to 1.8 bill EUR, followed by 4 bill EUR in 2004.

The highest FDI inflow came in 2005 (9.4 bill EUR) thanks to several big investment projects. After some fall in 2006 to 4.3 bill EUR there was another successful year, 2007, with 7.6 bill EUR.

The period 2008 – 2013 as for FDI inflow looks relatively better than economic development, as shown in the Table 2.

OECD in its review FDI in Figures (www.oecd.org) assumed the peak of worldwide FDI movement to be in 2007, which was valid for the Czech economy, too. Up to the peak in 2007 the stock of FDI in the Czech economy reached 73 bill EUR. In 2007 FDI went mainly to increasing equity capital in existing firms under foreign control, and to several smaller projects. High reinvested profits and paid out dividends show remarkable profitability growth of firms under foreign control.

In 2008 FDI inflow was represented mainly by credits provided by branches within the group from abroad, by increasing equity capital, and several smaller investment projects. Again, like in 2007, reinvested profits and dividends for foreign owners grew. This tendency went on in following years, too, and showed some advantage aspects of foreign owned firms. Within this tendency dividends paid to foreign owners grew more quickly than reinvested profits. In 2011 reinvested profits stagnated, but dividends were higher than in 2010.

In 2012 there was a positive tendency; equity capital, reinvested profits, and dividends grew remarkably compared to 2011. In 2013 total amount of FDI inflow fell down because of negative value of “other capital”, in spite reinvested profits grew for 17 %, but equity capital slightly decreased.

Territorial and industrial structures of FDI inflows to the Czech economy have more or less stable tendencies. In 90-ies there were changes in both characteristics, but 21st century shows repeating results.

Traditionally the highest share of FDI inflows goes to financial services, means of transport (especially cars), trade, and services in real estate and for firms, services more than manufacturing industries.

Territorial structure of FDI shows that more than 90 % inflows come from Europe, especially from Netherlands, Germany, and Austria, then from France, Luxembourg, Switzerland, Belgium and Cyprus. Such countries of origin as Netherlands, Luxembourg and Cyprus are so called third countries where firms move due to tax optimization. From outside Europe only very small share of FDI comes, mainly from the USA and Japan, and some big projects come from Korea, individual projects from Sweden, Spain, Slovakia, Thai-wan or UK. As for profit outflows, a visible part of them goes to offshore financial centres.

4 Positive and negative effects of FDI on the host economy - discussion

In this chapter some controversy in views on FDI is presented so as to enrich the approach to FDI and its evaluation. FDI have multidimensional effect – on the host country, on mother country, and also on the particular multinational company that realizes FDI. There are two opposite views on FDI, aversion, and irrational expectations, extremely pessimistic (or sceptic) on one hand, and extremely optimistic on the other one.

Evaluation of positive and negative effects of FDI is determined by the fact that FDI are realized in the interest of multinationals, not of host countries. This is what many economists do not take into account, but this is the right basis for assessing the efficiency of such investment. So effects on host country are in principle side effects of investment,

Nevertheless there are many visible effects of FDI activities – effects on economic growth, balance of payments, employment, consumption, spillover of knowledge and technologies, factor productivity, export, and distribution. Those effects can be both positive and negative given by the FDI character, and host country conditions.

Besides that there are many myths connected with FDI effects, as for instance the effect on employment. We have to take net change in employment given by the difference between new job places and withdrawn job places in other firms coming from higher productivity and competition.

Similarly we can evaluate the effect on the balance of payments (Brash, 2012). The classical interpretation that FDI inflow has a positive effect on balance of payments, while the profit outflow has a negative one, can lead to a conclusion that it is better not to have foreign investment. But such result does not take into account value added by FDI – a part of it take foreign shareholders, but also local employees (those who directly work in the firm, or those in other firms, who can have higher wages thanks to higher demand for labour on labour market). Parts of value added by FDI consumers take thanks to lower prices, higher quality or wider choice. And finally, parts of value added by FDI take financial authorities in the form of tax revenue.

On the other hand, value added by FDI should be decreased for deadweight loss coming from liquidating local firms due to stronger competition. Discussions like that can provide deeper insight to the topic of FDI.

In Moravian-Silesian region FDI play a very significant role. In industrial zones there work tens of foreign branches. The most successful project is probably realized by Hyundai, coming from 2006, and starting cars production in 2008. Besides that Hyundai brought to the region several more Korean firms that provide for Hyundai production of spare parts.

Moravian-Silesian region is after Prague and Central Bohemia the third most successful receiver of FDI in the Czech Republic. Many projects have positive effects on economic figures of Moravian-Silesian region, including employment and competitiveness. On the other hand, there are also firms that did not succeed – Philips in Hranice, JobAir in Mošnov, Evraz in Vítkovice, and, potentially, Arcelor Mittal (who is time-to-time declaring leaving the region especially in connection to environmental requirenents).

5 Looking to neighbours

The Czech Republic has neighbouring states linked to it by historical, cultural, and close economic relations – Slovakia, Poland and Hungary. All four states have an intention to exploit benefits of FDI inflows. Each of them has some specific features of their development going to some particular differences in economic performance and stability. This can be shown also in connection with FDI inflows in the chosen period. 2013 data are not available, and for the sake of comparability the percentage share of inflows and of stock on GDP can be used.

Tab. 3: Comparative data of FDI inflows (% GDP) in the period 2008 – 2013

		2008	2009	2010	2011	2012	2013
Czech Republic	%	2.9	1.5	3.1	1.1	5.4	
Slovak Republic	%	5.0	--	2.0	2.2	3.1	
Hungary*	%	4.1	1.6	1.7	4.2	11.1	
Poland	%	2.8	3.0	3.0	4.0	1.2	

* Without Special purpose enterprises

Source: Own calculation on OECD data.

It can be of interest to analyze the FDI inflows and FDI stock in those countries during the analyzed period. Traditionally Poland has the lowest share of FDI stock on GDP (see Table 4) due to the size of Polish economy. On the other hand this can be done by former development in the period 1990 – 2008.

On the other hand we can say that peaks are in different periods in those countries, and so we can see that global financial crisis did not have parallel effect of the same strengths and orientation on those countries.

Tab. 4: Comparative data of FDI stocks (% GDP) in the period 2008 – 2013

		2008	2009	2010	2011	2012	2013
Czech Republic	%	50.2	63.8	64.6	55.5	69.5	
Slovak Republic	%	54.1	60.2	57.6	53.4	60.8	
Hungary*	%	57.1	78.0	70.9	61.0	82.3	
Poland	%	31.0	43.0	45.9	39.5	48.0	

* Without Special purpose enterprises

Source: Own calculation on OECD data.

The factor of the same importance is economic policy in those countries and measures oriented to overcoming the consequences of economic decline which all four countries went through. Another factor has a visible significance – the size of the economy. Seemingly the Czech Republic and the Slovak Republic as small size economies are affected by individual big investment projects. Hungary has the highest fluctuations (which can be connected with economic weakness of the country), and Poland shows the highest stability in dynamics of FDI inflows.

Conclusion

Today's countries cannot exist without economic relations to other countries. In globalized world multinational companies take stronger and stronger economic power, so they are able even to modify economic policy measures of standard states.

Multinationals usually are the holders of FDI incoming to host countries which can take advantages or problems from attracting FDI.

The Czech Republic is a successful receiver of FDI with some negative consequences, but prevailing benefits. Even in the period of global financial crisis when investors were more aware of widening their activities and undertaking international risk (McKibbin, 2009) FDI came to the Czech economy. We can only guess whether the depression would have been deeper without FDI, as international activities of multinational companies who are the main providers of FDI are assumed to contribute to higher performance of host countries (Alfara, 2010).

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