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The Importance of the Foreign Direct Investments in Increasing the Economic Competitiveness of CEE Countries

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Abstract

In a global economy characterized by high competitiveness and rapid technological development, the role and importance of the foreign direct investments is acknowledged by an ever increasing number of states due to their contribution to the increase in productivity and resource competitiveness, assets and capabilities. For the new EU Central and Eastern European member states, foreign direct investments gains special importance if taking into account the necessity to reduce the economic differences which sever these countries from the highly developed and industrialized EU countries (EU-15). Therefore, as this study will demonstrate, the CEE countries where the quality and the volume of the foreign direct investments attracted in the economy will go hand in hand, will score the most outstanding successes in what concerns the increase in their economic competitiveness with positive impact upon economic and social development.

Key words: *foreign direct investments, economic competitiveness, development, quality*

Theoretical Aspects

The main contribution of the *foreign direct investments* (FDI) in what regards the receiving economies is materialized in increased productivity and resources, assets and capabilities competitiveness, which generate beneficial effects on a social and economic level.

This can be mainly achieved through: increasing production efficiency; a more efficient distribution of resources and capabilities on each sector; creation of new products; improving the quality of the already existing products; conquering new markets; increasing the speed or reducing the costs of the structural changes and improving organizational structures (Dunning, 1993, pag. 42).

If achieving an adaptation of Michel Porter's diamond (*the diamond of the competitive advantage*), John Dunning has demonstrated the influence exercised by FDI on the four facets of the diamond as well as on the governmental actions and on the mentality of the enterprising individuals within the host economy. According to Dunning, FDI interacts with the competitive advantage already existing in the host country and, at the same time, influences the future competitive advantage.
Starting from this theory, as well as from the one regarding the investment development path, we shall briefly present the competitive advantage stages as envisaged by the two researchers

(Porter and Dunning) in order to emphasise the potential role of FDI as acknowledged by a country in search for its competitive advantages.

- In the first stage, mainly *the stage of competitive advantage based on production factor instrumentation*, the investment flows are generally oriented towards intensive activities within the poorly qualified working force which provides the internal or external market with consumer goods characterized by a low processing degree (primary products). In this phase, the generated production factors (capabilities) have a minor economic role as they are placed on a very low level. It is important to state the fact that by identifying a competitive branch due to the instrumentation with production factors and to the stimulation of economic activities placed both upwards and downwards to it, one can initiate the process of creation of the "economic clusters". The majority of the developed countries have started the process aimed at improving their competitive advantages by generating these "economic clusters" starting both from intensive activities within the working force, this being the case of the countries which benefit from poor natural resources (such as Japan), or from the branches based on natural resources (for example USA).
- The second stage, of *the competitive advantage generated by the volume and quality of investments*, the statistical weight of the local investments in GDP rises from 5-8 % to 15-20% (Dunning, 1993, pag.273). Thus, the competitive advantage is generated by means of investments regarding the improvement of the quality of the existing production factors (investments in technology, in the development of infrastructure, and in increasing working force training). During this stage, the role of the foreign capital infusion mainly depends, on the governmental policies of the host country, respectively on its vision on the integration of FDI within the development strategy. For example, some states have restricted FDI entrances primarily using their own efforts (South Korea), while others have integrated the attraction of foreign capital within their industrial development policy. This stage is also characterized by encouraging foreign investment processes materialized in promoting certain adequate policies and in stimulating the development of infrastructure, thus generating the apparition and/or development of related economic activity clusters around which there can appear a subsequent development of interrelated activities that are sustained both by foreign and by local capital.
- During the third phase, namely *the stage of competitive advantage triggered by innovation*, the competitive advantages of an economy are mainly generated by the capacity of the local companies to sustain technological, managerial and organizational innovation (Dunning, 1993, pag.274). During this stage, the activities based on traditional factors are mainly relocated abroad. According to Dunning, foreign investors will move towards those states that promote certain policies focusing on the efficiency of the market operation and on the transactional costs of the companies.
- The fourth stage, *the informational (or post-industrial) phase*, is considered by Dunning to be the most advanced stage of economic development, being characterised by the fact that the success of the home economies regarding the accumulation of productive assets depends on the ability of the transnational corporations to coordinate resources placed within a regional or global environment. Thus, one can register an unprecedented intensification of the relationships between companies sustained by the development of informational processes. During this stage, the success of FDI within the host economy has to be judged, mainly, taking into account the way in which resources are organized and the extent to which it can positively influence the competences and the efficiency of the local companies.

- Regarding the stages of competitive advantages, Dunning has pointed out the fact that their succession is not necessarily applied to all states as such, the situation also sustaining the possibility of different development stages within various regions of the same country.

Data Analysis for CEE Countries

In order to emphasise the correlation between the registered FDI inflows and the level of competitiveness of CEE countries, we shall further on analyse two representative economic indices, respectively the inward FDI stock per capita and the Global Competitive Index (GCI).

The degree of penetrability of foreign capital within the host economy is most obviously made overt at the level of the inward FDI stock per capita. Data regarding the level of this index in the Central and Eastern countries (CEE) integrated within the EU in 2004 and 2007 emphasises the existing accentuated discrepancies between these countries (figure 1).

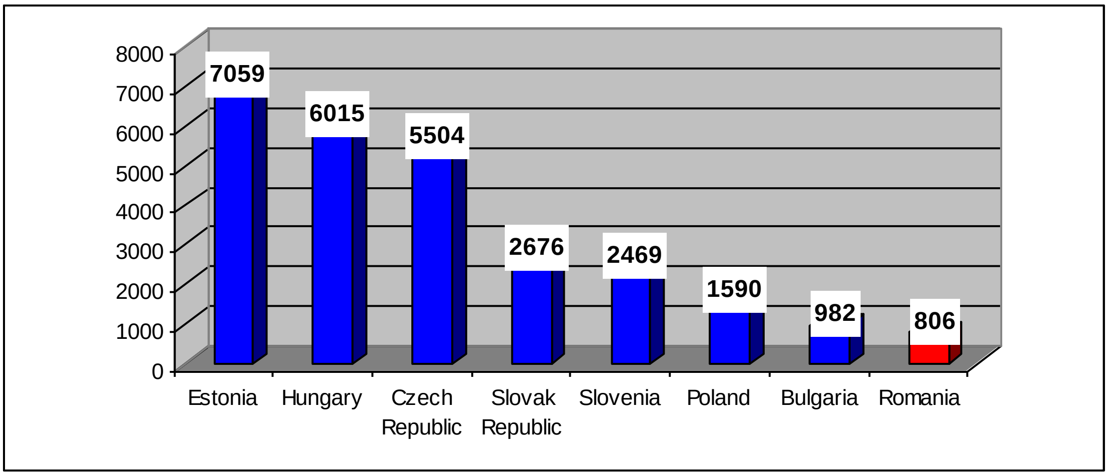

Fig. 1. Inward FDI stock per capita in 2005 (USD/capita)

Source*: own calculations based on UNCTAD, World Investment Report 2006 and statistical data from Eurostat (total population in each country, in 2005)*

According to these data, in the hierarchy of the CEE analysed countries, Romania ranks the last, with a level of the inward FDI stock per capita of only 806 USD/capita. Compared to other countries in the region, the discrepancies are increased, especially if comparing the inward FDI stock per capita registered in Romania with the one from countries such Estonia (7, 059 USD/capita), Hungary (6, 015 USD/ capita) and the Czech Republic (5, 504 USD/capita). A similar situation, even if not that dramatic, is also registered in Bulgaria (982 USD/capita).

Therefore, at a regional level, increased differences are registered in what concerns the involvement of the foreign capital in the Central and East European economies. Thus, Romania and Bulgaria are much under the average registered in the region, which undoubtedly proves the low level of involvement of the foreign investors in these two countries. At the opposite pole we find states such as Estonia, Hungary or the Czech Republic where the massive infusions of foreign capital have generated a significant stock at the level of year 2005, hence confirming the high degree of penetrability exercised by the foreign capital in these economies.

In order to evaluate the competitiveness of nations, WEF (World Economic Forum) is using the Global Competitiveness Index (GCI), which grants an overall image, by using a set of parameters considered to be essential for the competitiveness of any given economy.

These parameters are grouped in nine categories, respectively: institutions; infrastructure; macro-economy; health and basic education; secondary education and continuous learning;

market efficiency; technological training; the degree of sophistication in business; the capacity of innovation.

The WEF 2006 report emphasises certain changes, some of them quite spectacular, in what concerns nations competitiveness (table 1).

Table 1. Global Competitiveness Index (GCI) 2006 and 2005 comparations – extract

Country/Economy	GCI 2006 Rank	GCI 2006 Score	GCI 2005 Rank	Changes 2005-2006	
Switzerland	1	5.81	4	↗	3
Finland	2	5.76	2	→	0
Sweden	3	5.74	7	↗	4
Denmark	4	5.70	3	↘	-1
United States	6	5.61	1	↘	-5
Japan	7	5.60	10	↗	3
Germany	8	5.58	6	↘	-2
Netherlands	9	5.56	11	↗	2
United Kingdom	10	5.54	9	↘	-1
Hong Kong SAR	11	5.46	14	↗	3
Norway	12	5.42	17	↗	5
Taiwan, China	13	5.41	8	↘	-5
Iceland	14	5.40	16	↗	2
Israel	15	5.38	23	↗	8
Canada	16	5.37	13	↘	-3
Austria	17	5.32	15	↘	-2
France	18	5.31	12	↘	-6
Australia	19	5.29	18	↘	-1
Belgium	20	5.27	20	→	0
Ireland	21	5.21	21	→	0
Luxembourg	22	5.16	24	↗	2
Korea, Rep.	24	5.13	19	↘	-5
Estonia	25	5.12	26	↗	1
Spain	28	4.77	28	→	0
Czech Republic	29	4.74	29	→	0
Slovenia	33	4.64	30	↘	-3
Portugal	34	4.60	31	↘	-3
Thailand	35	4.58	33	↘	-2
Latvia	36	4.57	39	↗	3
Slovak Republic	37	4.55	36	↘	-1
Lithuania	40	4.53	34	↘	-6
Hungary	41	4.52	35	↘	-6
Italy	42	4.46	38	↘	-4
India	43	4.44	45	↗	2
Poland	48	4.30	43	↘	-5
China	54	4.24	48	↘	-6
Russian Federation	62	4.08	53	↘	-9
Romania	**68**	**4.02**	**67**	↘	**-1**
Bulgaria	72	3.96	61	↘	-11

Source: *World Economic Forum, Report 2006, www.weforum.org*

It is important to underline the fact that both in 2005 and in 2006, regardless of the registered changes, the countries that mainly rank first in the world are the ones traditionally developed and industrialised.

Still, two of the recently industrialised developing countries (Hong Kong and Taiwan), taken by M. Porter to face the second stage of the development of the competitive advantages (determined by the volume and the quality of the investments) in the '90s, rank quite high, overtaking developed countries such as Luxembourg, Canada, Austria, France and Belgium, states which are facing the final stages of the development of the competitive advantages (according to the Dunning and Porter model). A similar situation characterizes South Korea as well, which overtakes traditionally industrialised and developed countries such as Italy, keeping quite close to the afore-mentioned developed countries.

We have decided to underline these aspects since all the three mentioned countries have in common the fact that they "placed their bets" on the engineering industry, such as automobile constructions and electronics, thus trying to develop their competitive advantages, situation also characterizing some CEE countries (for example Hungary and the Czech Republic).

Practice has demonstrated that the biggest share of foreign investors from the Central and East European countries has taken special interest in those areas of activity registering high profitability rates. Thus, there has been noticed a high concentration of foreign investors within certain areas of activity. Initially, the main target sector for the foreign investors has been car industry where prestigious companies such as Volkswagen, general Motors or Fiat have realized serious investments. Subsequently, other areas of activity, such as electronics and consumer goods or the service sector (telecommunication, public utilities and banking services), have also attracted foreign investors.

In Hungary and in the Czech Republic the most important FDI within the secondary sector has been registered in the car industry and in that of electronics. It is important for the present study to mention the fact that the car industry from the Czech Republic, backed up by direct foreign investment infusions, has presently become one of the most developed and competitive from the entire European market.

Before analysing the empirical data for the Central and the East European countries, we consider it important to mention the fact that according to M. Porter's model and opinion, views generally shared by other specialists as well, CEE countries faced at the beginning of the last decade (the '90s) their first stage regarding the development of the competitive advantages based on the instrumentation with production factors and on their lower cost.

According to data provided by the WEF report, Estonia, which, at the level of year 2005 had already accumulated a significant FDI stock (rank 1, figure1) now ranks 25 after South Korea and before some traditionally developed countries, old EU members (Spain, Portugal and Italy).

A quite promising position is also occupied by the Czech Republic overtaking countries such as Portugal, Italy, Greece and South Africa, also receiving considerable FDI inflows (rank 3, figure1). Even if on a negative slope, Slovenia and Hungary still occupy honourable places, 33rd and 41st, out of the 125 analysed states.

In what concerns Hungary, the country that together with Estonia and the Czech Republic has benefited from massive FDI inflows (figure 1), the WEF report emphasises its success in attracting FDI and in economic restructuring. At the same time, the authors of the report have shown the fact that Hungary has to pass from the stage of innovation through import to that of own innovation, which requires the allocation of substantial funds to the research-development activity.

It is important to underline the fact that Romania and Bulgaria, ranking the last within the CEE analysed countries in what concerns the FDI inflows (figure 1), still occupy the same low positions regarding competitiveness, being placed on the 68th, respectively 72nd position in the global classification (table 1).

The analysis of the above-mentioned data emphasises some aspects that we consider essential regarding the role of FDI attracted by the Central and East European countries in what concerns the increase in their economic competitiveness.

On the one hand, even if at the level of year 1990, in all the analysed CEE countries the competitive advantages were generated by the instrumentation with production factors, 15 years later some of these, namely Estonia, the Czech Republic, Slovenia and Hungary, managed, in our opinion, to move towards the stage of competitive advantages based on innovation, thus registering levels of competitiveness which are very close to those of the traditionally developed and highly industrialized countries (table 1).

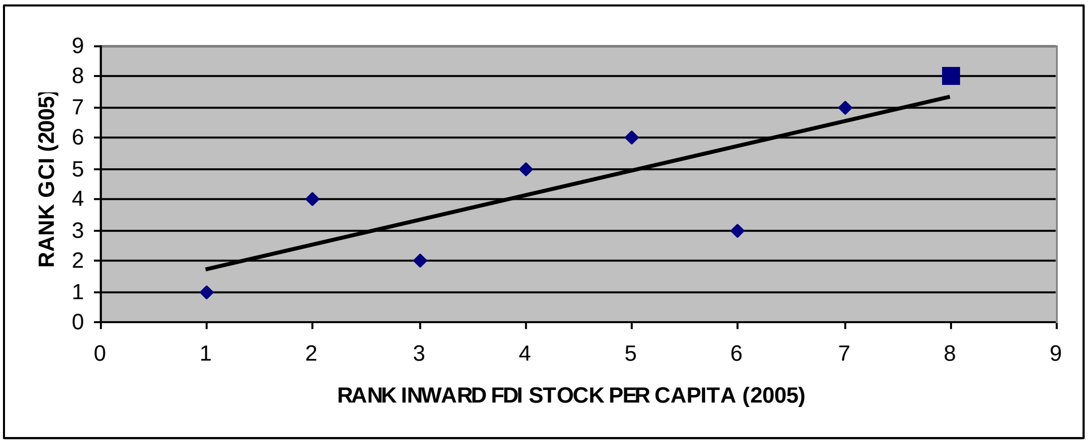

Fig. 2. Correlation between FDI and COMPETITIVNESS of CEE countries (2005)

Note: Romania is marked with ■

On the other hand, the presented empirical data emphasise the existence of a strong relationship between the FDI inflows registered by the CEE countries and their level of competitiveness. Thus, the states that have accumulated a significant stock of direct foreign investments (Estonia, Hungary and the Czech Republic) have also achieved the highest levels of competitiveness, alongside with Slovenia, while the countries disfavoured in what concerns the infusions of capital (Romania and Bulgaria) rank the last regarding their economic competitiveness as well (figure 2).

Consequently, the presented analyses confirm and acknowledge the theories regarding the role of FDI in increasing competitiveness among the transition economies from CEE, theories also shared by well-known specialists in Romania and abroad (Mazilu, 1999, pag. 206-209), emphasising, in the same time, the differences registered from one country to another due to, in our opinion, the foreign capital inflows quality.

Conclusions

For the CEE countries - with centralised, ordering economic systems common up to the‘90s- facing their first stage in economic development, attracting foreign capital has been a very important issue, regardless of the structure of this capital, because this action has been targeted at evading the “transformation labyrinth”.

As far as we are concerned, the importance of FDI infusions was given not necessarily by the financial inflows they generated, but by the transfer of organizational knowledge (managerial and of marketing) and competitive practices without which creating a market economy wouldn’t have been possible. Moreover, direct foreign investments attracted by these countries and targeted mainly towards the privatization of state-owned companies, have contributed to the creation of “economic clusters”. It may be precisely for that reason that attracting FDI in the economy has been seen as a “Marshall plan” for the reconstruction of ex-communist countries. Practically, we may say that in the CEE countries the market economy has been created alongside with the penetration of FDI in the majority of the activity sectors.

As a consequence, the countries which have attracted massive infusions of foreign capital (Estonia, Hungary and the Czech Republic) have successfully and rather rapidly got over the first stage, while the countries disfavoured from the point of view of FDI inflows (Bulgaria and Romania) have registered slow evolutions, marked by numerous hesitations, thus still facing the stage of competitive advantages based on factor instrumentation.

We shall henceforth end by emphasizing the influence of the FDI quality registered during the second stage of the competitive advantages, in order to move on to the economic development based on innovation. Regular practice has demonstrated that, while the economies of the CEE countries have turned into functional market economies, the quality of the FDI inflows has become essential to the progress towards stages where investments or innovations represent the core of actual development.

Thus, the Central and East European countries where the quality of the attracted FDI has completed, at a certain moment, their quantity, rank very high in what concerns their economic competitiveness. Within these countries, Slovenia represents a particular case, as it has searched right from the beginning for the qualitative aspects of the FDI inflows envisaging their impact on the local competences (Mazilu, 1999, pag. 211). Therefore, even if from the point of view of the received foreign capital it is placed far below the majority of the analysed countries (rank 5, figure 1), in what concerns competitiveness it overtake a vast majority of these (ranking after Estonia and the Czech Republic) due to the high qualitative impact of the direct foreign investments attracted in the economy.

In conclusion, in our opinion, in the future, the Central and East European countries where the quality and the volume of the foreign direct investments attracted in the economy will go hand in hand, will score the most outstanding successes in what concerns the increase in their resources, assets and capabilities competitiveness, with beneficial economic and social effects.

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Importanța investițiilor străine directe în creşterea competitivității economice a statelor central şi est-europene

Rezumat

Într-o economie globală caracterizată de o înaltă competitivitate şi schimbări tehnologice rapide, rolul şi importanța investițiilor străine directe sunt recunoscute de un număr din ce în ce mai mare de state datorită contribuției capitalului străin la creşterea productivității şi competitivității resurselor, activelor şi capabilităților. Pentru statele central şi est europene noi membre ale Uniunii Europene investițiile străine directe capătă o semnificație deosebită, având în vedere necesitatea reducerii decalajelor ce despart aceste state de țările tradițional industrializate, puternic dezvoltate, vechi membre ale UE (UE-15). În acest context, aşa cum acest studiu va demonstra, țările din Europa Centrală şi de Est în care volumul influxurilor de investiții străine directe va fi completat de calitatea acestora vor înregistra şi cele mai mari succese sub raportul competitivității economice cu impact pozitiv asupra mediului economic şi social.