International competition in the demand for foreign direct investment[1]

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Abstract
Foreign investments - on the one hand, a recognized element in the fight against reducing unemployment, but on the other hand, an outlet for a huge amount of funds that go there in the interest of the state's well-being, but as is often presented to the public, mainly in the interest of us, the citizens. Although huge financial corporations reinvest billions in the given country, this country is also forced to reinvest more, according to the contractual agreement with the given company, which mainly includes the purchase of land, the construction of access roads - the construction of infrastructure, state subsidies, etc.

Keywords
Foreign direct investments, competetive adventage, investment decisions, international trade

JEL Classification

Abstrakt
Zahraničné investície – na jednej strane uznávaný prvok v boji proti znižovaniu nezamestnanosti, na strane druhej však odbytisko obrovského množstva financií, ktoré tam putujú v záujme blaha štátu, ale ako je často krát prezentované verejnosti, hlavne v záujme nás, občanov. Obrovské finančné korporácie síce v danej krajne preinvestujú miliardy, avšak aj táto krajina je nútená preinvestovať ďalšie, podľa zmluvnej dohody s danou firmou, ktorá zahŕňajú hlavne výkup pozemkov, výstavbu prístupových ciest – vybudovanie infraštruktúry, štátne dotácie a pod.

Kľúčové slová
Priame zahraničné investície, komparatívna výhoda, investičné rozhodnutia

Introduction

One of the fundamental factors in deciding whether to provide investment incentives and in what amount is international competition in the demand for foreign direct investments. The governments of most countries are interested in the positive effects of FDI, and if one government starts offering support and concessions to foreign investors, it will attract to its country those investors who would invest elsewhere (or not invest at all). However, other governments will soon follow suit and match the offered attractions. There is a situation where governments compete with each other in how much they are willing to pay for the positive effects of FDI (that is, for the arrival of an investor). Another aspect is the bargaining power of

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national or regional governments vis-à-vis large investors, their economic power equals that of small nation-states. Thus, a situation arises when states, in a "competitive battle" for direct investors, balance each other's offered support and investors demand incentives as a matter of course. This situation can then be simulated by the theory of the prisoner's dilemma. In the international climate of active support of large investors, the flows of these investments are likely to converge to a state as if no one used investment incentives.

The automatic demand for incentives by large investors also highlights the fact that previously provided concessions can be reflected in an increase in the prices of investment goods, and direct investors must then de facto demand concessions. Direct and indirect effects are associated with the inflow of foreign direct investments, which can be positive and negative, and I will focus on their detailed description in the next chapter.

Expert economic literature distinguishes between direct and indirect effects associated with the inflow of FDI. The main direct positive effects accompanying the inflow of foreign capital include the stimulation of economic growth, the availability of modern technologies and managerial skills. Among the externalities associated with the inflow of FDI, we can include the spillover of positive effects from companies with foreign participation to domestic enterprises and the creation of ties between domestic companies and foreign ones, when the inclusion of domestic companies among the suppliers of multinational companies increases their competitiveness

1 Positives and negatives associated with direct foreign investment

Direct foreign investments include a whole range of positives that can be very difficult to substitute. The expansion of these positives is usually associated with many times higher costs in underdeveloped countries, when companies do not have modern technologies at their disposal. Among the most valued positives associated with the inflow of FDI, we can primarily include:

- Capital – FDI brings free financial resources to the economy. Unlike other sources of foreign capital, these funds are invested for the long term and supplement insufficient savings in the host country: If = (S-I) + (T-G), where S – savings, I – investments, T – taxes and G – government spending.
- Access to foreign capital – multinational companies bring modern technologies, establish research facilities, support technical progress and increase production efficiency.
- Access to markets – multinational companies provide their subsidiaries with access to foreign markets that would be very difficult for domestic companies to access on their own.
- Managerial skills – multinational companies employ highly qualified professionals all over the world, which is positively reflected in the spillover of these skills and experience to all subsidiaries.
- Environment – multinational companies are at the forefront of the world's development of technologies that try to do as little damage to the environment as possible. The spillover of externalities in this area in the form of environmental management can raise the overall quality of the environment.
- Improvement of the institutional environment in the host country – multinational companies can also positively influence the institutional system in the given economy and the overall business environment.
- Positive impact on domestic companies – the entry of multinational companies into the market of the host country, which is associated with increased investment activity, gives other domestic companies a chance to apply.

In addition to the above-mentioned positives that foreign direct investment brings to the host economy, it is necessary to note the adverse effects that may be associated with this inflow:

- Displacement of domestic savings by foreign savings.
- A hostile takeover with the intention of stifling production and occupying the market with its own products.
- As a result of the inflow of foreign capital, there is an appreciation of the domestic currency, which can be negatively reflected in the growth of the trade balance deficit.
- Development of a capital-intensive method of production at the expense of a decline in labor-intensive production, which is associated with the growth of unemployment.
- The increase in wages in enterprises with foreign participation, which mostly corresponds to the growth of labor productivity, spills over into domestic enterprises, in which, however, the rate of growth of labor productivity lags behind the growth of wages.
- The growth of the money supply related to the high inflow of FDI can have inflationary effects. The subsequent sterilization leads to high interest rates and lower investment activity in the host country's economy.
- Increasing import of raw materials and unfinished production (semi-finished products) by companies with foreign participation leads to the decline of domestic producers of these commodities, because they lose sales for their products.
- "Transfer pricing" (manipulation of prices in multinational companies) leads to a reduction of the tax base and consequently to a decrease in tax revenue. However, domestic companies do not have this option, which reduces their competitiveness.
- Repatriation of profits burdens the current account of the balance of payments.
- Lower economic performance of domestic companies compared to companies with foreign participation can lead to the emergence of so-called dual economy, which is negative from a regional and sectoral point of view.
- Support for companies with foreign participation may lead to neglect of support for domestic companies.

2 Time level and foreign direct investments

In the short term, the inflow of foreign direct investment through pressures to strengthen the exchange rate of the koruna creates problems for the export-oriented corporate sector. In addition, the growth in the import of investment goods, which is often associated with the inflow of foreign direct investments, also pushes for an increase in the trade balance deficit. A positive factor in the short term is the higher pressure on the restructuring of enterprises under foreign control, which is, however, related to a negative phenomenon in the form of an increase in unemployment.

In the long term, the impact of FDI on economic development is considered positive (mainly due to the contribution of new technologies, management skills and access to foreign markets). In addition, when it comes to export-oriented foreign investments, the inflow of FDI will be reflected in the growth of exports and the reduction of the trade balance deficit. The temporary inflow of FDI also burdens other investments, including the reinvestment of profit.

However, in addition to the already mentioned long-term positive effects of FDI on increasing the efficiency and performance of the domestic economy, it is also necessary to note certain dangers associated with the inflow of FDI. One of them is the creation of the so-called dual economy, when on the one hand we have prosperous companies with foreign participation and on the other hand declining domestic companies that are teetering on the verge of bankruptcy.

Another factor that will be a problem for the domestic economy in the not-too-distant future is the increasing repatriation of foreign companies' profits. In countries with a high inflow of

FDI in the form of privatization of state property, this factor does not play a very significant role, however, over time, when the inflow of FDI from privatization decreases and green field investments begin to dominate, there is an increase in capital outflow in the form of profit repatriation, which can exceed and the total inflow of foreign investments.

3 The impact of foreign direct investments on the balance of payments and trade

Direct foreign investments in the form of equity investments finance the current account deficit in a non-debt manner, but portfolio investments in equity securities can also play the same role. FDI in the processing industry causes a surplus in the trade balance, because there is an increase in the export of products abroad, but FDI in services, especially in trade, on the contrary, a deficit, because the import of consumer goods grows. The effect of FDI on the income balance is significantly passive. The overall effect on the current account can thus be compensated in the long run.

The purely macroeconomic effect of the so-called replenishment of domestic savings in the form of non-debt financing of the current account deficit. See the picture

If domestic investments exceed national savings, a current account deficit occurs, which must be financed from foreign savings or a decrease in foreign exchange reserves. Foreign savings can finance domestic investments through the inflow of debt or non-debt foreign capital. Due to the fact that the supply of foreign exchange reserves is limited and the inflow of debt foreign investments leads to a proportional growth of foreign indebtedness, the only long-term sustainable source of financing the current account deficit is the inflow of non-debt foreign investments.

Debt up to 40% of GDP is generally considered satisfactory. In the case of its growth significantly above this limit, the risk premium required by foreign investors also increases, and without macroeconomic restrictions, a spiral of further deepening of indebtedness, leading to a debt trap, or a financial crisis, begins. The inflow of FDI greatly exceeding the current account deficit can, on the contrary, contribute to the reduction of foreign indebtedness, strengthen foreign exchange reserves and ultimately be reflected in the improvement of the rating assessment of the host economy.

Portfolio investments in equity securities are also a non-debt source of current account financing. In order to achieve a comparable effect as FDI in the balance of payments, an alternative is, for example, the development of the domestic stock market and venture capital funds

4 Influence of foreign direct investments in the trade balance

Foreign direct investments not only finance the current account deficit, but their activities in the host economy are also significantly reflected in its structure and value. In balance of payments statistics, FDI transactions on the current account are generally not published separately from transactions of domestic companies or portfolio investors. However, for the trade balance, data are available directly from the customs statistics of foreign trade, broken down into FDI and domestic enterprises, or foreign trade within duty-free zones or special customs regimes (so-called production sharing schemes), in which multinational corporations participate to the greatest extent.

Companies with the participation of a foreign investor are, on average, significantly more efficient in terms of exports than domestic companies. However, the higher export performance of FDI is also accompanied by their higher import demand in the form of imports of machinery and intermediate products, but FDI also make relatively more use of foreign services. This feature is most pronounced in green field FDI during their construction and before full production start-up.

In the first years after the inflow of FDI, one can expect their negative effect on the balance of the trade balance. However, if the trade balance deficit is primarily driven by a high level of investment (import of investment goods), it is possible to assume a growth in export performance and a balance of the trade balance deficit in the following period.

The dynamics of foreign demand is also important, but FDI and domestic enterprises can also react asymmetrically to its development. For FDI, intensifying competition in an environment of stagnant global demand can be an additional impetus for cost optimization of production and the transfer or higher use of its capacities in countries with a lower wage level.

Conclusion

Economists agree when assessing the positive effect of foreign direct investment on a country's economy, but their opinions often differ when assessing the degree of effectiveness of these investments. Examples can be Ireland and Portugal or Greece on the other hand. These countries were supported by EU funds to a comparable extent, but their effectiveness and final result are diametrically different.

Massive FDI in the automotive industry and the related development of subcontracting services are becoming the driving force of the Slovak economy. The current export of the automotive industry makes up 32% of the total export of the Slovak Republic. When assessing the location of their investment, the companies of the automotive industry are mainly motivated by cheap and highly qualified labor, tax holidays, as well as other financial incentives of the Slovak government, which in some cases reach up to 20% of the total investment value. At the same time, foreign companies gain the right to use state financial support for the education and retraining of their employees.

In the early stage of the FDI attraction phase, the government is motivated to support any foreign investment, and competes for these investments with other transition economies. Some authors talk about the "race to the bottom" theory, in which countries compete fiercely with each other. What is important is the art of discerning when this enthusiasm should be replaced by sound economic reasoning. Currently, no one doubts the high degree of dependence of the Slovak economy on the automobile industry. This is an industry that, like other industries, is subject to seasonal influences and fluctuations, which can be fatal for such a small economy as ours. Therefore, the government and responsible institutions of the Slovak Republic should realize that the time has come to assess foreign direct investments not only according to quantity, but also according to quality.

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