

# Chapter 7

## Investment promotion in the Visegrad four countries: post-FDI challenges

Balázs Szent-Iványi

### 1. Introduction

Following the end of Communism, attracting foreign direct investment (FDI) has been seen as one of the key policies to promote development and technological upgrading in Central and Eastern Europe (CEE). In general, the CEE countries have been successful in putting themselves on the maps of multinational companies (MNCs): the share of Czechia, Hungary, Poland and Slovakia (the Visegrad countries, V4) in global FDI flows increased from 0.4% in 1990 to peak at 2.1% in 2007 (UNCTAD 2016). Although there were shifts in the specific policy tools, the promotion of foreign investment was the key element in the development and industrial policies of these countries for much of the two decades following the transition.

After the 2008 global economic crisis and its aftermath however, the strategy of relying on FDI as the main driver of growth has been increasingly questioned (see Galgóczi *et al.* 2015). The competitive advantages of the V4 countries, especially ‘relatively cheap, yet relatively skilled labour’ has increasingly eroded with the rise of even cheaper competitors. The positive developmental impacts of FDI have been questioned, and the crisis has shown just how vulnerable excessively open small economies, like Hungary or Slovakia, can be to the global business cycle. Industrialisation strategies based solely on large FDI inflows have led to a form of dependent development in the region (Pavlínek 2016).

These and other changes pose a clear question as to how investment promotion policies in the region need to adapt. The aim of this paper is to investigate the role of national investment promotion policies in this post-FDI age, focusing on the V4 countries, which have traditionally been the front runners in attracting FDI. Investment promotion is defined broadly to include policies aimed at attracting FDI, as well as policies aimed at increasing its benefits. If FDI is becoming less relevant for the region as a driver of development, does FDI promotion still have a role to play in these countries? Are investment promotion agencies (IPAs), and the policies they seek to implement now relics of the past? Should V4 governments abandon their FDI-focused development policies for different approaches? The paper investigates the impacts of three key features of the post-FDI age on investment promotion policies: (1) the changing competitive advantages of the V4; (2) the questionable nature of the long-term development impacts of FDI; and (3) the changing nature of multinational production, focusing on how discussions have shifted from multinational corporate networks organised through FDI to global value chains (GVCs) and global production networks (GPNs), where FDI is just one tool of governance.

The paper has two key findings. First, while investment promotion policies and IPAs can still be relevant in the post-FDI age, the policies regulating their operation are still (mostly) stuck in the 1990s. A number of fundamental changes are required in terms of their goals and operation for them to remain relevant in the post-FDI age. Most importantly, attracting new investments, as a primary goal for investment promotion policies, needs to give way to working with investors already present in the country, providing a wide range of aftercare services in order to foster reinvestment, upgrading, and productivity spillovers. Second, governments need to put a much larger emphasis on a number of different policies beyond investment promotion, which have been relatively neglected due to the excessive focus on promoting FDI. These include, but are not limited to, industrial policy, education and innovation support, which have been sidelined in the past 25 years at the expense of serving the interests of foreign investors, but are needed to support spillovers, integration into GVCs/GPNs and the eventual development of GVCs/GPNs run by V4 firms.

The paper is structured as follows. Section 2 focuses on discussing the impacts the changing competitive advantages of the V4 countries have had on investment promotion, and how IPAs have adapted. This is followed in Section 3 by an analysis of the role IPAs need to play in maximising the long-term development impacts of FDI. Section 4 deals with the impacts and possible reactions to the changing nature of multinational production, while the final section offers some brief concluding remarks.

## **2. Investment promotion and the changing competitive advantages of the V4**

There has been much discussion in the literature on how the ability of the V4 countries to attract large-scale foreign investments based on the perceived competitive advantage of a relatively cheap yet skilled work force has become increasingly limited after the turn of the Millennium (see e.g. Kalotay 2017). The types of investments which dominated during the 1990s, i.e. mainly export-oriented assembly plants relying on abundant and cheap labour, have come under pressure in the region. The wage advantage of the V4 (and other CEE countries) has deteriorated, and they now face much more severe competition than during the 1990s due to the rise of even cheaper manufacturing locations further east. The fact that wages increased faster than productivity after the turn of the Millennium, especially in Czechia and Hungary (Meager and Speckesser 2011: 53), contributed to eroding the competitive advantage of these countries even further. Moreover, labour in the CEE countries is no longer particularly abundant. Poland and Hungary have experienced mass emigration, which, coupled with structural mismatches between the education system and the needs of the labour market, have led to severe shortages of skilled labour (BBJ 2016). While long-term unemployment and low levels of labour market participation are significant issues in all four countries, it is extremely difficult to bring back people who have fallen out of the labour market due to their lack of skills, relevant experience or state of health.

The fact that FDI based on abundant and cheap labour is no longer a viable strategy has been shown by a number of corporate relocations from the region (Hunya 2004),

exacerbated by the post-2008 global economic crisis. Sass and Hunya (2014) show for example that relocations from Hungary are most dominant in the electronics sector, where cheap labour was a key concern for investors, and many of these investments have been moved to China.

Faced with these challenges, governments have increasingly been emphasizing the need to 'upgrade' FDI activities from relatively low value-added ones relying on cheap labour to ones which produce higher value-added products and services, and as such require more skilled labour (Gereffi *et al.* 2005). Indeed, the 'upgrading narrative' is compelling. CEE governments have long argued that the relocation and divestment of activities using cheap labour and producing low added value should not be seen as problem, if these activities are replaced by ones producing higher added value. These activities create better jobs as they require workers with higher skills and thus pay better (see Szent-Iványi 2017). Indeed, there is evidence of such upgrading happening. One often-cited example is that of shared service centres: after the turn of the Millennium, many such investments began to arrive in the region, creating relatively well-paid office jobs (Capik and Drahokoupil 2011). A number of multinationals already present in the region, instead of divesting, began granting their subsidiaries new mandates beyond the tasks of mere assembly, including procurement, logistics, or research and development (Sass and Szalavetz 2014; Szalavetz 2016).

While there are theoretical reasons to expect such upgrading processes to be automatic (Szent-Iványi 2017), it is clear that governments can play a role in catalysing them, especially in cases where relocation is threatening employment. There are two main ways for this: (1) incentivising new FDI projects with a higher value added than what is already present in the country; and (2) promoting upgrading among the investors already present.

In terms of new FDI projects, governments can use sector-targeting policies, which, put simply, give some form of positive discrimination to FDI in the preferred (higher value-added) sectors or corporate activities. These types of targeting strategies have been seen as a best practice for IPAs by both scholars and practitioners (Loewendahl 2001). In the most comprehensive econometric study on the topic, Harding and Javorcik (2011) find that such policies can be effective in the case of less developed countries where there is much red tape and information on bureaucratic processes is not readily available.

The IPAs of all four Visegrad countries emphasise prioritising FDI projects in high value-added sectors or activities and make use of sector-targeting policies. Capik and Drahokoupil (2011) argue that FDI promotion policies in the V4 have shifted towards supporting investments in the service sector. As shown by Tóros *et al.* (2017) in a comprehensive review of sector-targeting policies in the V4 countries, all of the countries have identified a number of 'priority sectors', in which investors are promised preferential treatment in the form of specialised support from sector experts and higher levels of financial and other incentives. There is a high degree of similarity between the sectors prioritised by the four countries, most likely reflecting the similar development challenges they face and including *inter alia* the automotive sector, business services

(with an emphasis on shared service centres), R&D, ICT, life sciences, nano sciences and renewable energy. Table 1 provides a full overview.

Table 1 Priority sectors for investment promotion in the V4 countries

Czechia	Hungary	Poland	Slovakia
Aerospace	Automotive	Aerospace	Aerospace
Automotive	Electronics	Automotive	Automotive
Business Support Services	Food industry	Biotechnology	Chemical industry
Data Centres	ICT	Business support services	Electrical engineering
Electronics & Electrical Engineering	Life sciences	Domestic appliances	ICT
Energy & Environment	Logistics	Electronics	Machinery industry
High-Tech Mechanical Engineering	Medical technology	ICT	Shared service centres
ICT	Renewable energy	Machinery and steel industry	Wood processing
Life Sciences	Shared service centres	Renewable energy	
Nanotechnology & Advanced Materials		Research & development	

Source: IPA websites

Little is known about how effective these targeting policies are in altering the composition of FDI and promoting upgrading. Törös *et al.* (2017) however identify a number of inconsistencies in the V4 targeting policies, showing that they are probably much less effective than they could be. First, they argue that it is unclear how the prioritised sectors are selected. Are these sectors the ones where the given country has a competitive advantage and is thus truly able to attract investments, or do they reflect wishful thinking on the part of governments? Indeed, as Loewendahl (2001: 11) argues, ‘sector targeting should identify sectors in which the host country is best placed to attract investment and which meet inward investment objectives’, clearly implying a trade-off between the two. As investment incentives are generally seen as secondary when multinationals make location decisions (Blomström *et al.* 2003), government targeting will not make much difference unless the country is really able to attract such investments. Second, the targeted sectors do not align perfectly with the incentive regimes: investors in priority sectors are not always eligible for more generous incentives. Investors in the Czech automotive sector for example can expect the same amount of government support as any other manufacturing industry, despite the fact that the automotive industry is named a priority sector. Naming a sector a priority, but then not providing meaningful additional incentives can send confusing signals to investors. Third, there is a lack of concentration. Based on the websites of their national IPAs, Hungary for example had nine ‘priority’ sectors in 2016, Poland ten. This leads to a fragmentation of the scarce IPA resources, and also makes it difficult to clearly communicate the competitive advantages of the country towards investors. As a fourth issue, it is possible to add that it is unclear to what degree these sector-targeting policies are actually driven by supporting upgrading, as opposed to other policy goals. Some countries, like Hungary, prioritise industries like electronics and the

food industry. Poland targets investments in domestic appliances, machinery and the steel industry. None of these are generally seen as high value-added sectors (although some niches are possible within them), and it is questionable whether the V4 countries can still realistically compete for investments in them. It is also difficult to classify many investments in the automotive sector, an industry prioritised by all four countries, as high value-added, especially in the case of lower-tier suppliers. It is therefore possible to question why these sectors have been selected for prioritisation. One potential explanation is that governments are driven not by upgrading considerations but by a desire to create jobs for semi-skilled workers, a category of workers hit especially hard by the post-2008 economic crisis.

The second way governments can promote upgrading relates to the activities of multinationals already present in the country. As mentioned, upgrading does not necessarily need to come from new investments, but multinationals already present in the country can also upgrade the mandates of their existing subsidiaries through reinvestment. The literature identifies several forms of subsidiary upgrading (Humphrey and Schmitz 2002; Szalavetz 2017), including product, process, functional and intersectoral upgrading. Subsidiary mandates, and the role of the subsidiary in the given multinational company network should be seen as dynamically changing, with possibilities for upgrading, but also downgrading for individual subsidiaries.

In the past decade, many multinational companies present in the V4 countries have progressively broadened or even shifted the tasks that their subsidiaries are charged with, and a significant stream of research has been dedicated to exploring these processes. Pavlínek and Zenka (2011) for example have found ample evidence of upgrading in the Czech automotive industry, with foreign-owned companies significantly increasing their value added per output ratio and engaging in both product and process upgrading. Sass and Szalavetz (2013) document rapid crisis-induced functional upgrading processes among Hungarian players in the automotive and electronics industries. By the end of the first decade of the 2000s, most of their case study companies had moved beyond being single-mandate manufacturing plants, and had taken on a number of other functions. These conclusions are echoed in Szalavetz (2017).

Governments can influence the decisions multinationals make regarding the mandates of their subsidiaries. When a multinational makes a decision to change a subsidiary's mandate, it weighs up several options, and more than one subsidiary can be a candidate, leading to a competition between them. The MNC in the end will award the new mandate to the subsidiary which it sees as the most capable of effectively executing it. This can be driven by several factors, including the traditional list of determinants of a country's competitiveness, but also less visible and tangible variables like the performance of the subsidiary's management, etc. Subsidiaries can have some bargaining power in these processes, but, acting alone, they are generally seen to have relatively little power to influence decisions made at the headquarters (Bouquet and Birkinshaw 2008; Sass and Szalavetz 2013). Support from the host country government can however bolster subsidiary bargaining power. The literature generally suggests that IPAs need to monitor subsidiaries for potential changes to their mandates, and, if the parent company is indeed considering such changes, to work together with the subsidiary to

ensure that a change leading to upgrading actually happens (UNCTAD 2003). This can involve supporting the subsidiary in convincing the parent company about the merits of upgrading in the country, and even providing financial incentives, such as grants for training workers or R&D support. Governments can even be more pro-active in initiating subsidiary upgrading – beyond creating the ‘right environment’ for upgrading, they can transparently communicate the incentives they have in place for these cases to all MNCs present in the country, as part of their broader country marketing efforts.

V4 governments have of course recognised the need for working with existing investors. Investment incentives offered by governments cover reinvestment by existing companies, or separate schemes exist for this. All IPAs offer ‘aftercare services’ to investors, including support for reinvestment, matchmaking with local suppliers, R&D support, advice on available grants, and liaising between the investor and the government on topics like amending legislation. The difficulty in providing pro-active and effective aftercare relates to the issue of information: the IPA will often have no *ex ante* information about upgrading decisions at multinationals. IPA staff therefore need to develop excellent personal relations with executives at subsidiaries, and also earn their trust (UNCTAD 2008), allowing them to gain first-hand information on internal process and to react accordingly.

IPAs across the globe devote much less attention to aftercare than is necessary (UNCTAD 2007), and the V4 countries probably devote even less and are generally unable to be proactive in this area. Aftercare services are rarely detailed, or indeed deserve more than a fleeting mention on V4 IPA websites. No IPA in the region has any publications or marketing brochures on aftercare, as opposed to the large number of publications covering various sectors and topics targeting new investors. One notable exception is CzechInvest, which provides details on what aftercare services actually entail, including support for ‘expansion, re-investment and the development of research capacities’, as well as a number of other services (CzechInvest 2016). CzechInvest also has a dedicated organisational unit for aftercare.

A key problem here relates to the capacities of V4 IPAs, which are generally geared towards generating new investments, with their ‘ideal’ investor a foreign company not present in the country and knowing little about it. This is again evidenced well by brochures and other marketing material published by V4 IPAs, which clearly target foreigners with relatively limited knowledge about the country – for example, much of this material includes details about life in the country and basic macroeconomic indicators. Some mission statements are also telling: ‘The Polish Information and Foreign Investment Agency (PAIiIZ), helps investors to *enter* the Polish market and find the best ways to utilise the possibilities available to them’ (PAIiIZ 2016; emphasis added). A significant IPA task relates to lead generation, i.e. sounding out which companies are likely to invest in the region, meaning that staff need to be outward-looking. Due to this, V4 IPAs are less well suited towards maintaining formal or informal relations with investors already present in the country, as the majority of their staff are preoccupied with generating new investments. Even CzechInvest, with its dedicated Aftercare Section, has only five people devoted to maintaining relations with the hundreds of foreign investors present in the country, while it has dozens of experts focusing on generating new investments.

This bias towards new investments is, in part, understandable, and due to the wider political economy of the issue, can be difficult to change for two reasons. First, there is clearly a degree of path dependency. Generating new investments was the *raison d'être* behind the establishment of the IPAs in the region in the early 1990s, and is deeply engrained in their organisational cultures. Second, due to their short-term preference for re-election, governments prefer new investments to upgrading. A new investment will always create new jobs and government officials can take some credit for it to enhance their chances of re-election. Upgrading however, while beneficial and indeed necessary for the economy as whole in the post-FDI age, has much more ambiguous effects on net employment in the short term: workers with lower skills might be laid off, with perhaps a smaller number of higher-skilled new hires.

Summing up this section, V4 governments have put some effort into promoting upgrading by introducing sector targeting and aftercare, but more is needed. They are on the right track with their targeting policies, but need to iron out inconsistencies to improve effectiveness. They also need to shift the scope of their IPAs from generating new investments more towards working together with existing investors by strengthening capacities for aftercare and promoting a shift in IPA cultures. The following section investigates the role played by IPAs and other government policies in maximising the benefits from FDI.

### **3. Investment promotion and maximising benefits from FDI**

A constructive relationship between IPAs and subsidiaries is important not only in terms of incentivising upgrading, but also in terms of ensuring that the benefits from FDI are maximised. These benefits can come from a number of factors, but the literature on FDI and development has singled out productivity spillovers as the main qualitative channel through which FDI promotes development in the long term, beyond the quantitative contributions from the additional employment and tax revenues they create (Blomström and Kokko 1998; Dunning and Lundan 2008). The eclectic paradigm of multinational production (see e.g. Dunning 1988) argues that foreign firms have some kind of ownership-specific advantage which gives them a competitive advantage over companies located in the host country. These advantages, often relating to intellectual property, technology, knowledge, methods of operation, etc. are however difficult to monopolise, and economic players coming into contact with the multinational subsidiary will also be exposed to them, at least to certain degree. These contacts, which include buyer-supplier relations, the movement of employees, R&D collaborations and a number of other forms, allow the multinational's knowledge and technology to gradually spill over to other firms present in the economy. This leads to increasing economy-wide productivity, but also the erosion of the investor's initial competitive advantage, forcing it to engage in further innovation (Perri and Peruffo 2016).

Spillovers can happen through a number of different channels, including horizontal and vertical relations with other companies, as well relations with employees. The literature has emphasised that spillovers are by no means automatic, but depend on

certain context-specific characteristics which determine just how strong each channel is (Szent-Iványi and Vigvári 2012). These characteristics relate to the investor (what knowledge and technology does it transfer to its subsidiary, to what degree does the subsidiary integrate into the domestic economy, and the steps taken to deter spillovers); the domestic firms (their level of technology and abilities to absorb new technologies); the market (level of competition and the degree to which companies are forced to innovate; the dynamics of the labour market); and the national political economy (e.g. the strength of IPR protection). The extent to which spillovers actually happen will thus depend on the specific constellation of these variables, and will vary across countries (see Görg and Greenaway 2003; Blalock and Gertler 2008; Szent-Iványi and Vigvári 2012; Newman *et al.* 2015).

If the environment is right for spillovers to happen, MNC subsidiaries will be under constant pressure to innovate and develop new technologies, just to stay ahead of domestic competitors. As a result of this, the competitive nature of the economy will change. The type of investments the country can attract will also change over time, leading to increasingly sophisticated investments by MNCs, both to bolster the competitive standing of their existing subsidiaries, but also to take advantage of the developments at domestic firms, and thus the changing locational advantages of the country. In this rather optimistic reading, spillovers can lead to an automatic process of upgrading in the domestic economy. Thus, as FDI brings in technology not previously present in the economy, it makes sense to incentivise these investments and convince as many MNCs as possible to invest (see also Blomström *et al.* 2003).

The question thus becomes empirical: what is the extent of spillovers in the CEE context, and can governments truly rely on these automatic upgrading and development processes caused by FDI. The issue does not lend itself easily to empirical research, as the extent of spillovers is difficult to quantify and measure. Nonetheless, there have been a relatively large number of studies aimed at finding evidence of their existence in the CEE region. The emerging picture from this literature is, unsurprisingly, rather inconclusive, and much depends on the specific sector and the chosen methods. One of the most comprehensive studies on the topic by Damijan *et al.* (2003), covering ten transition countries, found that the most significant channel for technology transfer is that between parent companies and their local affiliates, but that spillovers to domestic companies were much more limited. Hunya (2002) also found little evidence of spillovers, while authors like Konings (2001) actually argue for the predominance of negative spillovers. In a comprehensive review of the literature, Hanousek *et al.* (2011) also struggled to show strong evidence of spillovers.

Pavlínek (2016: 576) argued that the development impacts of FDI have been limited by the types of investments arriving to region, focusing on manufacturing based on cheap labour. In a similar vein, Capik and Drahokoupil (2011) argued that the types of service sector activities arriving to the V4 countries, including customer services and common corporate functions, are not the most knowledge-intensive ones, and that thus, while they represent FDI upgrading, their potential for spillovers is again relatively low. The main point on which the literature agrees is that the reason why spillovers have remained limited relates to the low capacities of local firms to absorb knowledge.

Even the more positive papers have expressed reservations, emphasising that spillovers only happen in certain cases. Javorcik and Spatareanu (2008) argued that spillovers in Romania are only associated with FDI projects with shared domestic and foreign ownership, echoing the conclusions of Javorcik (2004) in the case of Lithuanian firms. Manole and Spatareanu (2014) argued that domestically-owned Czech firms benefited little from horizontal spillovers, unless they had access to external credit. Pavlínek and Žižalová (2016) found evidence of strong productivity spillovers in the Czech automotive industry, but little evidence of technology spillovers, which would allow domestic companies to become innovators in their own right. Radosevic (2006) argued that only vertical spillovers are present in the CEE region, while the horizontal and other channels seem extremely weak.

It is therefore difficult to argue that spillover effects from FDI have been strong in the CEE region. There is evidence that CEE governments have tended to neglect this reality, and have simply assumed that positive spillover effects from FDI will emerge over time (Pavlínek and Žižalová 2016). This has clearly not been the case, pointing to how governments in the region need to be engaged more actively in creating the conditions through which spillovers can happen. There are several ways through which they can support this, mainly related to the three main channels through which spillovers can happen. The main government actions are summarised in Table 2.

Table 2 Policies to promote spillovers

Spillover channel	Policy
Horizontal relations (i.e. spillovers to competitors)	<ul style="list-style-type: none"> <li>– Increase absorptive capacity of domestic firms</li> <li>– Measures increasing market competition</li> </ul>
Vertical relations (i.e. spillovers to suppliers and buyers)	<ul style="list-style-type: none"> <li>– Increase absorptive capacity of domestic firms, universities and R&amp;D organizations</li> <li>– Promote linkages between foreign subsidiaries and domestic suppliers</li> </ul>
Employee relations (i.e. spillovers through employees)	<ul style="list-style-type: none"> <li>– Improve the skills level of the workforce through education and training</li> <li>– Improve labour market dynamics (e.g. by making hiring and firing easier)</li> </ul>
Wider institutional conditions	<ul style="list-style-type: none"> <li>– Conducive environment for spending on R&amp;D, including improving general regulatory framework (IPR regime, business environment, etc.).</li> </ul>

Note: the table does not include performance requirement measures, such as compulsory minimum spending on R&D, domestic sourcing or limits on imports. Many of these measures go against WTO and EU regulations and are thus not realistic in the V4 context. Source: compiled by the author

Some of the policy goals listed in Table 2 relate to investment promotion, but most go beyond it. Promoting linkages between foreign subsidiaries and domestic suppliers can be seen as part of the aftercare activities in IPAs. While V4 governments have indeed been engaged in activities like this, as well as other forms of support to domestic enterprises, these policies, as Pavlínek and Zenka (2011) point out, have never had a large emphasis in the region, and governments have mainly targeted multinationals

and not their domestically-owned suppliers, at least in the case of the automotive industry. The general consensus is that domestically-owned suppliers have a low share in supplying MNC subsidiaries, and the products they supply are generally low value-added. 80% of suppliers in the Slovak automotive industry are foreign companies (Pavlínek 2016), and only 13.5% of inputs are sourced from domestic sources in the Czech automotive industry (Pavlínek and Žižalová 2016: 344). The shift to services does not support spillovers either, as these investments generate lower levels of linkages, and are thus less likely to promote spillovers (Morrissey 2012).

Matchmaking services and support for domestic SMEs offered by IPAs to become suppliers to multinationals can only marginally help, supporting already relatively competitive companies in making the final steps, but unable to significantly alter the landscape. The same can be said for micro-level policies like support to SMEs for technological modernisation and R&D: there is significant literature showing that funds are usually awarded to companies which are competitive anyway, and do not contribute to closing the gaps between the able and less able.

Perri and Peruffo (2016) argue that policies which address the macro level and aim to create a more conducive environment for spillovers are more effective than micro-level support. This implies that investment promotion agencies have a lesser role to play in ensuring that spillovers happen, and that governments need to concentrate on a number of broader, institutional goals like the majority of the ones in Table 2. Increasing competition, enhancing workforce skills, spending more on education and creating a business environment conducive to R&D are more fruitful in the long term than micro management. These are goals which countries need to continuously focus on – for reasons broader than maximising spillovers and long-term FDI benefits –, as these support national competitiveness and development in general. Others, such as increasing labour market flexibility, are seen as more controversial, although a number of experts agree that overregulated labour markets are one of the main competitive disadvantages of Europe (Barbieri and Scherer 2009).

Summing up this section, evidence of spillovers in the V4 countries is inconclusive. Governments have put little emphasis on explicitly promoting these, and where they have, they have mainly used micro-level interventions, seen in the literature as less effective. Support to domestic companies has been neglected, while MNCs have received significant amounts of state money. V4 governments need to shift their emphasis to creating the wider macroeconomic and institutional conditions for spillovers to happen. While IPAs can be marginally helpful in linking up better-performing domestic suppliers with MNCs, they generally have a secondary role to play in this area.

The final section turns to examining how the changing nature of multinational production impacts the role of IPAs and government development policies.

#### 4. Investment promotion and the changing nature of multinational production

As discussed above, V4 countries still place a large emphasis on attracting new FDI projects in their investment promotion policies, and IPAs in the region are almost exclusively geared towards this. One question arises however: is FDI still as important as it used to be back in the 1990s? And, more importantly, can it still be relied upon as an engine of development?

Looking at the data on annual FDI inflows published by UNCTAD (2016), the absolute size of these flows has increased substantially since the early 1990s to almost every region of the global economy, CEE countries included. This is mainly due to accelerated globalisation, driven by technological and policy changes, allowing companies to increase the global scope of their operations. But a very different picture emerges if one looks at how the relative importance of FDI has changed. Indeed, a pronounced shift is observable in the literature on international production since the turn of Millennium. Since the 1970s and the classic works of Stephen Hymer (1976) and Richard Caves (1971), the literature has conceptualised MNCs as networks of companies in at least two different countries, where a parent firm is able to control the activities of all the others. The primary instrument for this control was seen to be ownership through FDI (see e.g. Cohen 2007: 39). Since the turn of the Millennium however, international production has been increasingly conceptualised in the frameworks of GVCs and GPNs, as opposed to MNCs (Gereffi *et al.* 2005; Neilson *et al.* 2014; Coe and Yeung 2015). FDI however has ceased to be the dominant tool used by lead firms in GVCs/GPNs to organise global production, with a wide range of non-equity and contractual arrangements becoming more popular (UNCTAD 2011), without actual ownership. These provide lead firms with much greater degrees of flexibility to react to changes in the market as opposed to FDI. Firms can become part of GVCs/GPNs without ownership linkages or even traditional non-equity methods like franchising or management contracts. Subcontracting and outsourcing have become increasingly common, and thus company boundaries have become much more blurred. A GVC/GPN is a much broader concept than an MNC, as it also includes the suppliers, strategic partnerships and other partners a firm comes into contact with to create a product or service with added value.

FDI thus only covers one of the tools used by lead firms in GVCs/GPNs to govern their networks, and there is evidence that its relative importance is decreasing (UNCTAD 2011), although exact quantification is difficult. The amount of FDI coming into a country, as compiled by UNCTAD based on data from national balance of payments statistics, has clearly become an unreliable measure of a country's global integration, as this integration can happen in a variety of other ways not captured by these (or other) statistics.

Investment promotion policies need to react to these shifts, not least in the V4 countries, where, as discussed, they still focus on generating new FDI flows. There are two key policies that V4 countries need to consider, adjusting their paths accordingly. First, instead of focusing solely on FDI, investment promotion policies need to broaden their activities to support the integration of the national economies into GVCs/GPNs.

Second, greater attention needs to be placed on creating an environment supporting the development of GVCs/GPNs run by V4 firms.

In terms of supporting national integration into GVCs/GPNs, Pavlínek (2016: 579) argues that the state has a key role to play in creating and maintaining the regional and national assets which determine how a country can integrate into GVCs/GPNs. These include particular labour skills, knowledge and policies. Indeed, the state needs to ensure a close alignment between national capacities and GVC dynamics (Capik and Drahekoupil 2011), an aspect echoing the conclusions of research on how the development dimension of investment promotion policies needs to be strengthened by grounding them in development policy frameworks (UNCTAD 2012). Most of the specific policy measures relate to what has been previously mentioned in terms of promoting spillovers and linkages with suppliers. Supporting the integration of domestic companies into GVCs, while a somewhat broader issue than supporting them in becoming suppliers, nonetheless leads to the same recommendations as covered in Section 3, and so will not be repeated here. Promoting FDI 'as usual' should also remain part of the mix, complemented however by a new policy element related to investment incentives. If financial investment is no longer the dominant way through which foreign companies can enter an economy and create jobs there, then it might make sense to come up with incentive schemes for the other methods as well. Most of these other methods, such as building up long-term supplier relationships and franchising, do not involve any financial investment from the foreign company, and as such are under the radar of IPAs. A broader focus on all possible ways through which companies located within the economy, be they foreign or domestically owned, can become part of GVCs/GPNs is warranted. V4 governments can consider broadening their incentive schemes by dropping requirements on foreign investment levels, instead developing schemes which incentivise other forms of cooperation for foreign companies.

Relying solely on integration into GVC/GPNs run by foreign lead firms has been shown to limit the development possibilities of national economies, as most of the value created in GVCs/GPNs tends to be captured by the lead firms (Coe and Yeung 2015). Low value capture in more peripheral GVC/GPN participants, like those in the V4 countries, means fewer resources remaining in the country for development. Upgrading the positions of local participants can help, although it has been shown that upgrading does not automatically lead to higher value capture in the V4 countries (see Szalavetz 2017 for the case of Hungary). Also, as argued by Pavlínek and Žižalová (2016) for the case of the Czech automotive industry, no domestic firm has upgraded enough to improve its position in the GVC hierarchy.

Therefore, V4 governments also need to focus on supporting the development of GVCs/GPNs with lead firms located in the region, especially in industries characterised by the high importance of intellectual property. This can be seen as the only way of increasing the developmental benefits of GVC/GPN participation in the long run, and thus avoiding dependency. A detailed discussion on the policy options for this has been given in Szent-Iványi (2017), and only some of the key insights are repeated here. The existing multinationals headquartered in the region form a good basis for this, but consideration must also be given to smaller, highly innovative born global companies,

a number of which have already made a reputation for themselves, including Prezi and iGO Navigation from Hungary, CDProjekt Red from Poland, Aeromobil and Staffino from Slovakia, or Avast from Czechia. Supporting these companies in further growth, as well as fostering the emergence of similar small, innovative firms which can evolve into lead GVC firms, is possibly the soundest approach for increasing the benefits of GVC integration for the region.

How exactly this is done is crucial. Governments need to take a long-term view and focus on creating the right conditions for these companies to thrive, and not on picking winners. Conducive education, science and technology, and entrepreneurship policies need to be at the heart of these efforts. Easing market entry and access to funding are also key elements. All of these are again similar to the policies recommended in Section 3 for increasing spillovers: supporting companies in absorbing foreign technology and knowledge may also allow them to become competitive developers of technology in their own right.

One word of caution is however due. Policies aimed to promote ‘national capitalism’, most strongly embraced by Hungary after 2010 and involving government-backed loans, privatisation and favouring certain companies in public procurement, is unlikely to bring the desired results in terms of the emergence of nationally-led GVCs/GPNs, and will lead instead to ineffective ‘crony capitalism’ (Ágh 2015; Kornai 2015).

## 5. Conclusions

The aim of this paper was to review the challenges faced by investment promotion policies in the Visegrad 4 countries in the ‘post-FDI’ age, as well as to offer possible ways for responding to these. The paper grouped the challenges into three categories, relating to a) the changing competitive advantages of the V4, b) the questionable nature of the long-term development impacts of FDI, and c) the changing nature of multinational production, arguing that the investment promotion policies in the region have only partially adapted to these. Despite some changes, like targeting higher value-added investments, these policies are still very much ‘stuck in the past’ and influenced by the legacies of the 1990s, remaining focused on generating new, large investments, primarily in the manufacturing sector.

There are several actions that the V4 governments can take to better align their policies with the changing environment. Some of these, like improving the effectiveness of targeting policies or investing more in aftercare services, are within the realm of traditional investment promotion, and show how this policy area still has relevance in the post-FDI age. Many policies however are outside this realm, and this paper has argued that they have been neglected due to an excessive focus on promoting FDI. Industrial policy, education, and innovation support, are all policies which need a new lease of life in the region. The policy goals recommended in the paper for governments to pursue are summed up in Table 3.

Table 3 Investment and other policy reforms for the post-FDI age

Challenge	Policy goal
1. The changing competitive advantages of the V4	<ul style="list-style-type: none"> <li>– Incentivise higher value-added investments through targeting</li> <li>– Promote upgrading among investors already present through aftercare and incentives</li> </ul>
2. Increasing the long-term development impacts of FDI	<ul style="list-style-type: none"> <li>– Promote linkages between foreign subsidiaries and domestic suppliers through aftercare and 'supplier programmes'</li> <li>– Support to SMEs for technological modernisation and R&amp;D</li> <li>– Macro-level policies: increase market competition, enhance employee skills, education, and create an environment in which companies are incentivised to engage in R&amp;D</li> </ul>
3. The changing nature of multinational production	<ul style="list-style-type: none"> <li>– Support national integration into GVCs/GPNs and similar policies promoting spillovers, but also focus on promoting foreign market entry with modalities not involving FDI</li> <li>– Support the development of nationally-led GVCs/GPNs</li> </ul>

Source: compiled by the author

The paper has aimed to offer a broad view on potential V4 government responses to changes defining the post-FDI age. Due to this broad scope, it was unable to go into the details of how exactly the recommended policies could be developed and implemented. Each policy recommendation would need considerable amount of further research to ensure that they are truly feasible in the region, and will indeed lead to the desired outcomes. The paper should thus be seen as setting the agenda for this research, and its recommendations should by no means be seen as definitive solutions to ensuring that the V4 continue to be attractive locations for international business, or benefit from these investments.

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