

Foreign Direct Investment in the Context of the Economic Recession in Slovakia

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Abstract Slovakia is one of the small economies, for which it is necessary to participate in international trade and for which exports and imports are an important item of gross domestic product. Foreign direct investment flows into the open countries with underpowered own resources, which are involved in various forms of international economic integration. Foreign investment brings benefits not only for himself an investor, but also the economy of the host. The aim of article is to inform about results of research which analyzed the evolution of foreign direct investment in the context of the economic recession in Slovakia and compared this development with the world and V4 countries. Based on research, we found out that the economic recession has caused a significant decline in foreign direct investment inflows in Slovakia, in V4 countries and worldwide. The distribution of foreign direct investment enterprises in the regions of Slovakia is considerably uneven. Most of the investment goes to more advanced regions.

Keywords: *foreign direct investment, economic recession, state aid, regions, jobs*

1. Introduction

Foreign direct investment (FDI) is an important phenomenon of our time, the accompanying sign of the globalization of economic and political and social processes. Their advantage is the fact that they contribute to the efficient allocation of resources, because investors are directing their investments in those regions where the expected achievement of economies of scale. They usually adapt to various rationalization measures to this aim.

UNCTAD defines the FDI as investments based on long-term relationship to the company and reflecting the continuing interest and control of resident operators in one country (the foreign investor or parent company) in an enterprise resident in another country, which may be a company with FDI or branch of a foreign company [1].

Direct investment enterprise may be a subsidiary, associate or branch in proportion to the direct investor in the capital. Concepts subsidiary, associate or branch used in the statistics of foreign direct investment, are differ from the definitions of terms used in the internationally accepted accounting standards. Subsidiary represents more than 50% share of the direct investor's capital or voting rights in respect of associate share of 10 to 50 percent. Branch is a 100%-owned direct them to investors, it may be a permanent office or agency, land and buildings owned by non-resident direct and mobile facilities that operate in the economy more than one year. As part of foreign direct investment are considered in addition to a share in the capital and reinvested earnings and other capital - associated with various intercompany debt operations [2].

There are many reasons why investors invest abroad. It is an attempt to acquire new natural and human resources at a lower price than the domestic economy. It may be finding new opportunities for marketing products, and ultimately to increase the efficiency of production but a growth of own revenue.

FDI is an integral part of an open and effective international economic system and a major catalyst to development. The benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and the international investment architecture matter for attracting FDI to a larger number of developing countries and for reaping the full benefits of FDI for development. The challenges primarily address host countries, which need to establish a transparent, broad and effective enabling policy for investment and to build the human and institutional capacities to implement them [3].

Foreign direct investment is an important source of capital for growth in developing countries. FDI in developing countries has flowed mainly into manufacturing and processing industries. It has traditionally been concentrated in a small group of countries, which partly reflects the size of their economies and partly their attractiveness as a location for FDI [4].

Foreign investment can complement the domestic investment. However, each form of foreign investment plays a distinct and important role in promoting growth and sustainable development, boosting countries' competitiveness, generating employment, and reducing social and income disparities.

2. Methodology

The aim of the research is to analyze the evolution of foreign direct investment in the context of the economic recession in Slovakia and to compare this development with the world and V4. Tasks that were directed to fulfilling the objective are:

- analyze the evolution of FDI in the world,
- analyze the evolution of FDI in the V4 countries and Slovakia,
- analyze the impact of FDI on the regional development of Slovakia,
- identification the problems associated with FDI in Slovakia.

Research hypothesis: due to the economic recession, FDI inflows declined not only in Slovakia, but also at the level of V4 countries and around the world. Methods used in research: analysis, synthesis, comparison, induction, deduction, description, mathematical and statistical methods.

3. Economic Recession and Worldwide Foreign Direct Investment

The volume of FDI is sensitive to business cycle phases. This is also confirmed in the current period of continue economic recession. FDI inflows in the world grew continuously since 2003 until 2008, when as a result of the financial crisis and subsequent economic recession, there was a slight decline. The crisis has changed the target territories. At the beginning of the crisis have been most affected economically developed countries. In 2009, the decline extended to developing countries for which FDI often represent the only source of external financing for development. The crisis decreased inflows into private equity funds, by contrast, have a positive outlook in developing countries, investments in agricultural production, which should lead to greater availability of food safety and also to increase agricultural productivity.

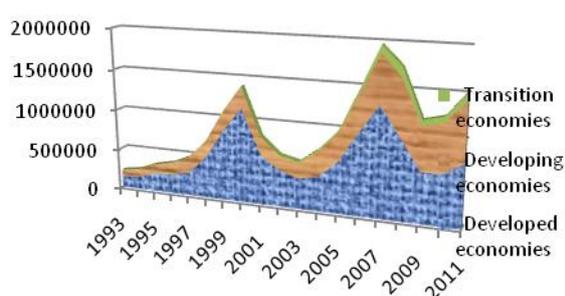


Figure 1. FDI inflows by group of economics, 1993-2011, million US dollars [4]

Global foreign direct investment inflows rose 16 per cent in 2011, surpassing the 2005-2007 pre-crisis level for the first time, despite the continuing effects of the global financial and economic crisis of 2008-2009 and the ongoing sovereign debt crises. Global foreign direct investment flows exceeded the pre-crisis average in 2011, reaching \$1.5 trillion despite turmoil in the global economy. However, they still remained some 23 per cent below their 2007 peak.

FDI inflows increased across all major economic groupings in 2011. Flows to developed countries increased by 21 per cent, to \$748 billion. Developing countries continued to account for nearly half of global FDI in 2011 as their inflows reached a new record high of \$684 billion. The rise in 2011 was driven mainly by investments in Asia and better than average growth in Latin America and the Caribbean. FDI flows to transition economies also continued to rise, to \$92 billion, accounting for another 6 per cent of the global total. In contrast, Africa, the region with the highest number of least developed countries, and West Asia continued to experience a decline in FDI.

There are top 5 host economies of around the world in 2011: USA, China, Belgium, Hong Kong, Brazil. Top 5 home economies (investors) include USA, Japan, UK, France and Hong Kong.

Table 1. Top 5 host and home economies, 2011[5]

	host economies (billion US dollars)		home economies (billion US dollars)	
1.	USA	227	USA	397
2.	China	124	Japan	114
3.	Belgium	89	UK	107
4.	Hong Kong	83	France	90
5.	Brazil	67	Hong Kong	82

During 2011, FDI in the primary sector rose gradually, due to an increase in investment in mining, quarrying and petroleum. The largest increases were observed in the food and chemicals industries. The food, beverages and tobacco industry was among those least affected by the crisis because it produces mainly basic consumption goods. The chemicals industry saw a 65 per cent rise in FDI, mainly as a result of large investments in pharmaceuticals. The automotive industry was strongly affected by the economic uncertainty in 2011. The value of FDI projects declined about 15 per cent. The decline was more pronounced in developed countries because of the effects of the financial debt crises. Financial services recorded a 13 per cent increase in the value of FDI projects, reaching \$80 billion. However, they remained some 50 per cent below their pre-crisis average. The bulk of activity targeted the insurance industry. UNCTAD predicts slower FDI growth in 2012, with flows leveling off at about \$1.6 trillion. [5]

However, the present business environment is still beset by uncertainties. Risk factors such as the unpredictability of global economic governance, a possible widespread debt crisis and fiscal and financial sector imbalances in some developed countries, may yet slow the FDI recovery. For FDI in the current period is characterized by several developmental tendencies. Most investment flows in the world economically strongest among the three regions, namely the USA, European Union and Japan. While in the recent past, dominated FDI oriented to the area of finance, is now interested in the energy, information technology and pharmaceuticals. Due to lack of natural resources and increase their prices, there is also a focus on sustainable growth and the related interest in alternative sources. For foreign investment in the world for the near future appears

to be a very interesting area of renewable energy, waste treatment and water availability, leading to conversion even more attention to the factor of production land and natural resources.

4. Economic Recession and Foreign Direct Investment in V4 Countries and in Slovakia

Visegrad Four (V4) is a political community of the Central European countries of Hungary, Poland, the Czech Republic and Slovakia. These countries agreed to harmonize common practice join the European Union and NATO. To facilitate mutual foreign trade they established a free trade association without duties - Central European Free Trade Agreement (CEFTA) in 1992.

On the Slovak territory were scarcely any FDI by 1998. This situation was caused by the fact that the government had also made efforts to build so-called Slovak capital community and it refused to open the Slovak republic for foreign investment.

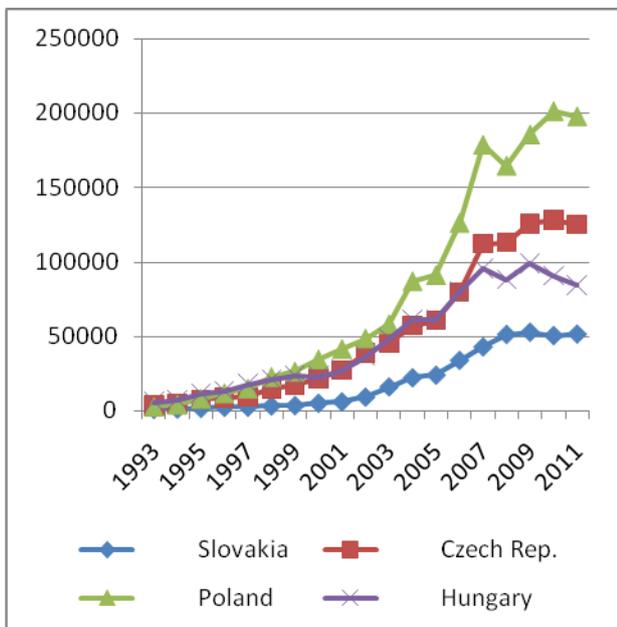


Figure 2. Inward FDI stock, by V4 countries: annual, 1993-2011, million US dollars [4]

To illustrate, while on 31.12.1998 poured in to Poland \$22.4 billion, \$14.3 billion in the Czech Republic, in Slovakia it was only \$2.9 billion foreign investment. Change occurred after the elections in 1998. At that time the new right-wing oriented government put into the practice such measures to halt the decline investment in relation to GDP, the openness for foreign countries and for create FDI inflows conditions.

In Poland, the stock of foreign direct investment culminated in 2007 (\$178.4 billion), then with the first signs of economic recession occurred fall at the level of \$164.3 billion in 2008. Nevertheless, the most of foreign direct investment of V4 flowed into Poland in 2010. Most projects were implemented by firms from Germany, France, the Netherlands, Luxembourg and USA. The largest investments were in the electronics and automotive industries, which absorbed the largest number of workers.

The positive is FDI is concentrated in electronics, aerospace, and automotive industry with a lot of a high skilled labor in recent years.

In Hungary has reached the highest level of stock of FDI in 2007 (\$95.5 billion). FDI fell to the level of \$88 billion in 2008 and it grew in 2009, FDI has fallen since. This is due to the poor economic situation in the country and the world economic recession. The largest volume of FDI went to the automotive industry and in the area of electrical machines. More than 56 per cent of FDI goes to the service sector, 36 per cent in power generation and water supply. The largest investors come from Germany, the Netherlands, Austria, Luxembourg, France and the USA. FDI stock is \$84.4 in 2011.

The sectional structure of investment flowing into the Czech Republic is long-term stability. The largest volume of FDI flows in the area of finance, then the industry of real estate and business services, trade and repair of motor vehicles. There are going up to the service sector goes up to 50 per cent of investments, in the manufacturing industry is 37 per cent. The key investors in terms of geography are those who come from the Netherlands, Germany, Austria and Luxembourg. While most investment flows into large enterprises in the Czech Republic FDI stagnated in 2007-2008 (\$113billion), but since 2009 the FDI increased slightly. Stock of FDI is \$125.2billion in 2011.

Like everywhere in the world, in Slovakia also there was a decline of foreign direct investment after 2008 due to the economic recession. This was reflected by a continuous increase in FDI, which had lasted since 2002. This situation was relieved by stagnation at around \$50 billion in 2008. Current stock of FDI is \$51.3 billion. The greatest interest in investing in Slovakia, have the investors from the Netherlands, Hungary, Austria, Germany, Italy, France, Sweden and South Korea. By 2006, FDI flows were mainly in traditional sectors. Important investment flowed in Slovakia in the area of banking as a result of the restructuring of the banking sector. At present, FDI is focused primarily in electrical, engineering, automotive, rubber, metal, wood, furniture and paper industries as well as wholesale. There is expected further investment in the energetics. Positive feature of FDI enterprises is the development of production with higher added value. [6]

When is comparing the status of FDI in selected countries, it should be recalled that the comparison was made in absolute values. To recalculate the status of FDI in 2011 to per capita, then we find that the order of the V4 countries is changed. In the first place is the Czech Republic (\$11 928), followed by Slovakia (\$9 326), Hungary (\$8 445). Poland is last with \$5 158 per capita of FDI. However, no matter what, it is important to evaluate the advantages and disadvantages of FDI for the host country.

The advantages of FDI include the introduction of new management techniques, new, more efficient technology transfer, increase of labor and capital productivity, competitiveness growth, easier access to foreign markets. All these factors contribute to the growth performance and, ultimately, in the long term to improve the standard of living of citizens. This is, of course, affected by the economic capacity of the recipient country, sector exposure, degree of saturation of foreign investment and

the absorption capacity of the country. On the other hand, incorrectly positioned FDI can contribute to the deepening economic problems of the host countries.

5. The Impact of FDI on Regional Development in Slovakia

When we talk about the positive impact of foreign direct investment at the macroeconomic level, these are these assertions significant in regional level, too. With the arrival of foreign investors coming into the region usually a new technologies that need to employ people with higher level qualifications. This promotes of the domestic competition and innovation activities in the region and the willingness of people to educate. When the domestic firms become the subcontractors for foreign investors, there is a possibility for them to expand into foreign markets, which is usually underpinned by foreign investor. Promote tourism in the region can attract tourists from the country of origin of foreign investors. This is opportunity for regions with lower economic level to boost production, employment and long term living standards of citizens of the region.

It is very convenient when a company of foreign investment is allocated in border regions. Then the positive impacts of FDI are multiplied. Great tool for monitoring of the conditions of the border business represent the social networks. Networks offer the options, which may to use small and large companies on their expansion. Built-in search network services provide the ability to search commercial and industrial information. There is possibility to search for specific companies from different sectors and look at the user's recommendations [7].



Figure 3. Regions of Slovakia

As a support of FDI inflow, the Ministry of Economy established the organization Slovak Agency for Investment and Trade Development. It is organization for professional guidance, for foreign investors, for providing consulting services, for assistance about investment projects and the identification of suitable sites for the implementation of investment projects. [8]

In Slovakia, FDI flowed to 2006, mainly to the western part and around Bratislava, even though it's most developed region. This fact was mainly caused by territorial proximity and excellent transport links to the countries of Western Europe, built the highway, a high level of human capital and a large number of universities in the territory of Bratislava.

For the purposes of equitable economic and social development of Slovakia is necessary that the FDI coming into the less developed regions with high unemployment. In 2006 and 2007 there was a turn in the direction of investment and investors are oriented significantly to Košice, Nitra, Trenčín, Žilina and Banská Bystrica region.

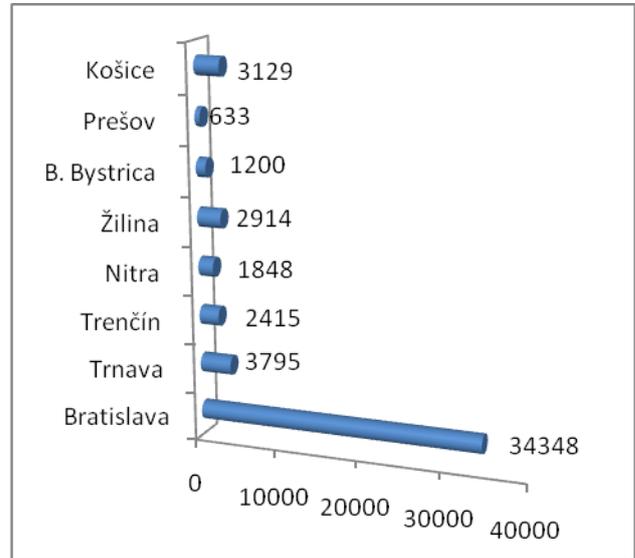


Figure 4. FDI stock: 31.12.2010 by Slovakia regions, million US dollars [21]

Although in recent years, foreign investment flowed into other regions than in Bratislava, FDI in the Bratislava region represents, 68 per cent of the total investment, cumulative to 31.12.2010 (this is the current latest available information). However, in the regions with the highest unemployment rate (e.g. Figure 5), with the lowest performance and efficiency of productive resources utilization, it is, paradoxically, the smallest shares. In Banská Bystrica it is 2 per cent and Prešov even only 1per cent of the total FDI inflows into Slovakia.

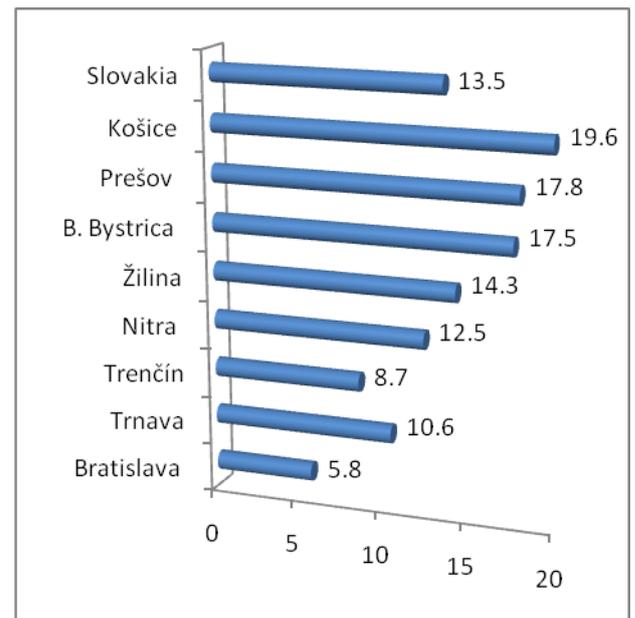


Figure 5. Unemployment rate: 31.12.2012 by Slovakia regions, per cent [19]

FDI inflow to Slovakia since 1998 has grown at a higher pace than in the past. This grow is intensified after

Slovakia's accession to the European Union. Turnover occurred in connection with signs of economic recession. It should be noted, that the number of completed projects does not inform about initial investor's investment or about the number of new jobs, which are the important indicators of any investment coming into the country. However, just this is very important information about the impact of FDI on future development of the region.

6. The State Aid and Job Creation

One of the temptations of FDI inflows to Slovakia is the provision of state aid for major investors. When investors decide on the location of investment, very motivating for them is a quality of infrastructure, human capital value, economic stability, legal and political environment in the host country.

The definition of state aid and the responsibilities associated with the provision are contained in Act no. 203/1999. The state aid is considered to aid in any form, which is provided for the enterprise or in connection with business service provider. The state aid may be granted to promote the economic development of regions with a low standard of living or high unemployment and the like. The main subject of state aid process is the Ministry of Finance in relation to the Government of the Slovak Republic and in relation to the European Union

One of the forms of state aid is the investment aid for regional development. Conditions of providing are described in Act no. 561/2007 about investment aid. The forms of investment aid are following: subsidies for the acquisition of tangible fixed assets and intangible assets, relief from income tax, contribution to create new jobs, the transfer of immovable property. The Act sets out conditions for granting investment aid for the four areas, namely industrial production, technology centers, shared services and tourism.

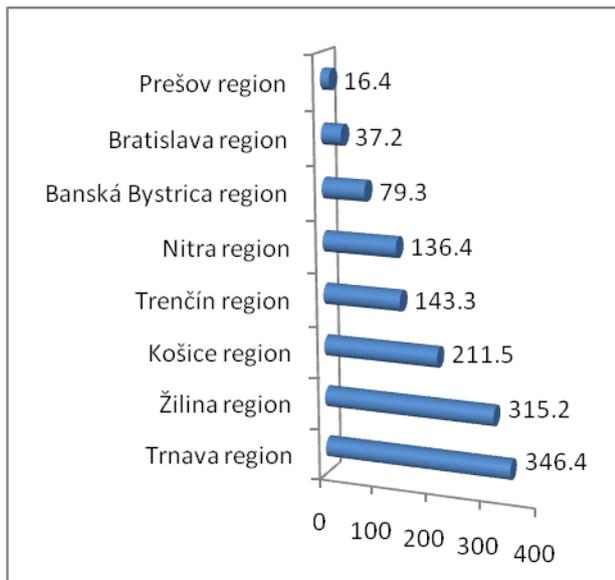


Figure 6. State aid granted to foreign investors by regions SR, 2001-2011, million EURO [18]

During the years 2001-2010, the highest level of state aid was given to foreign investors in Trnava region (€346.4 million) and Žilina region (€315.2 million) and

the smallest in the Prešov region, only about €16.4 million. Against expectation, the most of new jobs was created by investors with the state aid in Trenčín region (9753) and not in the Trnava region (7685). Žilina region with 5 945 jobs created was fourth in the regions of Slovakia.

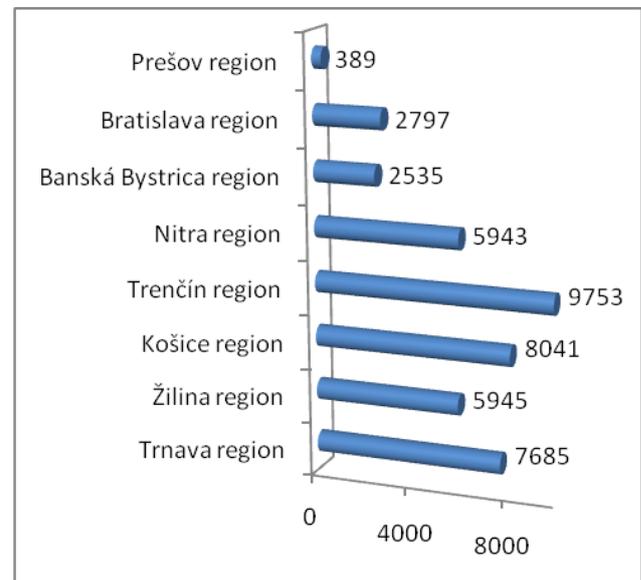


Figure 7. Number of jobs created by foreign investors with state aid in the period 2001-2011 by regions of Slovakia [18]

When we compare the evolution of unemployment across regions, there is an apparent significant disparity between western regions and those in the southern and eastern parts of Slovakia. For example, it is interesting that, despite the low cost labor, high unemployment still persists in eastern Slovakia. It is caused by it is not the completion of the motorway network of the road turn west - east, which discourages potential investors to seek business opportunities in the east. A high proportion of unemployed Roma with a low level of education leads to low competitiveness in the labor market. On the other hand, people with higher qualifications have a tendency go away for work either in the capital or abroad. Even though from 2003 to 2008 unemployment declined continuously, regional differences were maintained. However, after the arrival of major investors automotive and electronics industry in Trnava and Žilina regions was reduced gap in the level of unemployment compared to the Bratislava region.

In Slovakia, in order to alleviate unemployment and its consequences, is realized passive and active labor market policy. Passive labor market policy is providing of unemployment benefits. The measures in the active labor market policy should lead to the promotion or retention of job creation. The measures implemented by the Central Office of Labor, Social Affairs and Family have form of advisory services and financial support. The Office of Labor, Social Affairs and Family can offer job seekers and job changers professional consulting services designed to address problems relating to the employment assertion of a job seeker, matching his or her personality aptitudes with the requirements for the performance of a particular occupation, the influence of decision-making and behavior of a job seeker, as well as his or her social and occupational adaptation. Professional consulting services are professional services rendered by the advisors of the

Central Offices of Labor, Social Affairs and Family or by external suppliers of professional consulting services. They cover a system of provision of information, advice, support and specialist assistance to clients experiencing problems with the integration in the labor market. They may be provided in the form of group or individual consulting. Their main objective is to give the client efficient specialist assistance and encourage him or her towards independence and self-help in addressing the specific situation of unemployment [22].

The state also provides financial contributions for citizens, employers, contributions to education and training for the labor market, contributions to support the employment of persons with disabilities and the contributions to the activation activity. These contributions are financed by the public budget or the European Social Fund of the European Union. The problem is that these contributions do not lead to the elimination of regional disparities, but only conserve it at the current level.

To overcome regional disparities in employment helps the network European Employment Services (EURES). It is a network of entities designed to facilitate the free movement of workers within the European Economic Area (the EU plus Norway, Iceland, Liechtenstein and Switzerland). Into the EURES are involved the regional and national institutions dealing with employment issues, such as trade unions, employers and their organizations, and the like. EURES has an important role, especially for cross-border regions. EURES has a database of job vacancies throughout the European Economic Area. The mission of the network is to provide information, advice and assistance for placement in the labor market in relation to the free movement of workers, primarily in cross-border regions in different Member States. EURES in Slovakia supports cooperation on Slovakia-Poland border and Slovakia-Czech-Austrian border [23].

Developed European countries since the late 90-ies are oriented to support the employment growth. Support for the creation of new jobs should be implemented, especially in areas that may increase the country's competitiveness in the global market. Its aim is to promote labor market flexibility, the application of IT technology and support to small and medium enterprises in the field of perspective services.

Labor market flexibility involves flexibility in employment, related to the implementation of flexible working time models, the qualification flexibility and spatial flexibility. Instrument for achieving the qualification flexibility is graduation the various educational activities during working life and in the period when the individual is unemployed. Spatial flexibility (or mobility) is the willingness to move to the region with higher employment opportunities, or commute to work in remote areas due to the localization of own home. However, in Slovakia is low level of the spatial mobility due to high housing prices and rents, the need for care of family members and the language barrier [24].

After the experience of the past we can say that economic convergence of individual Slovak regions and reducing of regional unemployment should be pursued in the future, not only active labor market policies, but especially measures that will lead to the creation of a favorable business environment for the development of

small and medium enterprises, building industrial parks and foreign direct investment.

Foreign investors are located in individual regions of Slovakia unevenly and their contribution to job creation in view of the obtained amount of financial aid is different. Foreign direct investment has direct positive impacts on employment growth and decline in unemployment in the regions. Nevertheless, there are still problems in the employment of disadvantaged job seekers. The large enterprises of automotive employ the people from wide surroundings and declare the shortage of skilled people and on the other hand, they do not creating a new jobs for disabled citizens, graduates and older people of working.

7. Discussion

The economic recession after 2008 caused a significant decline in FDI from a global perspective and from the perspective of the V4 and Slovakia, too. The favorable trend of increasing FDI inflows to Slovakia disrupted the current economic recession. During the recession, foreign investors reduced their interest in investing in Slovakia. Those who are already established, as a result of the decline in demand forced, are reducing the production capacities and reducing staff. Although forecasts say about gradual revival of investor interest, the facts about the impact of the recession on FDI flows can be measured only in hindsight.

8. Conclusion

It should also be noted that the Slovak economy is still capital-undersized and just FDI provide resources to expand production opportunities, thus promoting economic growth and job creation. To attract FDI but is necessary to create appropriate conditions, for example providing the state aid, construction of industrial parks, creating regional or sector clusters. For the proportional distribution of FDI in the territory of Slovakia and for penetration into economically less advanced regions in the eastern part of the country, is essential to the completion of highways in the direction west-east. However, a main problem is the extension of time for completion of construction works and non transparent management of funds intended for construction of highways. However, the problems which really discourage the foreign investors from activities in Slovakia haven't economic nature. There are firstly ethical and moral problems. It is poor law enforcement, delays in court proceedings, unstable legal environment due to frequent legislative changes, bureaucracy and corruption in the public sector. If the deficiencies would not consistently remove, Slovakia will be for many foreign investors only an unconvincing partner.

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