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## **FOREIGN DIRECT INVESTMENT AND REGIONAL DEVELOPMENT: THE CASE OF THE CZECH REPUBLIC**

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**Summary:** The following text is focused on the analysis of direct foreign investments contribution for the regional development of the Czech Republic and individual regions especially Ústí nad Labem region.

The higher risk of asymmetric development on the regional level lie in the higher concentration of foreign direct investments that are more dependent on the development of economic cycle. Ústí nad Labem region does not fall behind other regions when speaking about the incoming of direct foreign investments but it rather has weaker development in the net of research and development activities, innovative business and also worse education and labour structure of its inhabitants. Foreign investments of qualitative character, strengthening the competitiveness of individual regions of the Czech Republic, have therefore key role in further regional development.

### **1. Foreign direct investments (FDI) in theoretical and geographical context**

Foreign direct investments (FDI) belong to a key indicator of economic transformation success evaluation in transitive economics. The aim of this contribution is to evaluate the importance of FDI from the regional development point of view, within the context of the Czech Republic and the development of regional economics in Ústí nad Labem region. At the first place the importance of FDI will be evaluated according to theoretical approaches, then the analysis of the FDI role in the economics of the Czech Republic will be carried out, especially more detailed analysis of FDI in Ústí nad Labem region.

This region has been chosen because of deeper economic transformation that is happening there (the same applies to Moravian-Silesian region) compared with other regions of the Czech Republic. Successful regional restructuring is extraordinarily topical and FDI have a very influential role within this process.

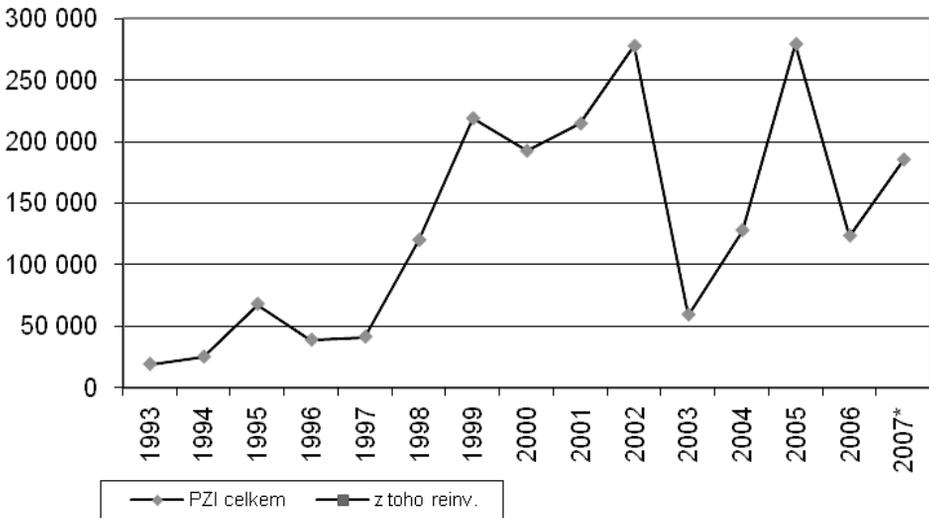
The analysis of FDI comes out of the question if the incoming of FDI is an indicator of competitiveness of Ústí nad Labem region in the context of regional deve-

lopment of the Czech Republic all taken from the regional development and regional economy point of view.

The contribution is based on the statistic analysis coming from the databases of the Czech National Bank, Czech Statistical Office and UNCTAD (United Nations Conference on Trade and Development).

Foreign direct investments are primarily the subject of macro-economy level research. There are a lot of publications and articles in the regional development research that deal with the analysis of the influence of foreign investments on regional economics [Turnock 2005; Toušek, Tonev 2003; Young 2005], the analysis of the competitiveness and of the regional development processes. A specific topic is also an analysis of the impacts of foreign investments localisation on socio-economic atmosphere of the specific regions [e.g. Dinga 2008].

While evaluating FDI within the Czech Republic a J.H. Dunning [1996] eclectic theory approach can be used. It focuses on the analysis of the life cycle of FDI. At the first place there is the FDI incoming to the target country; local firms are not able to invest more distinctively abroad.



**Fig. 1.** Incoming of Foreign direct investments into the Czech Republic in 1993-2007 (in millions of CZK)

Source: Czech National Bank.

A foreign investor does not develop any sub-supplier nets in the initial phase of transitive economics transformation. There are a lot of reasons: small amount of information about local surrounding, low trust rate (foreign investors do not believe in regional economic atmosphere), local firms are not able to fulfil the quality require-

ments, amount and technological development of the production. The vast majority of series production is exported to other markets and Massey [1995] describes these branches as so called “cathedrals in the desert”. It is followed by the increase of investment ability to profit and the headquarters of the company reinvest the profit into the expanding of the branch, or into creating a new one. Foreign investors increase the production and a part of their profits is reinvested according to investment attractiveness of the area. FDI become more closely connected to the local area, there are links to local firms and other localized investors. In the maturity phase the profit (from the FDI incoming point of view) to a great extent is repatriated and at the same time the amount of FDI is decreasing. With the increase of economic development production expanses increase as well. It can lead to the branch closure and in geographical view it can lead to the capital transfer to the countries that are cheaper in expanses. The level of FDI integration with other regional development participants is decisive considering the regional economics point of view. Keeping FDI is connected to the development rate of competitiveness in transitive economics and to the level of agglomeration savings that are connected to the working of the branch within the given region. The increase of qualitative level of production in local firms strengthens their export potential. Economic growth causes that in these firms in their decisions about localization of their investments there is a shift from regional to macro-regional level while having evaluation investment opportunities.

In Figure 1 there is incoming of FDI into the Czech Republic. Some specific tendencies can be noticed within the observed years 1993-2007. In the initial period within 1993-2002 the overall amount of FDI was usually increasing, in the following years the annual number of incoming FDI decreased to the level that did not reach the number from 1999-2002 with the only exception in 2005. The amount of reinvested profits from FDI began to increase as late as the 90s and kept increasing till 2007 when it reached the highest values. The growth of reinvested profits (altogether with dividends) can be understood as a proof of successful economics.

The incoming of FDI leads to the decay of original mutual dependency among local firms that slowly join to international production chains. Nevertheless Pavlínek [2004] and Srholec [2004] emphasize the fact that the incoming of FDI can lead to dual economics in which on one hand the original structure of local firms lasts. The firms are characterized by lower productivity, higher proportion of low qualified employees and generally by lower competitiveness. On the other hand FDI create new, separate economic atmosphere with higher competitiveness within local as well as foreign market and their regarding quality exceed host economics. The probability of origination and the size of duality is connected to the level of interconnection between FDI and local firms, the size of technological gap between local and foreign companies and the level of spill-over effects that are transferred into local firms. Zamrazilová [2006] states also that the duality in economics can become a negative displacement effect in which FDI gradually erase local firms from the market. The incoming of FDI is therefore at the same time the bearer of creative destruction in the

host economics and creative destruction is a key element of economical development according to Schumpeter [1976]. On one hand aged economic structures and firms that are not able to compete are replaced by new (foreign) subjects. These new subjects bring into regional economy new technologies, institutions, relationships among companies. They are able to establish themselves in local as well as in foreign markets. However, according to Zamrazilová [2006] the duality of Czech economics is not farther deepening, the pace of rapprochement of local and foreign sector efficiency is low and differentiated according to a given branch.

The subjects that work with FDI are primarily big international corporations that create specific hierarchy system in the firm that is formed for the profit maximizing. Technological and economic development has led according to Jessop [2001] to the transfer from production as in Fordistic perception that concentrated mass-production of the main production companies on flexible company specialization (for more see e.g. [Blažek, Uhlíř 2002]). The beginning of flexible production caused a fundamental change in the mechanism of production organization. It is decentralized from one place into the system of sub supplier companies specialized as specific component that are de-concentrated on regional and macro-regional level. The importance of these sub supplier firms increases especially in production chains. Sub suppliers specialized at component production for the main customer as well as for mutually competing companies. The production of the final item is the result of agreement relationship optimizing within the hierarchy of international corporation and also within the relationships of sub supplier companies. The long-term growth of regional economics is assured in connection with the decision making of these corporations, as according to Massey [1995], and with the positions of established branches in spatial and hierarchical organisation in an international corporation.

The incoming of FDI on the regional level of the Czech Republic is connected as Toušek, Tonev [2003] states to the factor of boarder position of the area. These areas were from the beginning more concentrated and connected with the level of economic development of border area, especially concerning German and Austrian border zone. Further period is connected to privatization and FDI incoming growth, the importance of horizontal spatial location decreases and the importance of concentration areas increases according to Žižalová [2006] as well as the socioeconomic development of the area for investment localization.

Removing of barriers in international market, drop in expanses on transport and the development in logistic systems have resulted in the change in the decision making localization of the investors from regional into global level, because of gaining positive effects on the basis of comparative advantages in individual states. From the Czech Republic point of view FDI income was supported also by a political aim of entering EU and EES because the Czech Republic had undergone a fundamental change in geopolitical orientation in western markets. After finishing the privatization processes in transitive economics FDI began to focus on Greenfield investments, combining boarder participants and acquisitions, (see [Pickles and Smith 2005]).

Foreign investors carried out those investments aimed at qualitatively less demanding production based on the basis of imported innovations from technology as well as management.

Higher rate of FDI in comparison with the amount of Czech investments abroad is not always an attractive indicator of a given country's economic atmosphere. Highly developed countries often have negative balance when summarizing incoming and efflux of investments. In transitive economy FDI positive balance has different significance than in developed economies, e.g. EU 15 has negative balance of FDI and this can be understood as the result of production transfer to new member countries as well. The similar state is in UNCTAD [2009] e.g. Japan, France. As Pavlínek [2004] states the Czech Republic and transitive economy are strongly determined by past development when talking about path dependence and they need high rate of FDI for economy restructuring. The amount of FDI incoming can be regarded on macro-economy level as an indicator of transformation processes success, positive perception of foreign investors and the manifestation of confidence of area stability.

## 2. Differentiation of foreign direct investments on regional level

The evaluation of FDI in Ústí nad Labem region from the geographical point of view comes out of the comparison of Ústí nad Labem region position among other regions in the context of overall FDI incoming in the Czech Republic. A complementing approach is different evaluation on the lowest level (district).

Ústí nad Labem region has belonged for long time to problematic regions and many of its indicators (e.g. disadvantaged education, professional and branch structure, unemployment rate) are behind the average indicators in the Czech Republic (see [Blažek, Csank 2007]). Ústí nad Labem region belongs to less successful regions as far as transformation is concerned. On the basis of macroeconomic data it can be expected that such a region will be also less attractive for foreign investors. Taking into consideration the incoming of FDI in individual regions (when talking about overall amount of FDI in 2000-2006), Ústí nad Labem region is in a long-term on the level of South Moravia and Moravia-Silesia region, right behind Prague and Middle Bohemia (see the chart). When recounting the amount of FDI per person Ústí nad Labem region is one of the most successful regions as the level of FDI incoming is higher there than the average level in the Czech Republic (apart from Prague where there comes about a half of the total amount of FDI; this fact would distinctively influence the comparison with other Czech regions). In the given time period Ústí nad Labem region is after Prague, Middle Bohemia and Pilsen, on the fifth place among the most attractive regions from FDI point of view per person, e.g. in Moravia-Silesia FDI per person is only a half of amount of Ústí nad Labem region.

For example Most district (Ústí nad Labem region) has above average values from the FDI amount point of view (in 1998-2006) and in a long-term it is over the

average level in the Czech Republic (apart from Prague). In quantitative evaluation it can be said that Ústí nad Labem region is not different from other regions (except Prague), a region and its districts cannot be therefore perceived as non-attractive for FDI. Although the amount of FDI is pretty high, worse macro economy results of the region prove their partiality within the regional development of the area because other participants from private as well as public sector should contribute to this development.

The interpretation of attractiveness of the region for FDI is rather simplified when limited only to the given values. It does not contain any detailed evaluation of foreign direct investments and foreign investors.

Qualitative indicator for FDI evaluation is the presence of FDI aimed at innovation and research development. According to the analysis of innovative potential of the regions in the Czech Republic (20) Ústí nad Labem region belongs to less attractive regions in the country with low expenses on research and development activities, low number of jobs in R & D, insufficient concentration of R & D institutions and technological centres, only partially developed high-tech branch and innovative enterprise. Although it is a weak point in regional economy in the long term the amount of innovative activities is not really increasing. For example CzechInvest has not supported any project in Ústí nad Labem region belonging to the category of technological centres.

**Table 1.** Development of foreign direct investments in the Czech Republic and individual regions in 2000-2006 (cumulative) in mln CZK

	2000	2001	2002	2003	2004	2005	2006
Czech Rep.	818,41	982,33	1 165,53	1 161,78	1 280,59	1 491,56	1 666,76
Prague	389,37	484,66	613,05	537,43	598,62	801,10	885,35
Central Bohemia	97,04	104,90	114,89	134,79	128,64	159,70	183,93
South Bohemia	31,07	35,21	38,41	32,97	41,48	56,95	60,63
Plzensky Reg.	33,25	39,12	50,06	49,79	47,27	48,54	53,11
Karlovarsky Reg.	10,51	11,10	14,78	13,82	15,44	16,04	16,32
Ustecky Reg.	60,95	69,28	76,27	67,83	75,84	61,92	60,63
Liberecky Reg.	15,77	17,77	22,31	28,88	43,61	46,12	47,17
Kralovehrad. Reg.	17,10	19,77	22,84	24,26	25,84	24,51	21,55
Pardubicky Reg.	22,41	27,78	26,81	39,73	34,70	36,01	38,05
Vysocina Reg.	14,48	24,38	18,45	31,88	33,45	35,26	0,00
Jihomoravsky Reg.	51,41	58,52	59,04	70,44	90,95	58,97	69,94
Olomoucky Reg.	17,87	24,35	26,61	31,00	33,78	28,08	26,54
Zlínský Reg.	20,33	26,42	30,81	28,15	28,88	29,55	29,64
Moravskoslez. Reg.	36,85	39,08	51,20	70,82	81,99	88,83	122,82

Source: Czech National Bank.

The development of innovative potential will be very difficult especially because of better competitive position of the majority of other regions despite the fact that it will be supported from public sources. This will lead to the decision-making localization of foreign investor in case of founding new branches or enlarging current activities with innovative activities.

Among the factors of regional competitiveness of districts there is not qualification of the inhabitants of Ústí nad Labem either. The region has less favourable educational and qualification structure when compared in a long term with the Czech Republic as a whole. Motives for production location are rather factors such as – preparation of possible location, investment incentives, more favourable area location to more developed markets and savings in transport and logistic expanses.

Interregional development difference in the space and structure of foreign investors is to a great extent influenced by path dependence as it is in case of Ústí nad Labem region – specialization at brown coal mining, coherent branches and a corresponding structure of human resources that is retrained only with difficulties and asserted worse position in the present job market.

Reaching of agglomeration advantages will be difficult in Ústí nad Labem region because there is under average innovative potential and connection between research and development and business in the Czech Republic. Matoušková, Macháček, Postránecký, Toth [2000] emphasize that branches of international firms will be more sensitive to economy cycle development because of their position in intercompany hierarchy and they are more endangered by closing or reducing of their production.

In Ústí nad Labem region partial inertia of regional area in East – West axe which is generated by preceding regional specialization of the area and which prevails in a transformed form as low qualified jobs and assembly production can be noticed. This situation will negatively influence regional development processes (especially in western part of the region) and it will result in low strengthening of external regional competitiveness in middle term and long term horizon.

Other risky fact is the survival of dual economy on lower level in some parts of Ústí nad Labem region. A technological gap between local and foreign enterprises causes the decreasing of an ability to implement new technologies, to produce competitive products and to develop sub supplier relationships to foreign companies. The concentration of FDI with lower demands on qualification and lower investment demands of jobs would lead to lower competitiveness of the companies and regional economics.

In case of investors in industrial zones FDI leaving risks can be prevented by a complex strengthening of agglomeration savings on regional level. It is for example qualitative development of regional labour market, networking support and information transfer on the basis of sector and inter-sector interactions and Blažek [2002] also says that the development of a system of subsequent care of investors (after-care programmes). Smith [2005] says that further FDI concentration influences the growth of external savings and agglomeration effects and it can increase a competi-

tive position of the region. In these regions there is therefore a stronger need for intervention arrangements eliminating the potential dangers mentioned. According to Smejkal [2008] setting and priority in regional branch politics will have a very important role because it can influence the decisions of foreign and local investors. In the period of transformation quantitative importance was prevailing but in a long term qualitative orientated FDI are fundamental especially because of increasing of competitiveness. The incoming of such FDI should be stimulated from public sources.

### 3. Conclusion

The importance of FDI incoming can be evaluated in a very differentiated way on national, regional and local level. In a long term FDI can contribute to the development of a new economic environment in the economics of the Czech Republic. Local firms also gradually integrate into this environment because they gradually overcome the technological gap and, together with FDI, contribute to the growth of the total competitiveness of the economics. On the level of regions the amount of FDI incoming is very different. On one hand Prague is distinctively dominating, followed by Middle Bohemia and Ústí nad Labem region is behind the other most attractive regions for the investors. At the same time there are not any distinctive differences in FDI incoming among regions that would correspond to the development rate of individual regions (except Middle Bohemia). In Ústí nad Labem region Most district is dominating on the level of districts. It could lead to a conclusion that it is an area in the Czech Republic which is highly attractive for foreign investments. Other conclusions can be drawn from the qualitative evaluation of FDI. Ústí nad Labem region (including Most district) does not fall behind when talking about FDI incoming of the Czech Republic. The problem is the overall low development rate of innovative business, the same with research and development activities and worse education and job structure of inhabitants. This leads to lower effects of agglomeration that motivates to greater FDI incoming from high-tech branch area or technology development area. The possibility of duality in economics survival is connected to these facts.

Duality in economics can be strengthened by the lower level of innovative activities in Ústí nad Labem region (when compared with other regions) and the growth or technology gap prevailing among local and foreign enterprises.

International differentiation in localization and foreign investor structure is to a certain extent influenced by previous socio economic development of the area. As a consequence this creates regional differentiated conditions for FDI localizations in Ústí nad Labem regions. Development differentiation in regional localization and foreign investor structure is therefore to a certain extent influenced by previous socio economic development of the area and that creates regionally differentiated conditions of FDI localization in Ústí nad Labem region.

There is higher danger in given asymmetry development in greater concentration of FDI with greater sensitivity to economic cycle swings that is multiplied by their weaker position within the structure of international syndicates. FDI is a relevant indicator of the regional competitiveness if its qualitative characteristics are observed especially as a needed long-term strengthening of competitive regional advantages. At the beginning FDI incoming was motivated by privatization processes as well as basic production factors of labour prize type, transport and technical infrastructure, availability and largeness of new industrial zone areas. In the following period the factors of qualitative characteristics will play more important role – agglomeration effects and competitiveness of regional innovative system.

In the post-transformation period the importance of quantitative criteria decreases while the evaluation of FDI and the importance of qualitative criteria increase because they should strengthen the competitiveness of the economics on local and regional level in a long term period. In the further development FDI of qualitative characteristics will play a greater role. It strengthens the competitiveness of the Czech Republic and Ústí nad Labem region.

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## BEZPOŚREDNIE INWESTYCJE ZAGRANICZNE A ROZWÓJ REGIONALNY NA PRZYKŁADZIE REPUBLIKI CZESKIEJ

**Streszczenie:** Niniejszy artykuł koncentruje się na analizie bezpośrednich inwestycji zagranicznych w odniesieniu do rozwoju regionalnego Republiki Czeskiej oraz poszczególnych regionów, szczególnie Usti nad Labem. Podwyższone ryzyko nierównomiernego rozwoju na regionalnym poziomie zależy od wyższej koncentracji bezpośrednich inwestycji zagranicznych, które są bardziej zależne od rozwoju cyklu ekonomicznego. Region Usti nad Labem nie pozostaje w tyle za innymi regionami w kontekście pozyskiwania bezpośrednich inwestycji zagranicznych. Słabszy rozwój regionu uwidacznia się raczej w obszarach badawczo-rozwojowych, innowacyjnych przedsiębiorstw, edukacji oraz struktury zatrudnienia swoich mieszkańców. Kluczową rolę w dalszym rozwoju regionalnym odgrywają zatem inwestycje zagraniczne o jakościowym charakterze, pomagające sprostać konkurencji ze strony innych regionów Republiki Czeskiej.