CEEI 2006 "The Changing Landscape of FDI in Europe"

Opening Remarks

Dr. Klaus Liebscher, Governor
Vienna, 20. 11. 2006

Es gilt das gesprochene Wort.

Ladies and gentlemen!

It is a great pleasure for me to welcome you all to Vienna and to our annual Conference on European Economic Integration (CEEI). Looking at the list of participants, I am glad that we have once more attracted a sizeable number of key experts from national and international institutions, academia and the private sector – both among our distinguished speakers and in the audience.

In the past, it has proven very fruitful to organize this conference in cooperation with other institutions. I am especially happy that this year we have been able to win the European Bank for Reconstruction and Development (EBRD) as a partner again. The EBRD is an institution with a long-standing tradition in supporting investment projects in Central and Eastern Europe. For this reason the EBRD is an ideal partner in our attempt to cover the interesting topic of this year's conference: "The Changing Landscape of FDI in Europe."

Thus, it is a special pleasure for me to welcome among us Mr. Schepers, Vice President of the EBRD, who is also going to share some opening remarks with us in a few minutes.

Let me at this point extend a special welcome also to several other distinguished speakers of the first conference day: EU Commissioner László Kovács, the Vice-President of the European Investment Bank Ivan Pilip, Robert Lipsey, Director at the National Bureau of Economic Research, who will deliver the first keynote lecture and ECB Executive Board Member Jürgen Stark, who will give the dinner speech this evening. A very warm welcome to all of you and many thanks for your participation.

I ask for your understanding that it is impossible at this point to list all other distinguished experts who will contribute to this conference with their views and expertise, but I am very much looking forward to all of your interesting presentations and many stimulating discussions. So let me thank all speakers for their contributions and the staff of the Oesterreichische Nationalbank and the EBRD for making this event possible.

As in recent years, the Conference on European Economic Integration of the Oesterreichische Nationalbank once more covers a topic that ranks high on the policy agenda. At first sight, foreign direct investment may appear to be a rather narrow topic. However, a closer look at the issues covered in the conference program quickly reveals how complex and controversial this topic really is. Robert C. Feenstra, a first-rate expert on FDI, expressed it the following way: "FDI combines aspects of both international trade in goods and international financial flows, and it is a phenomenon more complex then either of these."

For individual businesses, FDI raises questions of ownership and location considerations. For the public, FDI very often raises fears of unemployment and loss of independence. For policymakers, FDI and the internationalization of business are accompanied by the challenging task of increasing the attractiveness of their country as a business location and providing the ground for positive spillovers, while at the same time responding to the fears of the public.

And for international institutions there is a sheer endless list of tasks, from publishing comprehensive data on FDI and providing funds and investment insurance, to promoting an ongoing dialogue between the major nations in order to avoid the revival of protectionist and beggar-thy-neighbor policies.

International institutions such as the WTO, the UNCTAD, the OECD, the IMF, the EBRD or the EIB have – each in their respective fields – contributed substantially to providing satisfactory data, best practice catalogues and a growing body of scientific research, which has laid the ground for a discussion that is based on facts instead of sentiment and prejudices. It is our hope that this conference will contribute to this ongoing discussion by highlighting the most recent trends and research findings and bringing together experts from various backgrounds.

In our conference title, we refer to a changing landscape, as we have seen over the years that regional FDI links have indeed changed dramatically. Investors have extended and shifted their investment radius, entering new territory both in a geographical and a sectoral sense. Competition has increased both among investor countries and FDI host countries. At the same time, FDI has displayed its power to connect regions. Countries that appeared distant a decade ago are now perceived to be within easy reach, owing to close business relations and FDI links. In this sense, FDI is a connecting force which influences the entire business landscape.

To illustrate the complexity and the importance of foreign direct investments for the current political debate, I would like to present the topic from two perspectives: the European perspective and the Austrian perspective.

Let me start with the European perspective: At the very origin of the European integration project stood the hypothesis that economic integration – and at a later stage also monetary integration – would lead to intensified trade and FDI flows, which would mutually reinforce one another.

Furthermore, the more closely countries are linked through trade and FDI, the more the synchronization of their business cycles will progress. This in turn reduces the costs of a loss of customs and monetary autonomy. All these factors will ultimately lead to higher growth, promote development and stimulate the catching-up process. This line of argument is therefore essential for the assessment of the costs and benefits of removed trade barriers and monetary union.

Have these hypotheses been substantiated so far? Has the European integration process indeed stimulated trade and investment flows? And, if so: Have intensified trade and investment helped to accelerate growth and the catching-up process? Empirical evidence suggests that European integration has indeed stimulated trade and FDI. In 2005, in- and outflows of foreign direct investment funds from and to the EU reached a level that was only topped by the record year 2000. The European Union could attract almost half of all funds invested worldwide. We will hear more on the current trends and patterns of FDI in Session 1 this morning.

This leads me to the second question: Have trade and investment had the desired effect of stimulating productivity and growth through knowledge and technology spillovers? How can economic policy at the national and at the EU level contribute to generating a "win-win situation" in which both the investors and the FDI host countries profit from capital flows? We will hear more about the benefits and costs of FDI for the home and the host countries in Session 3 this afternoon and in Session 4 tomorrow morning, so I do not want to address these topics prematurely.

Let me at this stage just emphasize two important aspects: First, the European stability architecture provides the ideal environment for trade and FDI activities.

The design and the interaction of a stability-oriented common monetary policy at the euro area level, sound public finances and ambitious structural policies at the national level are all essential elements of a healthy business environment, which is conducive to FDI development. This ensures that the freedom of movement for persons, goods, services and capital, can fully materialize and bring about flexible and dynamic economies.

Second, the ten new EU Member States are the best example of how the FDI landscape has changed in the course of the European integration process. They have experienced trade intensification and a wave of FDI inflows, not just since May 2004 but already in the years preceding their membership.

In 2005, FDI inflows into all ten countries rose by 19%, reaching new record levels. Let me at this point express how pleased I am that Bulgaria and Romania will join the EU as new members in January 2007. Several essential reforms are still pending in these two countries, but once they establish a legal and institutional framework in line with EU regulations, I have no doubt that both countries will increase their attractiveness as FDI locations even further.

With the eventual adoption of the euro, the countries in Central and Eastern Europe will experience another impetus for trade and investment, just as the current euro area countries did. I would like to emphasize, however, that this next level of integration can only be successfully reached in line with the stipulations of the Maastricht Treaty. Before adopting the common currency, countries have to show sufficient and sustainable stability in their monetary and fiscal policies. The two-year minimum period within ERM II ensures that the fixed exchange rate regime is supported by the fundamentals. I am happy that Slovenia has managed to fulfill all these requirements and thus will join the euro area in January, 2007, as the first country among the new EU Member States. This will enable Slovenia, to reap all the benefits of the single currency.

Against the background of its stability architecture, Europe has no reason to fear the effects of globalization. Quite the contrary. Europe is well-prepared to meet the new challenges and to reap the benefits of global integration. The interaction of stability-oriented monetary, fiscal and dynamic structural policies in the European context provides the optimal response to the challenges ahead within a changing business landscape. If we want to take advantage of open markets we have to continue the implementation of the reform agenda and to advance both dimensions of integration: deepening and enlargement.

What we have achieved in Europe is today seen as giving direction to the discussions at the global level. International institutions such as the WTO, the IMF or the OECD are trying to advance worldwide trade liberalization and economic cooperation in ways that became reality at the European level years ago. At the G-7 summit in Singapore, the participant countries stressed the importance of advancing multilateral trade liberalization as an essential contribution to enhancing global growth and reducing poverty. We can therefore be confident that we are pursuing the right strategies to respond to the challenges of globalization.

At the same time I am worried about the recent protectionist tendencies in some of the new EU Member States. We have seen cases where attractive business sector reforms are now being reversed and privatization plans interrupted. Such moves raise uncertainty and are not conducive to promoting investor confidence. In the short run such defensive strategies may appear a tempting reaction to budgetary shortages and public concerns. But in the long term only proactive policies have the potential to sustain and support a countries' role within the context of globalization.

Let me now come to the Austrian perspective. It is actually not a surprise that the topic of changing FDI patterns in Europe is taken up in our country. Austriacan indeed be seen as a good example of a country that has for decades profited from outward and inward FDI flows.

On the one hand, Austria is a typical FDI host country. Starting from a relatively low stock of foreign direct investment, Austria has caught up substantially in recent years. In 2005, Austria's FDI stocks already reached 20% of GDP, which is close to the average of the developed economies. German companies are the most important source of funds, followed by British and American investors with a focus on business and financial services, retail and the chemical industries.

On the other hand, Austria is known to play an increasingly active role as an investor. In 2005, the FDI funds of Austrian companies reached a new peak. Almost half of those funds are invested in Central, Eastern and Southeastern Europe. In the first half of 2006, Austria was the top investor country in Slovenia, Bulgaria, Croatia and Bosnia and Herzegovina.

Today, Austria is a gateway to the new and to future EU Member States. If you pass through the Vienna airport, this role as a gateway becomes evident. The flight destinations and the accumulation of top managers from companies worldwide, who use Austria as a stopover on their way toward the East and Southeast, all underline Austria's central position. But Austria is not only a stopover location. Many multinational companies today choose Austria as their operating base for expanding into eastern markets. In my view there is no doubt that Austria has profited substantially from the opening of the former Eastern bloc and from EU enlargement.

Austrian companies' investments came in subsequent waves, both in terms of targeted regions and sectors. Starting with our neighboring countries Hungary, the Czech Republic and Slovakia, companies later on enlarged their investment radius. Investors initially focused on manufacturing and trade industries. In a second stage, banks and insurance companies entered the markets and prepared the ground for subsequent investment waves.

More recently, investment projects have shifted from labor-intensive, low-skill industries to more skill-intensive industries and the service sector. This may indicate that the new EU Member States have reached a new level of development. In this sense, Austria is not only confronted with a changing FDI landscape in Europe, but is actively participating in shaping it. The profitability of Austrian investment projects in Central and Eastern Europe is much higher than in other regions. As most projects are still young, profitability can be expected to remain above average for the years to come.

By turning to the East, Austrian companies have not only succeeded in reaping benefits for their own operational business; they have also contributed substantially to European integration and the realization of welfare gains. However, I do not want to finish my elaborations on Austria's FDI situation without adding some words on the challenges ahead.

Based on the excellent experience with investing into Austria's neighbouring countries and the wish to maintain their pioneer role, companies have begun to move farther east- and southeastward searching for new investment opportunities.

This regional shift does not come without additional risks: Austrian companies are approaching markets that are more distant both in a geographical sense as well as in their traditions and business culture. This makes a comprehensive judgement of the associated risks more difficult. At the same time, Austria increasingly faces competition from what used to be typical FDI host countries, which are now emerging as active investors in their neighboring countries, often sharing with them a common language and a common history.

The changing FDI landscape in Europe is thus a challenge for investor countries like Austria. But Austria will also be challenged as an FDI host country. Investors constantly update their investment strategies in geographical and sectoral terms.

I appeal to the future Austrian government to continue the stability-oriented fiscal and dynamic structural policies in order to preserve Austria's attractiveness as a business location. Besides an appealing tax system and investment incentives this also requires a highly trained workforce and continued wage moderation in combination with flexibility and social peace. Reform deadlock or "defense play" would be a short-sighted and risky strategy that will neither bring growth nor employment.

The focus of this conference lies on the countries of Central, Eastern and Southeastern Europe. But over the next two days we will also hear about experiences in western European countries or the U.S. After all, FDI trends worldwide are dominated by the richest countries. About three-quarters of the global FDI stock is currently

located in developed countries and the vast majority of FDI funds invested worldwide comes from developed countries.

At the same time, FDI patterns are changing most rapidly for developing and transition countries, where funds are concentrated in a handful of countries such as China or India. This is why we will also hear about the Asian experience.

Interestingly enough, some of the motivations for investors' location decisions are not so different between developed and developing countries. Factors such as access to large and fast-growing markets or the circumvention of trade barriers are equally relevant to the U.S. as they are to China or India.

Other factors are more specific to single regions. Overall, I am confident that there will be a lot to learn for us – across countries and across regions – during the next two days. I wish all of us an interesting and successful conference.

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