

FOREIGN DIRECT INVESTMENT IN THE CZECH REPUBLIC

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Abstract: The inflow of foreign direct investments into the Czech Republic has been growing during the last period. The structure of these investments is especially important for the future economic development. Recently, most of the investments have been going into sectors with the bigger share of less qualified workforce (e.g. building of the retail chain stores). In contrast to Poland or Hungary, the Czech Republic is falling behind in preparation of the areas suitable for the future investors. System of government incentives is directed to attract investors especially into processing industry and to create already mentioned suitable pre-invested zones.

Key words: Foreign direct investment, transitive economics, investment incentives, industrial zones

1. INTRODUCTION

It is estimated by The Organisation for Economic Corporation and Development (OECD), that the total annual amount of foreign direct investments (FDI) in the whole world reaches more than 300 billion USD. Around two thirds of these investments flow among the most developed countries, which encourage foreign investors to bring money into their economies by for example providing them with various advantages. In the Czech Republic, the question of the amount of inflow of foreign investments into the national economy is also discussed very often. Our country is compared to other transitive economies. The structure of investments and the problem of under-valuation of the importance of the foreign investments by previous governments are discussed. There has been major improvement in the field of investment incentives recently. The total amount of foreign direct investments into the Czech Republic has also been

growing. The numbers of the foreign direct investments for 1998 prove, that the Czech Republic is still one of the countries, which are attractive for foreign capital.

2. FOREIGN DIRECT INVESTMENT IN THE CZECH REPUBLIC TILL 1998

Under the words - foreign direct investment (FDI) we mean foreign investor's share of ten per cent and higher in company's basic assets. The condition is investor's participation in the management. During the last year (1998), foreign companies invested around 2.5 billion USD (82 billion CZK) in the Czech Republic. It is double of the previous year and the second best result during the whole transitive period. Inflow of foreign direct investments reached more than 11 billion USD during the whole transition period (till the end of 1998). To say whether inflow of foreign investments into the Czech economy is sufficient is difficult. Concerning the absolute gains of the Polish and Hungarian economies, it seems that the Czech Republic obtained only a small proportion of the total amount of investments. Since 1989 the inflow of foreign direct investment into Poland was 22 billion USD and into Hungary 17 billion USD. Coefficient of an average share of inflow of foreign direct investments during the last years is more suitable for our comparison. During this period annual average inflow of foreign direct investment into the Czech economy was 3 per cent GDP. It makes the Czech Republic the second most successful economy in Central Europe after Hungary (5.4 per cent) and before Poland (2.2 per cent). Table I shows the origin of the biggest foreign investments into the Czech Republic.

Table 1 Foreign Direct Investments in the Czech Republic (31.12.1997) - Territorial structure

Country	Invested capital (thousand CZK)	Share (per cent)	Investments into industry (per cent)
Germany	99 285 107	30,9	74,1
the Netherlands	88 987 474	27,8	51,9
Austria	30 396 669	9,5	34,3
the USA	20 639 112	6,4	49,1
Great Britain	16 010 525	5	72,8
Sweden	9 377 345	2,9	79,9
The Slovak Republic	6 694 598	2,1	7,1
Italy	5 719 421	1,8	89,1
Switzerland	5 140 495	1,6	84,3
Others	37 569 504	12	60,4
Total	319 820 250	100	60,6

Source: ČNB 1998

As Table 1 shows, the German investors have the biggest share of the total foreign direct investments in the Czech Republic. The majority of the German investments went into car industry (23.9 billion CZK). The Dutch investors put their money especially into telecommunications (25.7 billion CZK) and into food industry (20.6 billion CZK). The biggest Austrian investments in the Czech Republic were in banking (5.8 billion CZK). In industry, the Austrians invested their money especially into the production of building materials. The Americans directed their investments also mostly into banking (4.3 billion CZK) and then into chemical (2.6 billion CZK) and food (2.2 billion CZK) industries. Concerning the sectors of the national economy, the biggest inflow of foreign direct investment was into industry (60.6 per cent). In industry, the biggest foreign investments went into food industry (e.g. Nutricia, Danone, Čokoládovny), into the building material production (e.g. Wieneberger, Ytong) and into mechanical engineering (e.g. Škoda Auto). In some cases, the foreign companies managed to gain control over the whole sector. Foreign capital controls the production of for example cement, bricks, pottery and porcelain. Foreign share in beer production and sugar- making are also significant.

Table 2 Foreign Direct Investments into Industry (31.12.1997)- Sector structure

Sector	Invested capital (thousand CZK)	Share (per cent)
Food industry	38 821 479	20
Building material industry	33 451 074	17,3
Mechanical engineering	32 725 776	16,9
Electrical industry	14 527 987	7,5
Energy production	13 866 291	7,2
Paper- making	11 119 657	5,7
Chemical industry	10 533 398	5,4
Metal working industry	8 870 162	4,6
Rubber industry	6 470 892	3,3
Oil industry	5 986 611	3,1
Textile industry	4 473 407	2,3
Metallurgical industry	4 324 212	2,2
Printing industry	3 329 938	1,7
Others	5 345 012	2,8
Industry total	193 845 896	100

Source: ČNB 1998

According to preliminary results, foreign direct investments in the Czech Republic were around 82 billion CZK in 1998. The Dutch capital has got the biggest share (19.6 billion CZK), followed by the Germans capital (17.3 billion CZK). The British (10.9 billion CZK) and the American (8.3 billion CZK) shares are also significant. As far as the sector structure is concerned, the dominant role is moved from the sector of industry to the sector of services, especially because of the vigorous entrance of the big trade chains into the Czech market.

3. INVESTMENT INCENTIVES IN THE CZECH REPUBLIC

Until 1998, there was no incentives system in the Czech Republic. In April 1998 the Czech government approved of foundation of incentives system and set 25 million USD as the minimum limit of investment to obtain incentives. In December 1998, this minimum limit was brought down to 10 million USD. Today incentives are provided only in the field of processing industry. Investors fulfilling all general criteria are free to apply for all incentives or only for some of them.

General criteria:

1. The investor has to invest at least the equivalent of 10 million USD into fixed assets.
2. The investment has to be made into a manufacturing sector and at least 50 per cent of the production line (in terms of cost) must consist of machinery listed under a Czech-government approved list of high-tech machinery.
3. Investment into machinery has to account for at least 40 per cent of the total investment.
4. The investment must be made into the construction of a new production plant (green-field investment) or into the purchase or lease of existing production facilities to launch a new production activity (brown-field investment). Acquisitions are not eligible.
5. The proposed production must meet all Czech environmental standards.

Investment Incentives offered by the Czech Government:

1. Corporate tax relief for up to 10 years
2. Location in a customs- free zone
3. Duty-free imports of machinery and equipment
4. Job-creation grants
5. Training grants
6. Provision of low- cost building land and/or infrastructure.

Incentives 1, 2, 3, and 6 are offered throughout the Czech Republic. Job-creation grants are offered in regions with high unemployment. 10- 50 per cent of total training costs may be covered by government grants depending on the unemployment rate in the district where the investment is to be made. The investors not fulfilling the general criteria can ask directly local (state) authorities for incentives 4, 5, and 6.

Because investments in green-field projects play a great part in the structure of foreign direct investments, the incentive No. 6 is very interesting for potential investors. In the beginning of this year (1999), the government passed a resolution concerning the support of the development of the industrial zones. The most important fact is that the newly framed arrangement allows municipalities to gain under pre-set conditions the state contribution for the preparation of the strategic areas in advance. 158 million CZK was earmarked from the state budget for this year. 18 municipalities were chosen out of all registered municipalities interested in the program. Most of them are towns, which

already started to build these zones in the past. The Table 3 shows amount of the state contribution obtained by individual municipalities.

Primary projects were realised in Karviná and in Bystřice pod Pernštejnem (both zone 55 million CZK), before the introduction of the state contribution system for these newly built zones. They still have not got concrete investors. Compared with that, in other supported zones in Kladno-Kročehlavy and in Plzeň- Borská pole, big foreign investors already started production and there are also other investors interested in these zones (c.g. Nemas).

Table 3 Industrial zones support in 1999

Municipality		Area size (ha)	State contribution (thousand CZK)
Advancement projects			
1	Plzeň	45,0	20 250
2	Olomouc	18,7	8 400
3	Uničov	30,6	21 000
	out of that: in 1999		15 000
	in 2000		6 000
4	Kláštorec nad Ohří	62,0	29 500
	out of that: in 1999		20 000
	in 2000		9 500
5	Podbořany	10,7	1 000
6	Pardubice	50,0	22 500
7	Pelhřimov	10,5	5 600
8	Stod	10,9	5 600
9	Chomutov	18,2	9 000
10	Ždírec nad Doubravou	5,8	1 500
11	Moravská Třebová	11,5	6 500
12	Blatná	10,0	2 000
Advancement projects-total			132 850
out of that: in 1999			117 350
Incentives projects			
1	Brno	3,3	8 060
2	Jičín	34,3	13 350
3	Kladno	19,8	5 000
4	Staré Město	5,1	4 740
5	Šumperk	13,4	9 000
	out of that: in 1999		6 000
	in 2000		3 000
6	Znojmo	1,8	3 500
Incentives projects-total			43 650
out of that: in 1999			40 650
Total			158 000

Source: CzechInvest 1999

4. CONCLUSION

The inflow of foreign direct investments into the Czech Republic has been growing during the last period. The structure of these investments is especially important for the future economic development. Recently, most of the investments have been going into sectors with the bigger share of less qualified workforce (e.g. building of the retail chain stores). In contrast to Poland or Hungary, the Czech Republic is falling behind in preparation of the areas suitable for the future investors. Large zones are especially missing. System of government incentives is directed to attract investors especially into processing industry and to create already mentioned suitable pre-invested zones. This is the only way for the Czech economy to reach suitable structure of the foreign investments and to use qualified labour-force in beneficial way, especially for the restructuring of the affected regions.

Resume

Přímé zahraniční investice v České republice

Organizace pro hospodářskou spolupráci a rozvoj (OECD) odhaduje, že roční celková hodnota přímých zahraničních investic (PZI) ve světě dosahuje více jak 300 miliard dolarů. Přibližně dvě třetiny těchto investic se přelévají mezi nejvyspělejšími státy, které uplatňují pro nalákání investorů nejrůznější výhody a pobídky. V České republice je otázka velikosti přílivu zahraničního kapitálu do ekonomiky diskutována velmi často. Jsme v tomto ohledu srovnáváni s ostatními tranzitními ekonomikami, diskutuje se o struktuře investic a v neposlední řadě i o podceňování role pobídek pro zahraniční investory předchozími vládami. V poslední době však došlo v oblasti investorských pobídek k výraznému zlepšení a i celkový objem přímých zahraničních investic do ČR má rostoucí tendenci. Údaje o přímých zahraničních investicích za rok 1998 svědčí o tom, že Česká republika je stále mezi zeměmi, které jsou pro seriózní zahraniční kapitál lákavé. Přímé zahraniční investice v České republice v posledním období rostou. Důležitá je z hlediska dalšího ekonomického rozvoje především jejich struktura. V posledním období však značná část investic vstupuje do odvětví, kde je vyšší podíl méně kvalifikované práce (např. budování obchodních řetězců). Oproti Polsku, či Maďarsku Česká republika zaostává v přípravě území vhodných pro investory. Chybí zejména velké zóny. Systém vládních pobídek směřuje k přilákání investorů zejména do zpracovatelského průmyslu a k vytvoření vhodných, zainvestovaných zón. Jen tak může česká ekonomika dosáhnout vhodné struktury zahraničních investic a cíleně využít kvalifikované pracovní síly zejména v restrukturalizaci postižených regionech.