A Tension between Continuity and Change

The Third Conference on

A New Dialogue between Central Europe and Japan

FDI in Central European Countries

- Truths and Challenges

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July 26-28, 2000, Prague, The Czech Republic

1. Privatization and FDI

1.1 The "Aporia" of Privatization

The privatization of the so-called transforming countries faces many fundamental difficulties, which highlight specific features of transformation in the contemporary era. In my book, *Economics of System Transformation* (published 1994 by Shinseisha in Japanese), I summarize the difficulties of privatization in the following seven points.

First, the scope of privatization covers almost 70-80 percent of the national economy (large-scale privatization).

Second, almost all state companies suffer from business and financial difficulties as a result of the collapse of the old system and the loss of markets. The delay in the transformation of state owned companies has resulted in the continuing decline of the market value of assets (urgency).

Third, domestic capital accumulation is severely lacking, and therefore the conditions for domestic producers and citizens to buy out national assets do not exist (lack of capital and independent entrepreneurs).

Four, the legal system is short of the means to clarify ownership of the privatization of various assets (poor legal system).

Five, an evaluation system of assets by the markets does not exist (insufficient market valuation).

Six, even though the transformation of state-owned companies into joint-stock companies has been accomplished, there is no capital market for public offering (underdeveloped capital market).

Seven, social normative for regulating selling and distribution of national assets is lacking (inappropriate social normative).

The difficulties described above seem to pose an unsolvable contradiction, a vicious circle, which can be called the "aporia of privatization". All the difficulties teach us that the formation of a legal framework is not difficult, though making it sufficiently substantial is not as easy. It has been an urgent and pressing task for all the transforming countries to create private companies which can function in market environments.

1.2 What is privatization?

What is the task of privatization? If the end result of privatization is the transformation of the ownership structure of state companies, then it is exclusively a legal task. However, legal transformation does not create private companies which can work effectively in market environments. Legal transformation is simply a precondition.

We should take into account that International organizations such as the IMF and EBRD placed priority on the swift transformation to lower state ownership, even through formal change, due to inefficiency and discontinued state ownership. However, the experience of the past ten years clearly shows the universal truth that we cannot create the substance(real private companies) by formality(the legal framework).

How can it be possible to create efficient companies under circumstances in which there are enormous technological gaps with the world market, an absolute shortage of capital and a lack of competent managers? It seems an impossible mission; creating something from nothing.

All the difficulties show us that there are only a few choices to be made in privatization in order to break through the vicious circle.

One way is to distribute assets of state companies among citizens or workers and managers, and wait for the emergence of new entrepreneurs (waiting for a self-developing market economy).

A second way is to select promising state-owned companies and valuable assets and to appoint competent managers and invest state money into the selected companies and assets, and thus create efficient companies in the world market (priority production measures). The events of recent history have not followed the definitely intended measures described, but competent individuals and groups have instead been legally or illegally utilizing or even stealing valuable assets from the state, and thus creating quasi-private or private companies.

A third way is to import capital, technology and management: the three factors are “the three sacred treasures” for complete privatization. By selling state companies to foreign investors they bring “the three sacred treasures” to the economy.

Although the actual process going on in the transforming countries is a mix of the three types, we are nevertheless able to characterize each country's dominant process as being closer to one of the three ways. For example, the Czech and Slovak Republics are characterized by the first way, the Russian Federation by the second way and Hungary by the third.

Of the three ways the third choice is the most favorable in order to quickly establish competitive companies. However, it is not the country receiving capital, but the investor who chooses the country to be invested in. That is, the third way exclusively depends on the decision of foreign investors, and not on the decision of the country.

1.3 Prejudice and Misunderstanding of FDI

Immediately after the collapse of the old system there emerged the viewpoint that foreign direct investment represented capital export in the form of economic imperialism. Even today, some are looking for the so-called "third way" toward a new system, neither capitalist nor socialist, which saves the country from degeneration into a mere wage-earning subcontracting country. I would describe this type viewpoint as "the Imaginary Third Way".

The opinion expressed by governments and people is also different according to the country in question. In Russia, contrary to the superficial welcoming lip service, both the government and the people firmly believe that foreign capital comes to exploit cheap Russian labor (A Naive Feeling of Exploitation). Consequently, various governmental institutions are trying to exploit foreign companies at every step, which hinders the entry of foreign companies to Russia.

In Poland, the country which suffered for many years from the heavy burden of external debts, there strongly exists a continuing distrust of foreign capital irrespective of whether it is portfolio investment or direct investment (Fundamental Distrust).

In the Czech Republic Mr. Klaus, a proud Czech, abolished preferential policy for foreign capital in 1993 when the Czech-Slovak Republic was separated. He believed that highly reputable Czech companies could compete with foreign companies* and therefore they should be put under the same conditions as foreign companies ("Over Self-confidence of Nationalism ").

* When Matsushita Panasonic established Color TV manufacturing company in Plzen, the initial local content was 2%, and the present one is 6%.

Nowadays, all the transforming countries including the Czech Republic have an incentive system in place for attracting foreign direct investment. Reluctance towards FDI has disappeared, at least on a governmental level. Both Poland and the Czech Republic are undertaking aggressive policies with the aim of facilitating foreign direct investment, representing a radical change in policy.

2. Historical Trends of FDI

2.1 The First Half of the 1990's

Reflecting the initial stances held by governments toward FDI in Central Europe, Hungary enjoyed the largest inflow of FDI in this region, since only Hungary was free of prejudice against FDI in the first half of 1990's, though in fact the absolute amount of capital received was not that large.

Table 1 shows the forecast made by *The Economist* regarding the inflow of FDI in the second half of the 1990's. The main predictions of the forecast are as follows.

(1) Total FDI inflow to the ex-Soviet Union and East European countries in the coming years (1996-2000) will amount to about 100 billion US dollars.

(2) In the same period both Poland and Russia will receive more than 20 billion US dollars. The two countries will be the leaders in FDI inflow among ex-socialist countries.

(3) The weight of Central Europe in the share of FDI will decrease as a result of the large inflow to Russia.

(4) Within Central Europe the weight of Hungary will decrease and that of the Czech Republic will increase.

Table 1　FDI in the First Half of 1990's and a Forecast in Million US Dollars

	1994	1995	1990-1995 Accumulation	Country Allocation,% （regional、%）	Forecast for 1996-2000 (country allocation、%)
Hungary	1,146	4,400	11,200	31.38 (44.29)	12,968 (13.07)
Poland	1,875	2,500	7,148	20.03 (28.26)	21,969 (22.15)
Czech republic	878	2,500	5,666	15.87 (22.40)	15,466 (15.59)
Slovakia	187	200	775	2.17 (3.06)	2,150 (2.17)
Slovenia	87	150	501	1.40 (1.98)	3,052 (3.08)
Central Europe	4,173	9,750	25,290	70.85 (100.00)	55,605 (56.06)
Albania	53	75	205	0.57 (11.08)	583 (0.59)
Bulgaria	105	150	412	1.15 (22.27)	1,428 (1.44)
Romania	340	400	933	2.61 (50.43)	4,017 (4.05)
Yugoslavia	120	100	300	0.84 (16.22)	2,210 (2.23)
CE and Balkans	4,791	10,475	27,140	76.03 (100.00)	63,847 (64.37)
Baltic states	430	400	1,280	3.59 (14.96)	1,890 (1.91)
Russia	1000	2,000	4,400	12.33 (51.44)	26,960 (27.18)
Ukraine	91	113	574	1.61 (6.71)	1,400 (1.41)
Other CIS	640	800	2,300	6.44 (28.89)	5,085 (5.13)
Total	6952	13,788	35,694	100.00 (100.00)	99,186 (100.00)

Notes: *Economic Intelligence Unit*, April 1996.

2.2　The Second Half of the 1990's

Shocked by the large inflow of FDI to Hungary, the governments of Poland and the Czech Republic changed their attitude towards FDI and began to initiate positive policy in order to appeal to FDI. The two governments established PAIZ (Poland) and CzechInvest (Czech Republic) as advertising bodies to invite FDI into their countries. Contrary to the official stance, the Klaus government even offered several individual preferential measures to large investments.

As the privatization of Hungary came to an end by the middle of the 1990's, Poland with the largest domestic market became the next target for FDI in this region. Thus, Poland became the main recipient of FDI in the region in the second half of 1990's. On this point the forecast of *the Economist* was right.

On the other hand, FDI to the Russian Federation has been stagnating. *The Economist*'s forecast was entirely wrong in the case of Russia.　Although the weight of Hungary has been decreasing, the Czech Republic has not been able to catch up with the level of Hungary, mainly because of the failure of voucher privatization.

Table 2 FDI in the Second Half of 1990's in million US dollars

	1996	1997	1998	1999	1996-1999 (total) (regional allocation、%)	1990-1999 (total) (country allocation、%)
Hungary	2000	1700	1500	1600	6800(18.57)	18000(16.60)
Poland	2800	3000	6600	6500	18900(51.62)	26048(24.03)
Czech Republic	1400	1300	2500	3500	8700(23.76)	14366(13.25)
Slovakia	251	177	508	500	1436(3.92)	2211(2.04)
Slovenia	178	295	154	150	777(2.12)	1278(1.18)
Central Europe	6629	6472	11262	12250	36613(100.00)	61903(57.10)
Albania	97	42	45	43	227(2.23)	432(0.40)
Bulgaria	100	497	401	700	1698(16.70)	2110(1.95)
Romania	263	1224	2040	1345	4872(47.91)	5805(5.35)
Yugoslavia	535	868	1129	840	3372(33.16)	3672(3.39)
CE and Balkans	7624	9103	14877	151178	46782(100.00)	73927(68.19)
Baltic states	639	973	1716	900	4228(16.30)	5508(5.08)
Russia	1700	3800	1200	3500	10200(39.32)	14600(13.47)
Ukraine	500	600	700	600	2400(9.25)	2974(2.74)
Other CIS	1971	2507	2543	2089	9110(35.12)	11410(10.52)
Total	12434	16983	21036	158267	72720(100.00)	108414(100.00)

Notes: Balance of payments data.
Source: EBRD, T*ransition Report 1999*, London 1999.

3. Motives of FDI and Unbalance of FDI Inflow among Countries

3.1 The Two Main Motives

There are two main motives for multi-national companies to invest in transforming countries.

One motive is to transfer their production base from the West to the East or establish a second production base in Europe. By utilizing cheap labor, multi-nationals are able to reduce production costs and maintain their competitive position on the market. Despite 10 years having past since the beginning of system transformation, the wage level in Hungary remains at one-seventh or one-eighth of that in Germany.

The other motive is for companies to widen their sales base, since a large consumer market is now open to multi-nationals in Central-East European countries. Providing effective demand exists, the potential exists to establish production and a sales base specific to the given country.

The two targets sometimes overlap. However, the basic strategy of the two targets is different depending on whether specializing in exports or in domestic sales.

Then, the main decision for investors to make is whether they should buy out existing companies or establish new companies. So far, generally speaking, buyout investments have been observed in consumer goods industries, while green field investments are dominant in high-tech industries. Even in the case of the takeover of existing companies, sooner or later, new investment in productive equipment becomes necessary in many cases and sometimes the amount of new investment is larger than that the initial cost of a takeover.

Poland has been chosen as a FDI target from the standpoint of its large domestic market, while Hungary has been a FDI target from the standpoint of being an export production base. The delay of real privatization in the Czech Republic so far limits the inflow of FDI. Although it is certain that the Czech republic will draw in more FDI in the future, the geographical position of the Czech Republic in itself confines FDI flow to targeting its export base towards the East. On this point the role of the Czech Republic is different from Hungary's, since Hungary can play the role of meeting point between East and West.

3.2 Hungarian Case

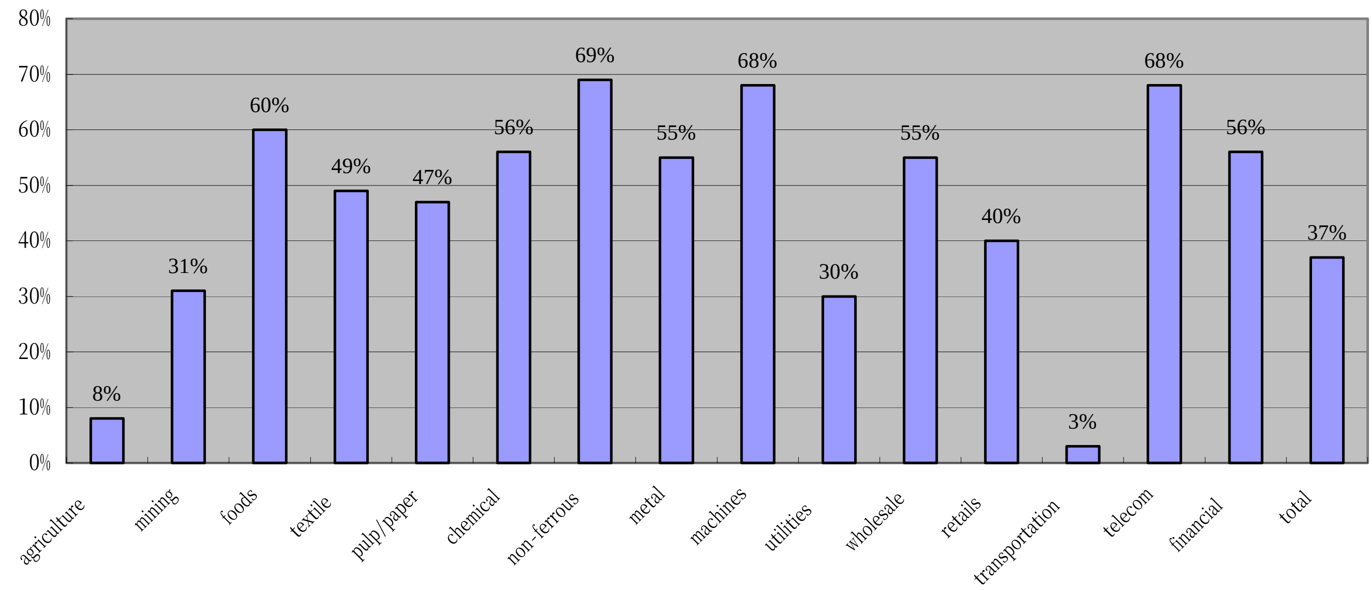
The Hungarian domestic market, with its population of 10 million, is not at all attractive for multi-national companies. Therefore, those who invested in Hungary neglect to take its domestic market into account and see its role as an export base. The reasons Hungary received almost half of the FDI inflow in the first half of 1990's are the following.

(1) Hungary is traditionally friendly to foreign investment and offered preferential measures for FDI.

(2) The market infrastructure for industry is better than in any other transforming country and therefore it is relatively straightforward for investors to enter Hungary.

(3) From Hungary's point of view, it was an urgent task to sell off state companies and to lessen the burden of external debts. Almost every company in every sector has been up for sale.

(4) Historically Hungary has held a close relationship with Austria and Germany. Consequently, Austrian and German companies have had few problems in coming into Hungary.



Note: The rate of foreign capital occupied in gross capital of each industry.
Source: ECOSTAT.

Figure 1 Foreign Capital in Hungarian Industries(at the end of 1998)

(5) Much of Southern and Eastern Europe came under the reign of Hungary in the era of the Habsburg Empire. Hungary can play the role not only as a production base for the West, but the role of a hub for the South and the East as well.

Thus, during the early years of system transformation, Hungary was a model for FDI to ex-socialist countries. Even now, Hungary is a model country for privatization of the banking and utility sectors via FDI.

As can be seen in the Figure 1, except for agriculture and transportation, the rates of occupation of foreign capital in Hungarian industries is exceptionally high compared not only to transforming countries, but also to developed countries.

According to statistical data, companies with foreign capital created more than half of the value added produced by whole industries in Hungary in 1998. At the same time, about 70% of Hungarian exports have been attributed to companies with foreign capital.

3.3 The Polish Case

A large domestic market in itself is an attractive proposition, even for multi-nationals whose primary aim is not the domestic market to be invested in. Furthermore, the existence of a market near the production base is a vital condition for small-medium size companies in taking the decision whether to invest in transforming countries or not. From this point of view, Poland with its 40 million population earns exclusive merit compared to other Central European countries. Moreover, if production is confined to the domestic market, then the newest technology is not necessary, which also makes the decision easier. Even if foreign capital acquires companies by way of privatization, new investment required will be of a minimum level.

In spite of these merits, during the first half of the 1990's Poland was not able to receive satisfactory FDI inflow, because of the absolute limitation of effective demand set by its low-income level. However, the steady growth of the national economy and the consequent increase in individual income make Poland a possible target as a selling market. FDI inflow to Poland has been increasing during the last three years thanks to the progress of the privatization process, to the extent that Poland is now the leading FDI recipient not only in this region, but also among all ex-socialist countries.

On the other hand, the Polish type of FDI inflow, as Asian experiences show, is likely to put Poland's trade balance and balance of payments in chronic deficit. In order to correct the external imbalance in time, the Polish government periodically has to take restrictive policy-measures, which will make its currency unstable. Among Central European countries Poland most resembles the Asian type of economic development.

3.4 Japanese Investment

According to research carried out by the Nomura Research Institute in Sept. 1997, out of about one thousand companies listed on the stock market, 310 companies showed interest in future investment towards the ex-Soviet and Eastern Europe region. Among those who considered investing in Central Europe, more than 50% of the companies intended to establish production and export bases, and only 35.7% of the companies

Table 3 Target Country for Japanese Investment (Sept. 1997)

Poland	33.40%	Hungary	26.40%	Czech Republic	18.40%
CIS	6.80%	Slovakia	5.80%	Others	9.20%

Source: Nomura Research Institute.

intended to establish sale bases for expanding their own products into this region. These rates are entirely different in the case of investment in developed countries, where the main aim is to generally expand sales of their own products.

The cumulative investment of Japanese companies during the last 10 years in Central European countries is estimated to amount to 1.5 billion US dollars. Japanese investment appears to be quite small in relation to its economic size. However, we should remember that not only its presence in Central Europe, but also its presence on the entire European continent is small, mainly because European markets are highly divided and not sufficiently attractive to giant Japanese companies which are primarily interested in scale merit. This explains why only those companies which have their own European strategies have come to Central Europe, for it is an urgent task for these companies to establish competitive production bases in Eastern Europe if they intend to be strong competitors in Europe.

Of the 1.5 billion US dollars, roughly estimating, 0.9 billion dollars went to Hungary, 0.4 billion to Poland and 0.2 to the Czech Republic. Each country has its representative investment from Japanese companies: Suzuki in Hungary, Isuzu in Poland and Matsushita in the Czech Republic.

Although Hungary has received several large scale investments such as from Denso, Sony, TDK, and Clarion etc., the other two countries have not succeeded in receiving successive investments from Japan.

There are several reasons why Japanese companies choose Hungary as the best country to invest in. Besides the factors already described, Hungarians are rather flexible in negotiations, which is a very important business practice in Japan, and there is little fear of labor disputes in Hungary. The image of the country to the Japanese is different in each case: Poland has a reputation for labor struggles and debt-cancellation, from which Japanese banks suffered, and the Czechs have strong national pride and are rather stubborn in negotiations (comparable to Germans).

Overall Japanese companies are, first of all, seeking production bases, and from this point of view favor a good geographical location and good infrastructure with flexible response to their demands.

4. Privatization Reconsidered: Voucher was Virtual

There is no "royal road" or short cut to privatization. Nevertheless, many transforming countries sought effective and rapid roots to privatization, the promising way of which seemed to be voucher privatization, since the IMF praised Czech voucher privatization

Table 4 Mass Privatization Programs in Central and Eastern Europe and the CIS Countries

Country	Year voucher distribution began	All shares issued in waves or continuously?	Are vouchers bearer, tradable or nontradable?	Is investment in funds allowed, encouraged or compulsory?
Albania	1995	Continuously	Bearer	Encouraged[1]
Armenia	1994	Continuously	Bearer	Allowed[2]
Bulgaria	1995	Waves	Nontradable	Encouraged
Czech Rep.	1992	Waves	Nontradable	Encouraged
Estonia	1993	Continuously	Tradable[4]	Allowed[5]
Georgia	1995	Continuously	Tradable	Allowed[2]
Kazakhstan	1994	Waves	Nontradable	Compulsory
Kyrgyzstan	1994	Continuously	Bearer	Allowed[6]
Latvia	1994	Continuously	Tradable	Allowed[5]
Lithuania	1993	Continuously	Nontradable	Allowed[5]
Moldova	1994	Waves[7]	Nontradable	Encouraged
Poland	1995	Waves	Tradable	Compulsory
Romania[8]	1992	Continuously	Bearer	Compulsory[9]
Romania	1995	Waves	Nontreadable[10]	Allowed
Russia	1992	Continuously	Bearer	Encouraged
Slovakia	1992	Waves	Nontradable	Encouraged
Slovenia	1994	Continuously	Nontradable	Allowed
Ukraine	1995	Continuously	Nontradable	Allowed

Note:
1 By July 1996 only one or two funds applied to receive vouchers.
2 Although a legal entitlement exists to invest vouchers in funds, in practice this option was limited.
3 The results of the first voucher auction were cancelled in March 1995, and fund licenses were suspended from then until August 1996.
4 Vouchers were nontradable at the outset of the programme, but cash trading was legalised in the spring of 1994.
5 Citizens could also exchange vouchers for other things such as apartments or land.
6 Citizens could invest their vouchers in housing as well as hare. They can sell their vouchers to funds, but no formal mechanism exists for them to subscribe to funds.
7 Although the design of the Moldavian program was based on the offer of companies in waves, the waves were small in the early stages, and thus had many of the characteristics of a continuous issue.
8 In 1991 Romania introduced a scheme based on the distribution of certificates of ownership in five private ownership funds. In 1995 a supplementary mass privatisation programme was introduced involving the distribution of coupons that could be exchanged for company shares or fund shares, after wich the funds are to be transformed into financial investment companies.
9 Under certain circumstances certificates of ownership in funds could be exchanged for company shares.
10 Certificates of Ownership were bearers, coupons were registered and nontradable.

Source: Saul Estrin, "Some Reflections on Privatisation in Belarus", Economic Trends Quarterly Issue *Belarus*, July-September 1999.

and its economic recovery as being a “miracle”, which made it worthwhile to at least try the methods. This can be seen in Table 4.

It has been clearly established that Czech voucher privatization was not successful or was indeed rather harmful in establishing a healthy market economy. In this sense “voucher” was virtual. However, there was no alternative in privatization for the countries where FDI inflow could not be expected.

The Czech Republic has confronted the task of re-privatizing the previously voucher-privatized companies and the process is going ahead. Although the Czech Republic will receive enough FDI for its re-privatization, and therefore the process is promising, other voucher privatized countries have suffered from the shortage of FDI and have no bright prospect of re-privatization.

5. The Effect of FDI: Revaluation of Economic Factors-the Main Engine of Growth in Systemic Transformation in Central Europe

In terms of the level of economic activity, system transformation implies the liberation of the huge potential economic power of the population from political oppression which had previously been necessary in order to make the planning of national economy simple and routine.

One good example is the size of the workforce. When the working population tendency in Central European countries is observed, an absolute decrease in the active working population since the beginning of transformation can be found. According to traditional growth models, the decrease in labor power in some way contributes to the decrease of the growth rate or to negative growth. However, fairly high GDP growth in Poland and Hungary can be observed, which is partly explained by the rapid increase in labor productivity thanks to the liberation of economic activities and partly by the upward revaluation of labor power, which is the inevitable result of continuous market integration towards the world market.

Thus, system transformation has brought about qualitative changes to economic activities on one hand and the gradual leveling of the value of economic factors on the other. This dual effect ensures that the growth rate of the countries concerned remains high throughout the transformation period.

From this point on, I would especially like to emphasize the effect of the revaluation of economic factors, which are usually neglected in traditional approaches. The source of revaluation can be explained by the fact that existing economic factors posses a potentially higher value than they represent in present forms, which has not yet been realized because of isolation from market valuation. Such economic factors would receive appropriate valuation once they were properly combined with capital, technology and business opportunities.

It is of no doubt that Central Europe has potential reserves in valuation and that market integration has been continuously converting these reserves into actual values. Thus, revaluation or the correction of value would be the source of high-economic growth through system transformation, which is still not sufficiently visible in this almost ten-year process.

To summarize, it can be said that marketizing the national economy makes the revaluation of economic factors inevitable by introducing market valuation, i.e. by its leveling effect due to capital inflows, even when there are no essential changes in their qualities. Labor forces have been receiving relevant market valuation and economic assets such as land and business opportunities have also been encountering revaluation according to the degree of market development.

At the same time, part of the labor force and assets which are not viable under new market conditions have lost their value. Nevertheless, we can observe gradual upgrading and upward revaluation especially regarding labor forces and real estate in Central European countries which are actively combined with new businesses and markets. The dynamic revaluation process has been able to help potential economic reserves to transform into actual market values.

Of course, systemic change in itself does not automatically bring about the upward revaluation of economic factors. It can be accomplished only when capital and technology are combined with potentially competent work forces. In this respect, Central European countries have labor forces of sufficiently high quality and good business opportunities, and have so far succeeded in inviting a fair amount of FDI. This explains the difference between Central European countries and Balkan countries, the latter of which have so far had no opportunity to receive enough investment from abroad.

Thus, the flow of capital in the form of FDI has been continuously playing the role of revaluing economic factors towards closing the gaps in valuation between East and West in the long run. Needless to say, the amount of capital flow depends on the business opportunities in a given country and this particularly causes the divergence in economic development among ex-socialist countries.

6. The Role of FDI in Socio-Economic Integration with the World

6.1 Implications of Globalization

It is a common view that since the collapse of the socialist system the world has been moving towards the globalization of capitalism. It also represents the same type of view to maintain that the large capital inflow of multi-national companies into transforming national economies will result in the subordination of the country to the economic giants. It is a common defect in these discussions that portfolio investment and direct investment are not clearly separated and understood as one mixed vague concept: capital.

When we observe that the globalization of the market economy has been continuing for hundreds of years, and that the inflow and outflow of direct investment has been extremely active over the past two decades, it is very curious that the media and economists are only now starting to talk of globalization.

What is essentially discussed under the topic of globalization in 1990’s is to what extent the freedom of capital flow should be permitted. Clearly enough, what is discussed regarding capital flow in this context is not direct investment, but portfolio investment. As is naturally understood, it is essential for portfolio capital to minimize transaction time and cost in order to maximize profit. The immediate transfer of capital is a fundamental condition for the realization of the optimal transaction. Complete freedom of capital inflow and outflow is demanded by portfolio capital, and this is the contemporary topic of liberalization of capital flow in world economy.

I have to say that portfolio capital is “lazy capital” which demands maximum profit for minimum work and, in essential points, is different from capital used in direct investment.

On the other hand, direct investment is very tiresome and time-consuming work for investors, from selecting production sites through to accomplishing production lines to managing the company. As long as the company continues in business, investment risk prevails, and as a matter of fact, this type of productive activity truly creates economic value and forms a real economy. However, people are under the illusion that portfolio investment creates economic value, and is in some way superior to tiresome direct investment in the sense of the superiority of brainwork to physical work.

We should clearly establish that direct investment is productive work and that portfolio investment is a money game. It is natural and rightful for governments to set various limitations on the inflow and outflow of portfolio money, but there is no reason to limit the inflow of direct investment which brings with it capital and technology with its own risk.

6.2 Direct Investment as Transfer of Civilization

The strongly concentrated redistribution system under the socialist regime resulted in the degeneration of social activities of people: de-civilization and degeneration of social normative are characteristic of ex-socialist societies. It is hard to imagine that investing companies have had to teach workers extremely elementary practices: not to take the company’s assets home, not to use company telephones for private use, not to do side business during work, keeping work-shops clean and adhering strictly to maintenance rules, managing stocks of materials and products, keeping to delivery times and to try to win clients’ confidence, etc.

What an investing company confronts in transforming countries is working discipline and morals as described, which were entirely neglected during the old system. Before teaching work techniques, companies have to create working morals. Thus, direct investment is a far-reaching project covering the teaching of discipline and technology to work training and management.

In this sense direct investment plays the role of transferring not only technology, but also work civilization to the country which is to be invested in. It is for this reason that currently almost all-transforming countries welcome FDI and have created incentive policy to entice foreign companies. However, their policies are still not sufficiently developed and are far inferior to those of developed countries on various points.

6.3 Problems of Receiving Countries: What should be done?

It is not enough for the receiving country to simply announce its preferential system to investors. The business of attracting FDI has become very competitive among transforming countries, especially in Central Europe. If the government is not sufficiently sensible in reviewing its invitation system, it will lose the opportunity. The following are typical problems for investors in transforming countries.

(1) Although government proclaims to welcome FDI, facilities to receive foreign representatives are not well established: obtaining residence and work permits is too complicated.

(2) The level of personal income tax is extremely high in every country in question. The income of foreign representatives quickly reaches the highest taxation bracket. In this aspect, Holland has well-designed lessening-measures of personal income tax for foreign representatives.

(3) There is no counter-service for high tax paying foreigners, who have to pay additionally for health care and education of their children.

(4) As employers' contribution to social security and personal income tax is so high, labor costs are not as low as official statistics suggest.

(5) Living costs are not cheap as once thought, because imported consumer goods

are at the same price level as in developed countries, and value-added tax is also high, ranging from 22% to 25%.

(6) Legal changes occur rather frequently, complicating life and confusing management.

(7) The customs system is badly organized, and therefore time and money needs to be spent on smooth custom clearance.

(8) “Hungry spirit”, i.e. hard work for the sake of living, is not present in workers of Europe’s transforming countries, which makes difficult for Japanese investors to understand the way of thinking and the behavior of workers.

6.4 Tasks for Japanese Companies

European society is different to Asian society in many aspects. In a word, Asia is a massively over-crowded society with a large population and conflict between people, and therefore Asian society needs firm rules and organizing units to be able to integrate society. Poverty in a crowded society is also a typical Asian phenomena, which drives people to work hard, sacrificing their own individual interests in favor of work.

On the contrary, Europe is a scarce scattered society and people like to avoid interference and prefer to live in a calm manner pursuing individual interests. Even being poor in the sense of current income, people do not sacrifice their interests and time for work, which is quite a difficult concept for Asian people to comprehend.

The main merit that Japanese companies found in Central Europe is relatively low labor costs with favorably good quality of workers. However, there are dual mistakes in their understandings.

First, although the level of wages is low enough according to official statistics, nobody lives only with the average income that statistics suggest. Actual living needs double or triple the average income, and therefore workers simply leave their jobs or take sick-days if the company sticks to ensuring only average income for them. This happens even in cities with high rates of unemployment, which is again quite difficult for Japanese managers to understand.

Another typical mistake made by Japanese companies is that they choose Central Europe simply because they see it as a low wage zone, which is only partly true. However, as long as Japanese companies evaluate Central Europe only on the value of physical workers, they will not fully utilize the potential work power of Central Europe. As shown by Nokia and Ericcson, who established large scale research institutes in Hungary, European companies are well aware of the high level of brainpower in this region. In fact, as plans of the German government show, IT engineers of Central Europe are the target of German companies. It is a universal problem and a task for Japanese companies to utilize foreign brainpower for fulfillment of their international strategies.

As for Central European countries, the so-called "brain drain" is a big loss for the countries. Therefore, it is an important task for governments to retain IT engineers as R & D manpower in home countries, irrespective of domestic or foreign ownership. One option is to encourage R & D activities within joint-venture companies with preferable policy measures for both the country and companies.

Appendix: Manipulation of FDI Data

FDI data is published in the Balance of Payments by central banks. As internationally defined, portfolio investment even qualifies as direct investment once the acquired equity exceeds 10% of the issued stock of the company. Besides this there are some items which lie on the borderline of definition such as capital contribution in kind, credit from the parent company and reinvestment of profit, etc., which generally do not add up to a large amount.

This is the reason why the FDI published data does not perfectly coincide with Balance of Payments data. If the discrepancy between the two types of data is large enough, then the source of the gap should be explained. However, in the case of Poland, there exists two kinds FDI data: one from the Polish Central Bank and one from PAIZ, the FDI promotion body in Poland, and the discrepancy in the two sources of data is extremely large.

For example, at the end of 1999, FDI data from the Central Bank represented 26 billion US dollars, while that of PAIZ suggested 38 billion US dollars. Despite the fact that these two institutions are governmental organizations, there is still no reasonable explanation by the government for the discrepancy in the two kinds of data. In the same way, international organizations and the media also use the two types of data in a mixed way, painting a very confusing picture of the real state of FDI in Poland.

One point should be emphasized: PAIZ is not a statistical unit, but a promotion unit of government. Therefore, PAIZ does not hold any responsibility for its correctness. In fact, PAIZ collects data monthly via questionnaires given to companies with foreign participation. As far as we know, there is no real checking of the validity of their answers or whether they have already reported the data or not. Even future plans are included in the report by companies, which results in double and triple counting of the data.

Thus, we should be careful in using Polish data on FDI.