Impact of Globalization and Foreign Direct Investment on the Regional Economies: The Case of the Czech Republic

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Abstract

The inflow of foreign direct investment is one of the key indicators of competitiveness of the national economy and regions in the Czech Republic. In the case of transitive economies (such as the Czech economy), globalization is deeply associated with the inflow of foreign direct investment that is able to integrate the national economy to global markets and global production chains. The aim of this paper is to analyze the role of foreign direct investment as a carrier of globalization in the case of the Czech Republic. The second aim is to evaluate the impact of foreign direct investment at regional level and to analyze regional differences within the Czech Republic, which could show different ability of regions to compete in global economic space.

Key words: foreign direct investment, region, Czech Republic, globalization, competitiveness

Introduction

Current research of regional development stresses the importance of the institutional context of regional development (Rutten and Boekema 2007: 138). From the institutional economy point of view, the actor is strongly interwoven through contractual relationships and market mechanisms with other entities (Mlčoch 2005) and uses networking to optimize its market position. The institutional approach also provides new insights into the socio-economic development of the state and its regions (Toušek and Tonev 2003: 456) and the operation of regional actors within the national and international market mechanisms (Hamppl, Žížalová and Blažek 2008: 705, Viturka 2010: 132).

From the path dependence point of view, the Czech Republic and the other transitive economies in Central and Eastern Europe are strongly determined by the development in the past and, therefore, they require high levels of foreign direct investment for the restructurization of their economies (Pavlínek 2004: 47). The transformation of the spatial arrangement of the economy is based on the intensification of the globalization processes (Jeníček 2002: 2) which results in a faster growing volume of world trade than the world economy. International companies are looking for new possibilities of expansion that are reflected in the inflow of foreign direct investment in national economies.

According to Britton (2005), the inflow of foreign direct investment will result in the decrease of the original mutual dependence of home companies that will be successively integrated into global production chains. The mechanisms and actors of regional development
are formed by rather complex societal systems at different order levels that are difficult to encompass in their wider context at an elementary research level. The amount of FDI inflow could be considered as the indicator of success of the transformation process and a sign of the investors' trust in the stability of the system.

**Positive and negative effects of FDI**

Foreign direct investments can accelerate the transition process (Bevan and Estrin 2004: 776). Investors bring modern technologies into the country and support technological progress (Srholec 204: 44), increase production efficiency and promote the restructuring of enterprises (Pavlínek 2004: 48). At the same time, in terms of human resources management, they allow knowledge, skills and experience sharing in the affiliate companies in the host country, especially in the fields of research and development, know-how, production organization and sales and in the field of management skills. FDI also contributes to the development of domestic companies because increased investment by supranational companies can help local companies through subcontracting relationships. Supranational companies can open access to foreign markets that would otherwise be difficult to enter for local companies, resulting in new export opportunities. Generally speaking, they contribute to a change in the institutional environment (Dunning 2008: 178), help to improve the efficiency and competitiveness of the host country, and increase the pressure to improve adherence, protection and enforceability of intellectual property rights. These supranational corporations are given preferential treatment and unemployment can rise significantly in those regions with a small inflow of FDI.

However, foreign direct investment can also indicate some negative effects. Foreign investors can displace local competing enterprises, particularly when focusing on the local market. In practice, hostile acquisitions of companies can take place in order to decrease competition so that the foreign investor could flood the market with its products. This inflow of the foreign investors can also be reflected in the increased unemployment level in the case of the development of capital-demanding production at the expense of work-demanding production. In association with the restructuring of production, streamlining of operations and the introduction of new technologies, the number of jobs is reduced in many industries. The increased unemployment level especially applies to acquisitions (i.e. purchase of ownership interest in local companies) while on the contrary, FDI in the form of green field investment increases the employment level. In the interest of winning new foreign investors, the state administration may either limit or neglect support for local companies that are associated with excessive optimistic expectations and concessions to foreign investors. All comparisons of the business performance confirm that companies with FDI are much more technically developed and outperform local companies. After all, it is true that in each country and industry, exporters are more productive than other companies and companies investing abroad are more productive than exporters without foreign investment. This is the origin of the usual argument in support of FDI from public resources - it is expected that exceptionally productive foreign companies will positively influence the operation of local companies after their arrival and that these local companies will learn better technologies through subcontracting relationships. However, the consequences can also be negative; the arrival of a developed company at an industrial area can result in the decline or termination of local competitors. Another negative phenomenon also is transfer pricing or price handling in supranational companies that try to elude high taxes and reduce tax revenues by transferring otherwise taxable amounts between countries with different taxation levels. In addition, the system of investment incentives distorts the economic environment and disadvantages domestic companies compared to foreign companies. Governments in different countries approach investment support in different ways and with different levels of intensity.
Macrophysical differences in inflows of FDI in the Czech Republic

Supranational companies play a prominent role in research and development in transitory economics. Due to globalization, markets and international business relations are less determined by the national borders. At the macro-regional level, the world trade growth dynamics is reflected in the restructuralization of the transition economies in Central and Eastern Europe which have undergone a profound transformation over the past twenty years and have become a new investment opportunity for many foreign companies.

Foreign investors transform these economies by means of the foreign direct investment, support of corporate research and development, as well as development of new sub-contractor relationships. The vast majority of foreign direct investment originating from the EU member countries goes to the OECD countries although we can see that a growing share goes to developing economies. The difference in FDI is also obvious within the EU where the majority of the original member countries have recorded a drop in investment activities in favor of the new members.

As Table 1 shows, the inflow of foreign direct investment in the Czech Republic is not stable. The period from 2000 to 2009 saw a great oscillation in absolute values of foreign direct investment. From the territorial point of view, the role of the European countries is most important. It is witnessed by the relative values that represent a share of the foreign direct investment from Europe with respect to the total amount of the foreign direct investment to the Czech Republic. In average, the share of Europe accounted for about 89 % during the monitored period of time. The lowest share 57.13 % was achieved in 2003; in this year, the foreign direct investments from America (26.29 %) and Asia (16.16 %) to the Czech Republic were relatively strong. A lower share of the European investment was also reported in 2009 with 76.68 % share. Once again, this weaker position was due to relatively stronger position of American investment (31.48 %) and for all other territories, negative values of foreign direct investment were reported. Should we take a look in the opposite end, i.e. the years with the relatively highest shares of foreign direct investment in the Czech Republic compared to the total volume of foreign direct investment in said years; the year 2008 was exceptional when foreign direct investment from Europe to the Czech Republic was relatively and absolutely higher than the total value of the foreign direct investment worldwide – they accounted to 107.7 % share. For other parts of the world, the foreign direct investment values were negative and therefore, they reduced the value for the European countries. A high share of Europe was also achieved in 2009 with 99.51 %, again thanks to low shares of the other parts of the world.

Table 1: Share of territories in inflow of foreign direct investment to the Czech Republic

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</thead>
<tbody>
<tr>
<td>Europe</td>
<td>76.68</td>
<td>107.74</td>
<td>88.34</td>
<td>99.51</td>
<td>95.02</td>
<td>87.51</td>
<td>57.13</td>
<td>96.62</td>
<td>92.45</td>
<td>89.48</td>
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<tr>
<td>Africa</td>
<td>-0.01</td>
<td>0.01</td>
<td>-0.05</td>
<td>-0.35</td>
<td>-0.09</td>
<td>0.94</td>
<td>0.64</td>
<td>-0.02</td>
<td>-0.01</td>
<td>0.00</td>
</tr>
<tr>
<td>America</td>
<td>31.48</td>
<td>-3.94</td>
<td>-0.17</td>
<td>0.16</td>
<td>3.43</td>
<td>10.08</td>
<td>26.29</td>
<td>2.04</td>
<td>6.39</td>
<td>9.46</td>
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<tr>
<td>Asia</td>
<td>-8.11</td>
<td>-2.66</td>
<td>11.96</td>
<td>0.88</td>
<td>1.50</td>
<td>1.39</td>
<td>16.16</td>
<td>1.37</td>
<td>1.30</td>
<td>0.95</td>
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<tr>
<td>Oceania</td>
<td>-0.12</td>
<td>-0.01</td>
<td>-0.07</td>
<td>-0.21</td>
<td>0.14</td>
<td>0.07</td>
<td>-0.22</td>
<td>-0.02</td>
<td>-0.14</td>
<td>0.10</td>
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<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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Source: Calculation based on data from the Czech National Bank

From the point of view of the Czech Republic, the EU member countries played the major role in the inflow of foreign direct investment in Europe. They contributed to almost 90% of
the total European values in the period in question, with the maximum value in 2005 (100.39 %) and minimum value in 2003 (76.27 %). In 2009, the highest foreign direct investment came from Cyprus followed by Belgium and Austria. The top ten with tailing Hungary included, for example, Mexico. In 2008, the top three were Austria, France, and the Netherlands. Interesting countries in top ten include Malta or the Bermudas. In 2007, the Netherlands occupied the first rank followed by Luxembourg and Germany that ranked first in 2006. Spain was the country with the highest share of foreign direct investment in the Czech Republic in 2005. A stable ranking was reported by the Netherlands that often ranked the highest and in 2004, it was the leading country; rather high investment came also from France and in 2003 and 2001, they accounted for most investments in relative terms.

**Figure 1:** Regional differences in the inflow of foreign direct investment in the Czech Republic between 1999 and 2009 per capita (in thousand CZK)

Source: Calculation based on data from the Czech National Bank

Deployment of FDI in the Czech Republic can be regarded as fragmented because rather substantial regional disproportions can be observed (see Fig. 1). The regional factors, which influence the location of FDI, include, among others, quality and availability of human resources, economic structure, transport infrastructure and especially the effect of agglomeration savings strongly interrelated with the metropolitan areas of the Czech Republic. Following Prague, only Mladá Boleslav county holds a very strong position due to the highly concentrated level of investment associated with investment by Volkswagen in the automotive industry and the Škoda company.

In addition to the concentration in the metropolitan areas, the diagram shows a surprisingly high concentration of FDI in the north-west region of Bohemia (Hlaváček 2009: 30). Reinforcement of the north-west in addition to the north-east regions is the result of investment both into existing industrial companies and into the location of the so-called

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incentive investors due to the investment incentives system which is primarily focused on regions with above average unemployment.

It is impossible to draw any conclusions regarding the success of the economic transformation based on regional differences in the inflow of FDI. The uneven deployment of FDI for higher investment demand and higher quality (e.g. research and development investment) further supports the regional differences and highlights the markedly successful "adaption" of the regions to new global economic conditions. It can be assumed that the differences will further deepen. It is expected that countries in Central Europe will see a growing number of investors in industries with higher added value and strategic services that are much more demanding on quality human resources and the general business environment. Therefore, it can be assumed that this investment will be especially directed to the most developed regions, i.e. foreign direct investment will further act as a factor for differentiating the regions.

Conclusion

It can be said that the mechanisms which integrate regional and local economies into global production chains are still strengthening and, therefore, the globalization processes actively influence all territorial levels of the Czech Republic. New forms of economic organization of individual regions are created within the regional economies and their arrangement due to globalization. Regarding development of the economy of the Czech Republic, globalization is closely associated with the process of economic transformation with differentiated impacts on regions. When closely looking at the districts of the Czech Republic, it is obvious that the investments are located highly unevenly. The differences in deployment of the foreign direct investment are associated with the size of towns when the regional centres such as Plzeň or České Budějovice, compared to remaining parts of the regions, show higher attraction for foreign investors.

Other differences in the inflow of foreign direct investment are related to the region's geographical position within the Czech Republic. Generally speaking, the higher the regional differences in the inflow of foreign direct investment, the more obvious are the globalization processes in the regional development process. Dependence of the regional economies on the world market grows via the sub-contractor relations. Therefore, the inflow of foreign direct investment is also an indicator of success of economic development and competitiveness of the region because successful export proves the ability of a region to succeed in the international competition that continuously increases due to globalization.

References


