

UNCTAD: World Investment Report 2002 – Lessons for Central Europe

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The United Nations Conference on Trade and Development (UNCTAD) publishes a yearly report on investment. The 2002 issue of the World Investment Report, as its subtitle indicates, concentrates on Transnational Corporations (TNCs) and Export Competitiveness.

Overseas investment activity increased considerably throughout the nineties. According to the report there are about 65,000 TNCs in the world today. Outward foreign direct investment increased from \$1.7 trillion in 1990 to \$6.6 trillion in 2001. The largest TNCs are to be found in the telecommunications, energy and automotive sectors.*

The period between 1980 and 2000 saw a continuous and accelerating increase in the worldwide flow of FDI, which was followed by a sharp decline as recession set in, in 2001. This decline has been uneven in terms of geography. It primarily concentrated itself in the developed economies (-59%), this comparing with a less significant decrease (-14%) in developing economies. Inflows to Central and Eastern Europe as a whole have remained stable. This region's share of world FDI inflows actually rose from 2% in 2000 to 3.7% in 2001. Five countries - Poland, the Czech Republic, the Russian Federation, Hungary and Slovakia - accounted for more than three quarters of the region's inflows in 2001.

UNCTAD has tried to assess the different countries of the world in terms of their-potential for attracting foreign investment, as compared to their *actual* performance in this respect. It thus developed the *Inward FDI Performance Index*, which compares the ratio of a country's share in global FDI flows to its share in global GDP. The EU has had the highest score for this index (1.7), and Japan gets the lowest (0.1). Central and Eastern Europe attained a score close to one. Another index, UNCTAD's *Inward FDI Potential Index*, takes a handful of structural characteristics into account in order to estimate a country's potential for attracting FDI. The Visegrad states have marked high on both potential and performance, while Russia marked high on potential but low on performance.

Hungary, Poland and the Czech Republic are all inside the first twenty countries that gained most in terms of export market shares in the years 1985-2000. All of the Visegrad countries are very much open in terms of their share of foreign affiliates within their exports. Especially striking is the situation in Hungary, where the percentage of such exports in the year 1999 was 86% in manufacturing and 80% for all of its industries! This is an unusually high number in a global comparison, and is only matched by only one other state, Ireland. This single figure demonstrates well how Hungary has benefited from the presence of TNCs since transition, but also how exposed its economy has become. (The corresponding figures for Poland were 52% and 56% respectively, and it was 47%

* E. g. Vivendi, GE, ExxonMobil, GK Royal Dutch Shelf, BP, Toyota, Telefonica, Fiat, etc. - ranked according to foreign assets. The largest firms in Central and Eastern Europe are Lukoil, Novosibirsk, Latvian Shipping, Primorski Shipping, Hrvatska Elektroprivreda, Gorenje, Far East Shipping, Podravka, Pliva, Atiantska Plevidba, Krka, Mol, TVK, Adria Airways, and Petrol Group.

in the Czech Republic for manufacturing.) In addition to the sharp increase in market share and the opening up of their economies, the countries of Central Europe have also experienced a shift in their export structure away from non-dynamic to dynamic products and from low technology to medium and high technology activities. In fact, many of these countries have relied on FDI to generate their most dynamic exports - much like China, Ireland or Mexico. One of the key factors of the success of Central European countries, according to the report, has been their preferential access to a major market - in this case the European Union.

The report argues that export competitiveness can facilitate the development of countries, and that the global value chains of TNCs can play a role here. The most dynamic products in the world today are found mostly in non-resource-based industries such as electronic, automotive and apparel. TNCs tend to focus more and more on the knowledge-based, less tangible parts of the value chain, such as product definition, R&D, managerial services, marketing, and brand management. In consequence, the number of service manufacturers has grown rapidly. These firms carry out the lower value-added production for well-known firms in the world, and without their name appearing on the finished product. As an interesting new phenomenon, TNCs have also been entering recently into joint innovation agreements with suppliers, buyers, research laboratories and even competitors. The result is that the emerging global production system is increasingly open in terms of ownership.

Specialisation in the different segments of the international production chain brings assorted benefits. Specialisation in the labour intensive segments is undesirable for a number of reasons. It brings few advantages in terms of training and technology and few spill-overs for the local economy; also, the comparative advantage of low costs disappears as wages rise. So it is to a country's advantage if it turns its labour surplus towards labour intensive exports if it is unable to make use of this surplus in more economically desirable activities. The question is whether such countries can, in the longer run, upgrade and sustain their exports.

There are a growing number of policy tools that can help countries achieve this, yet they are only really effective if they are used in a coherent and targeted manner. They include an analysis of corporate strategies affecting the choice of location, the identification and targeting of production niches, the establishment of investment promotion agencies, memberships of free trade areas, preferential trade schemes, clusters of economic activity, industrial parks, etc. It is important to make sure that what is targeted through investment promotion is in line with the country's broader investment and development strategies. Incentives have to be focused in such a way that encourages TNCs to invest in strategic activities. Host countries should try to involve the foreign affiliates of the TNCs in the upgrading and development of human resources while sharing in the burdens of the state - which has a primary responsibility for creating the necessary conditions. High quality infrastructure (including even specialised infrastructure, such as science parks) is essential. Finally, host countries should aim their support at domestic enterprises, suppliers and for cluster development. One of the key benefits from FDI could be the spill-over effect into the local economy through such arrangements, though domestic agents need to play a role in facilitating the establishment of these links. Thus, the

challenge for countries is to attract export- oriented FDI - and to tap the potential of these TNCs by making their locations more conducive to the specific kind of export activities they wish to foster. Indeed, the most important recipient countries of export-oriented FDI now need to upgrade their economies to handle the effects of rising wages and to maintain competitiveness with their export base.

These tasks, evident lessons from the *2002 World Investment Report*, are all too familiar for the successful transition states of Central Europe.

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