

# **Industrial policy in Central Europe: FDI-driven export-oriented growth**

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# Outline

- Manufacturing in Central Europe (CE)\* in the beginning of 1990ies
- Policy Response
- The Czech Investment Promotion Agency (IPA) and Investment Incentives Scheme (IIS)
- Implementation and Results
- The Growth Model

\* CE in this presentation means the Czech Republic, Hungary, Poland, and Slovakia, i.e. the Central European former Soviet Bloc countries

# CE Manufacturing in Early 1990ies

- The manufacturing sector in CE post-communist countries in the beginning of 1990ies had numerous weak points, including
  - state ownership of manufacturing enterprises (100 % or close to 100 %)
  - excessive size and scope (imports were restricted and the services sector was underdeveloped)
  - technical obsolescence, with low international competitiveness
  - export orientation toward the CEE world, USSR being the most important export destination
- In short: New Underdeveloped Countries
- 1990 -1991: Collapse of USSR market → fast re-orientation of manufacturing export from USSR to EU
- Export to EU based on price competition (low quality – low price)
- Manufacturing in need of huge modernization investments
- Lack of domestic capital resources

# CE Manufacturing in Early 1990ies

- The manufacturing sector in CE and the countries themselves had also lot of strong points and structural advantages:
  - long industrial tradition going back to the 19th century, including various segments of engineering
  - educated human resources, particularly with good technical skills including shop worker level
  - strategic location in the center of the European continent, in vicinity of Germany and other highly developed European nations
  - comparatively good or at least acceptable transportation and ITC infrastructure
  - political and economic support of EU and many EU countries, including transfer of institutional know-how and assymetric liberalization of trade allowing temporary one-sided protection of several ,sensitive‘ markets in CE countries
  - the perspective of a future EU membership (took place in 2004)

## ■ Privatization

- selected businesses sold to strategic foreign direct investors (typically manufacturing companies, e.g. the sale of the Czech car manufacturer Škoda to VW in 1991)
- most business privatized locally, partly because of nationalist resentments
- domestic privatization typically didn't bring many inputs to the privatized business, particularly not capital, markets, and industrial know-how

## ■ Investment Incentives

- to attract foreign investors CE countries gradually introduced industrial policy scheme based on targeted investment incentives for direct greenfield investors (particularly in manufacturing, later also in selected fields of the services sector)
- greenfield investment projects significantly contributed to the improvements in unemployment rates
- Czech Republic is the most successful among CE countries in attracting FDIs

# Czech Investment Incentives Scheme

- The Czech investment promotion agency (IPA) CzechInvest was established in 1992. From the very beginning all its activities were pursued as fully compliant with EU state aid and competition regulations. The Investment Incentives Scheme (IIS) was approved in 1998, and it contains the following incentives:
  - corporate income tax relief (for up to 10 years)
  - transfer of a land for free or with discount price
  - job creation grants
  - staff training grants
  - cash grants on capital investments
  - information and legal support
  - **all incentives are granted automatically, dependent on eligibility of the particular project – no discretionary decision-making**

# Czech Investment Incentives Scheme

- Eligibility:
  - selected industries (most manufacturing industries, several hi-tech and hi-value-added service industries)
  - total sum of investment in one investment project at least CZK 50 to 500 mn (approx. EUR 2 to 20 mn), the sum varies regionally according to the regional unemployment rate; certain incentives are not available for projects located in the City of Prague where the unemployment level is significantly lower than in all other regions
  - certain incentives are eligible only if they create certain number of jobs (on top of the sum of the investment)
  - fulfilling specific technological (like percentage of new machinery and equipment in the investment project) and environmental criteria
  - **the scheme is available irrespective to the country origin of the investment**, eligible for both domestic and foreign investors

- To operate the IIS and to promote investment in the Czech Republic, CzechInvest was developed into a strong, commercially managed and driven organization. Apart of its headquarters in Prague CzechInvest operates
  - 13 regional offices in the Czech Republic (one in each region)
  - 8 offices abroad (4 in Western Europe, 2 in the US, 1 in Japan and 1 in China)
- Since 1992 up to 2012 CzechInvest completed
  - 2,148 investment projects with total value of
  - CZK 741,721 mn (EUR 29,669 mn) of pledged investments, which created
  - 240,706 long-term jobs
- CzechInvest twice awarded the European IPA of the Year (2000, 2001)



# IIS - Implementation and Results

- Since the implementation of the IIS the inward FDIs in the Czech Republic skyrocketed
- However this was not just the effect of the IIS and of the excellent performance of CzechInvest. In 1997 - 1998, several other policy initiatives supportive for FDI inflow were introduced simultaneously:
  - privatization of four biggest banks and several large businesses in energy, telecom, iron metallurgy or mining
  - official start of the EU enlargement negotiations (including the screening of the Czech legal system and its adaptation to the *acquis communautaire*)
  - second generation reforms (improvements in legal enforcement, transparency of both the government and the business environment, financial markets regulation, deregulation of the energy, telecom, and railway sectors, and many other pro-market reforms significantly strengthening the institutional setup of the market economy), mostly within the process of implementation of the *acquis*
  - support of inward foreign investment promoted to the top of the policy agenda

# IIS - Implementation and Results

Development of investment projects mediated in the period 1993-2012

Year	Number of projects	Total investment (CZK mil.)	Total investment (USD mil.)	Jobs
1993	2	361.39	12.50	570
1994	7	2,131.99	71.00	1,392
1995	6	2,260.10	80.90	1,243
1996	5	5,216.76	196.20	1,865
1997	5	1,624.00	59.39	872
1998	16	28,621.17	850.65	4,164
1999	23	15,259.34	525.73	5,576
2000	58	94,164.97	2,623.03	19,947
2001	55	54,690.05	1,459.80	13,179
2002	57	61,714.92	1,748.94	15,862
2003	65	35,850.80	1,185.35	12,218
2004	138	55,595.14	2,187.14	21,948
2005	153	77,470.00	3,299.78	21,998
2006	176	114,617.00	4,710.67	34,824
2007	196	70,954.00	3,532.23	30,598
2008	208	27,859.64	1,666.88	14,315
2009	186	16,888.91	875.87	5,769
2010	209	16,247.87	822.70	9,423
2011	233	33,665.83	1,895.07	12,617
2012	350	26,077.10	1,323.54	12,326
<b>Total</b>	<b>2,148</b>	<b>741,270.96</b>	<b>29,127.37</b>	<b>240,706</b>

Source: CzechInvest (2012 Annual Report)

# IIS - Implementation and Results

FDI Top Sectors in CR January 2003 – 2012

Sector	Total	Investment (mil. USD)	Jobs
Automotive Components	184	5,136	40,299
Financial Services	104	3,204	7,597
Textiles	94	1,164	9,322
Software & IT services	93	1,401	9,266
Industrial Machinery, Equipment & Tools	91	2,115	14,935
Food & Tobacco	87	2,002	15,773
Consumer Products	80	2,210	17,420
Real Estate	70	6,748	50,075
Business Services	69	438	2,708
Electronic Components	60	1,664	21,878
Plastics	58	885	6,186
Communications	53	2,141	4,940
Consumer Electronics	51	846	9,683
Automotive OEM	45	7,428	24,253
Metals	42	1,054	3,798
Pharmaceuticals	35	582	2,127
Alternative/Renewable energy	22	3,795	1,565
Business Machines & Equipment	22	571	6,819
Chemicals	21	316	1,333
Paper, Printing & Packaging	15	869	1,703
Medical Devices	15	207	1,554
Building & Construction Materials	11	668	1,075
Aerospace	9	321	1,853
Others	233	6,234	22,259
<b>Total</b>	<b>1,546</b>	<b>56,286</b>	<b>284,706</b>

Source: CzechInvest (Factsheet No. 2, 2013)

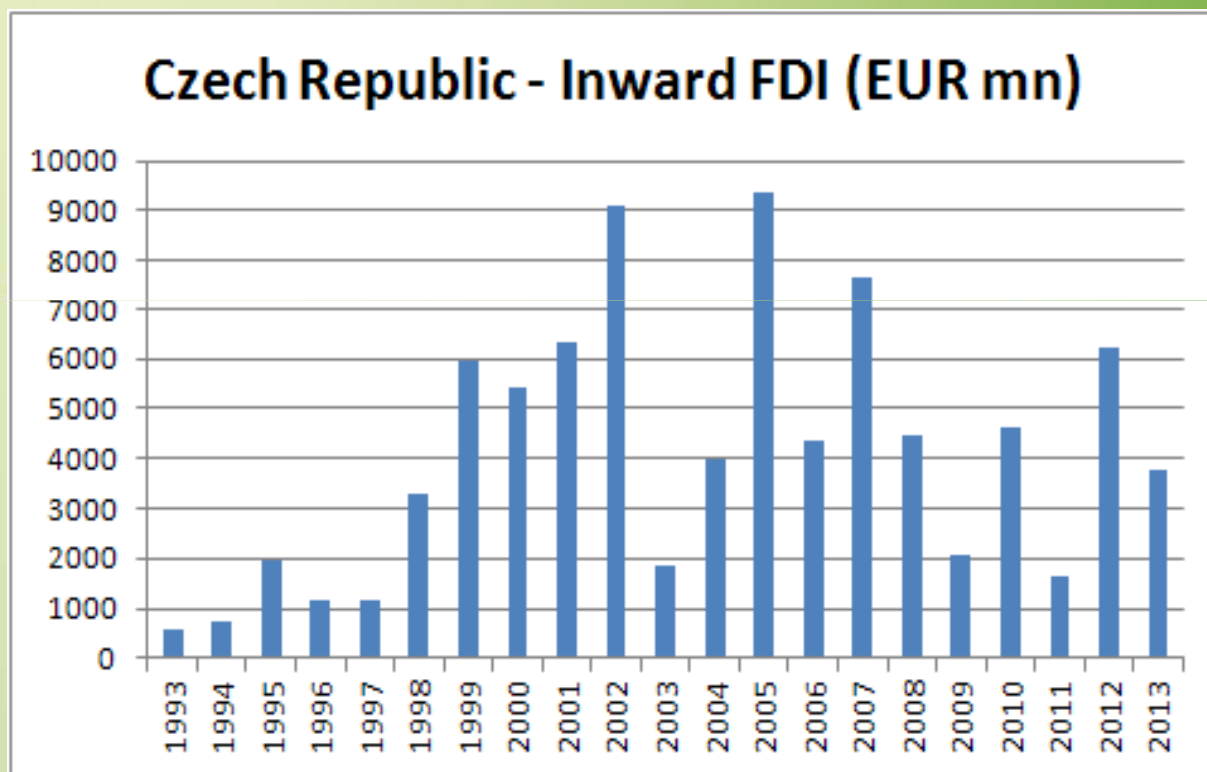
# IIS - Implementation and Results

## Top 10 Investment Projects mediated by CzechInvest

Company	Source country	Type of activity
Hyundai	South Korea	Automotive
Toyota/PSA	Japan/France	Automotive
Volkswagen	Germany	Automotive
Denso	Japan	Automotive
Caterpillar Solar Turbines	USA	Machinery
Eaton	USA	Electronic components
DHL	UK	IT Data Centre, Strategic Services
Red Hat	USA	IT
IBM	USA	IT, Strategic Services
Honeywell	USA	Aerospace, Strategic Services

Source: CzechInvest (Factsheet No. 2, 2013)

# IIS - Implementation and Results



Source: Czech National Bank (ARAD database)

# IIS - Implementation and Results

**Inflow of FDI by country (EUR thousand)**

	2006	2007	2008	2009	2010	2011	2012
Austria	796,236	803,499	1 461,169	533,964	1,394,521	601,184	1,073,430
Denmark	-30,468	165,201	69,162	13,994	29,763	-12,742	80,685
Finland	-11,450	8,924	16,849	17,490	-5,596	63,592	-7,466
France	213,260	39,728	795,985	403,530	-394,685	-154,587	302,817
Germany	1,535,545	881,490	369,699	-667,095	1,052,870	1,318,579	1,275,706
Ireland	-551	56,694	432,511	-421,145	-535,435	-265,279	6,506
Italy	-36,394	40,827	262,084	-35,875	20,665	2,820	95,679
Japan	120,707	296,484	-161,301	-155,759	17,967	-93,043	-133,127
South Korea	-166,615	269,071	78,086	5,666	145,833	290,877	284,698
Luxembourg	1,105,311	1,541,792	-32,416	295,903	-230,940	-270,568	19,867
Netherlands	-342,170	1,621,195	703,998	-399,187	1,498,872	-1,454,814	3,556,202
Spain	-23,740	199,249	-71,209	-117,750	157,934	-485,483	-228,593
Sweden	-153,939	248,220	-77,693	-104,064	160,226	-36,754	79,046
Switzerland	423,686	708,549	576,437	115,229	-421,365	311,368	260,343
United Kingdom	209,436	-390,492	-485,066	-297,225	1,263,806	638,750	153,112
United States	-14,720	301,599	-325,370	451,018	277,503	248,652	410,159

Source: Czech National Bank

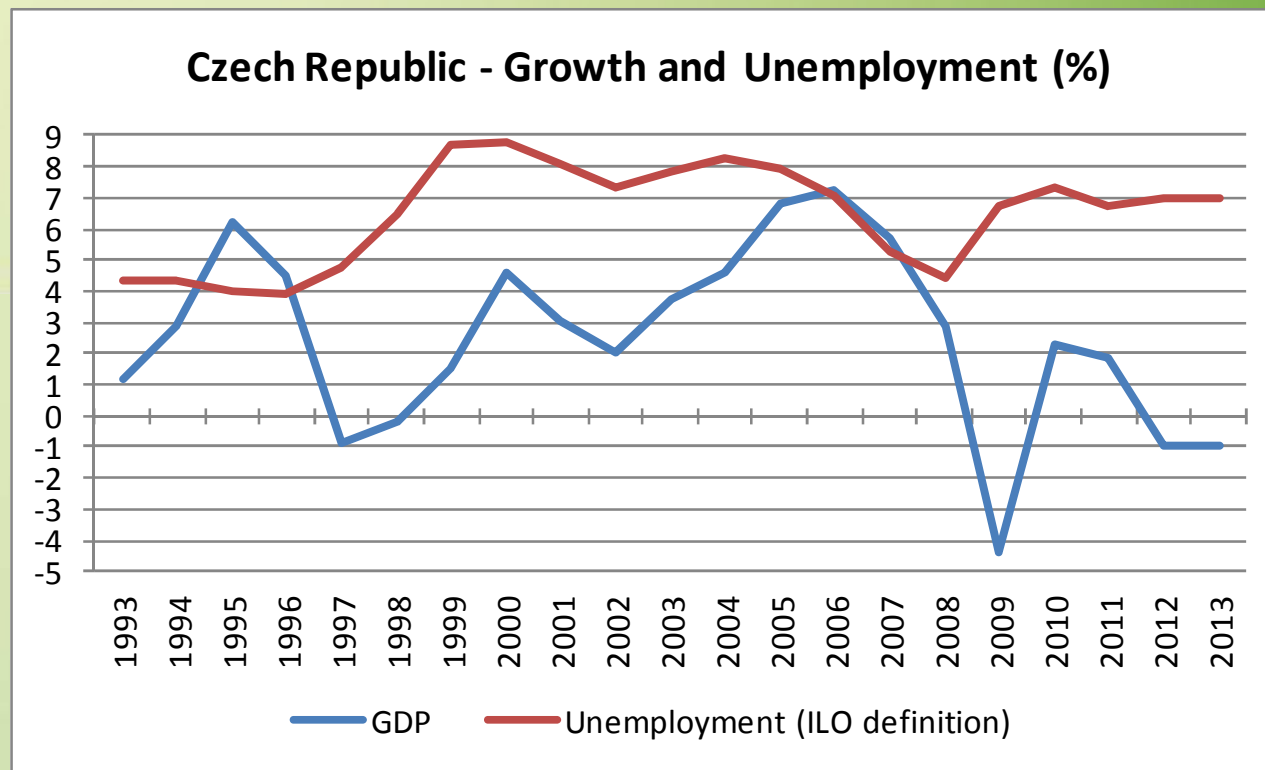
# IIS - Implementation and Results

## Inflow of FDI by sectors (EUR million)

	2006	2007	2008	2009	2010	2011	2012
<b>Manufacturing</b>	<b>1,352</b>	<b>2,825</b>	<b>556</b>	<b>-1,387</b>	<b>-354</b>	<b>869</b>	<b>2,378</b>
Food and tobacco	129	255	297	-93	-528	132	255
Textiles, wearing apparel, and leather	18	86	35	-16	45	-52	53
Wood, paper and publishing	76	22	29	-67	85	-189	17
Refined petroleum and chemicals	450	289	-229	-235	235	164	396
Nonmetallic products	-211	386	150	-49	0	0	0
Basic metals and metal products	259	584	-121	-239	-152	148	226
Machinery and equipment	596	1,146	328	-680	-240	583	1,021
Recycling and other manufacturing	35	57	66	-7	201	84	410
<b>Non-manufacturing</b>	<b>3,003</b>	<b>4,809</b>	<b>3,860</b>	<b>3,497</b>	<b>4,992</b>	<b>799</b>	<b>8,870</b>

Source: Czech National Bank

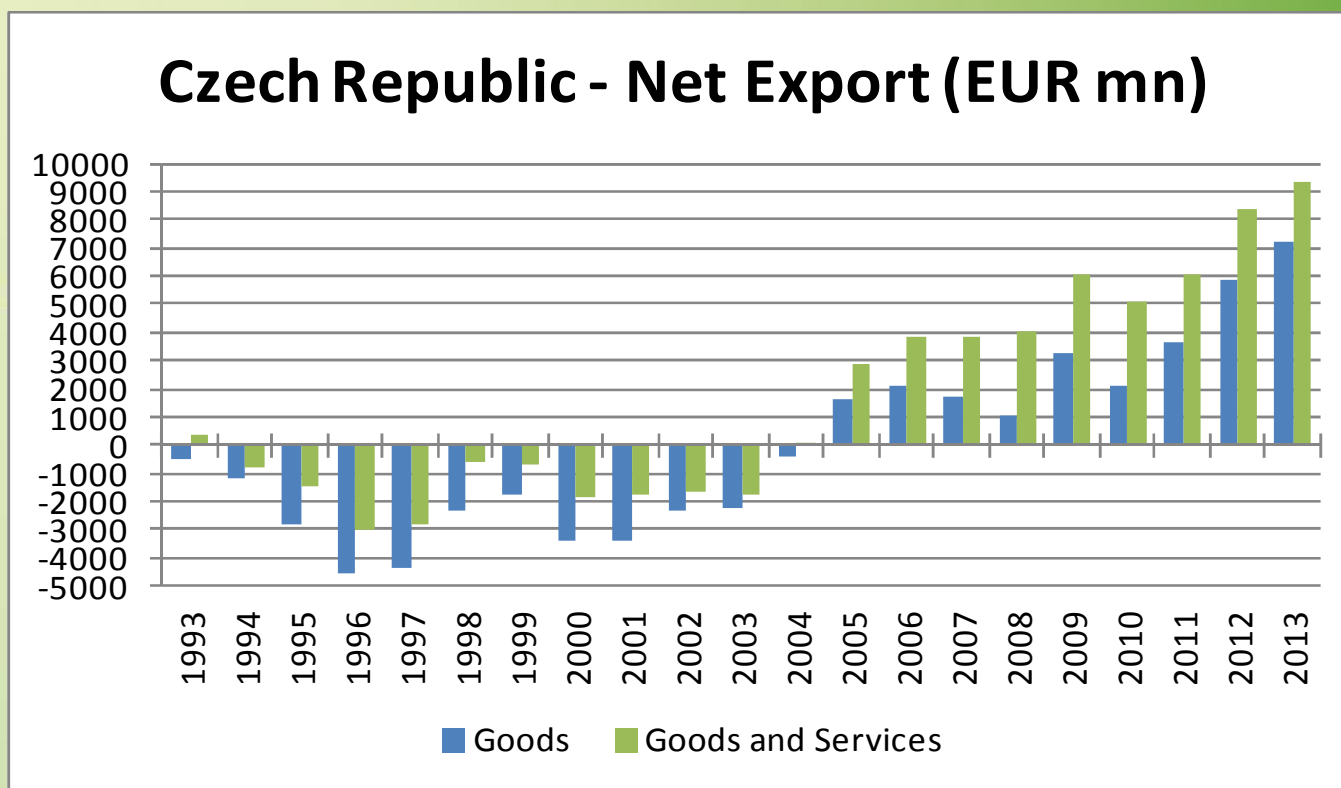
# IIS - Implementation and Results



Source: Czech Statistical Office



# IIS - Implementation and Results



Source: Czech National Bank (ARAD database)

# CE Growth Model

- The economic growth of the Czech Republic and other CE countries is chiefly driven by export-oriented manufacturing with medium value added (automotive industry, mechanical engineering, electric engineering and electronics...)
- This growth model established in the second half of 1990ies is now partly worn out (particularly in the Czech Republic). This is caused by
  - growing wages that make many industries less price-competitive
  - exhausting of available factors of production and of existing capacities (namely free stock of skilled labor) → visible consequence today: decline in size of the investment projects (fortunately compensated by their growing number)
  - growing international competition in leading CE industrial sectors (China and ASEAN, Turkey, South-Eastern Europe...)

- This growth model will continue to work in the foreseeable future but it will not generate those growth rates and labor market improvements as during the previous decade
- It's time for policy change – not to call off the successful policies of the past but to complement it with new policy measures fostering hi-value-added activities. Key points of these new policies should be
  - improvements in work of the government agencies and public institutions, focusing on the efficiency of the public sector, its credibility, transparency, predictability and accountability, and anti-corruption
  - massive and systematic investment into human and social capital, including education, culture and R&D

- Success of such policy re-orientation toward the ‘knowledge economy’ is by no means guaranteed...

but

- Doing nothing but just continuing in the successful policies of the past guarantees failure in the future

**Thank you for your attention!**

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