Japanese investments in the Central and Eastern Europe[1)]
—In the case of Czech Republic—

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1. Introduction

In May 2004, the AC-10 (10 acceding countries: Poland, Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Malta, and Cyprus) finally joined the European Union. The EU now consists of 25 member states with a total population of 453 million. The total GDP of the EU is about ¢ 9.6 trillion, almost the same as the USA. A comparison between the EU15 and EU25 reveals a 23.1% increase in total area and a 19.5% increase in total population, yet only a 4.8% increase in total GDP (See Table 1).

Table 1. Basic Indicators for the EU, Japan and the USA in 2002

	EU15	EU25	Japan	USA
Area (thousand km^2)	3191	3929	378	9373
Population (million)	379	453	127	289
GDP (billion ¢)	9,162	9,600	4,240	10,979

Source: The European Commission.

Over the past decade, the AC-8 (AC-10 excluding Malta and Cyprus) have made remarkable progress with structural reform, and are now considered stable democracies with functioning market economies that should be able to withstand competitive pressure within the EU (See Table 2). As a result of their progress, growth in the AC-8 since 2000 has exceeded the levels seen in the EU-15 and other emerging markets. This growth has been driven and sustained by foreign direct investment (FDI), exports to the EU, and domestic demand (See Figure 1).

Table 2. Basic Macroeconomic Indicators for the AC-8

(%)

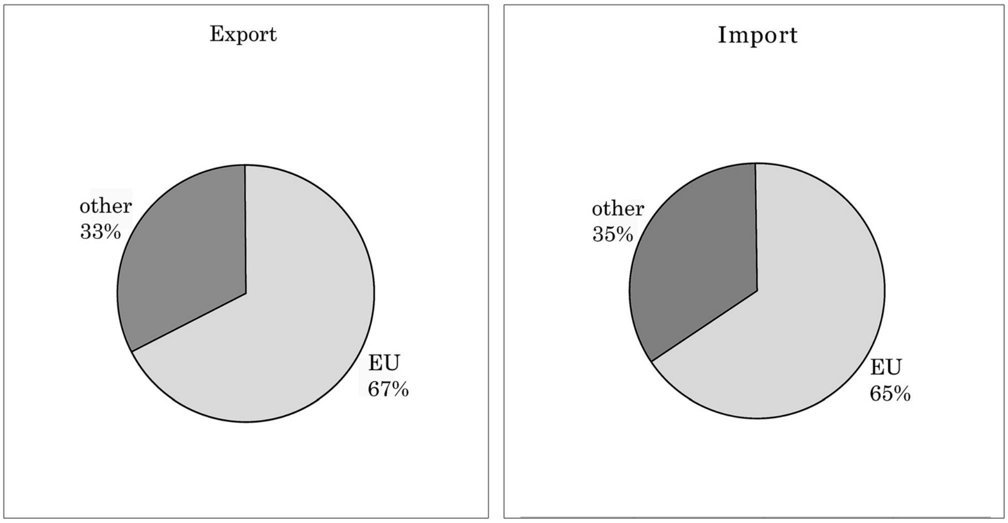
	2000	2001	2002	2003	2004	2005
Real GDP	4.1	2.5	2.4	3.6	4.0	4.2
Individual Consumption	3.3	2.2	4.5	4.4	3.7	4.0
Government Expediture	1.2	2.7	2.8	1.7	1.0	1.4
Gross Constant Capital Formation	3.5	-1.9	-0.6	1.9	5.7	7.3
Export	18.5	7.1	4.4	9.6	8.9	8.5
Import	15.1	4.2	4.6	8.6	8.1	8.4

Note: Data for 2004 and 2005 are forcast.
Source: The European Commission.

In some ways the AC-8 can be compared to the previous southern enlargement of the EU. Yet there are a number of differences between those southern European countries and the AC-8. For example, the AC-8 had lower income per capita in terms of purchasing power, which according to EU policy would mean higher budgetary transfers.　In 1980, the average GDP per capita (in PPP) for Greece, Portugal, and Spain was 66% of the EU-9 at the time.　The average GDP per capita (in PPP) of the AC-8 was only around 47% of the EU-15 in 2001 (See Figure 2).

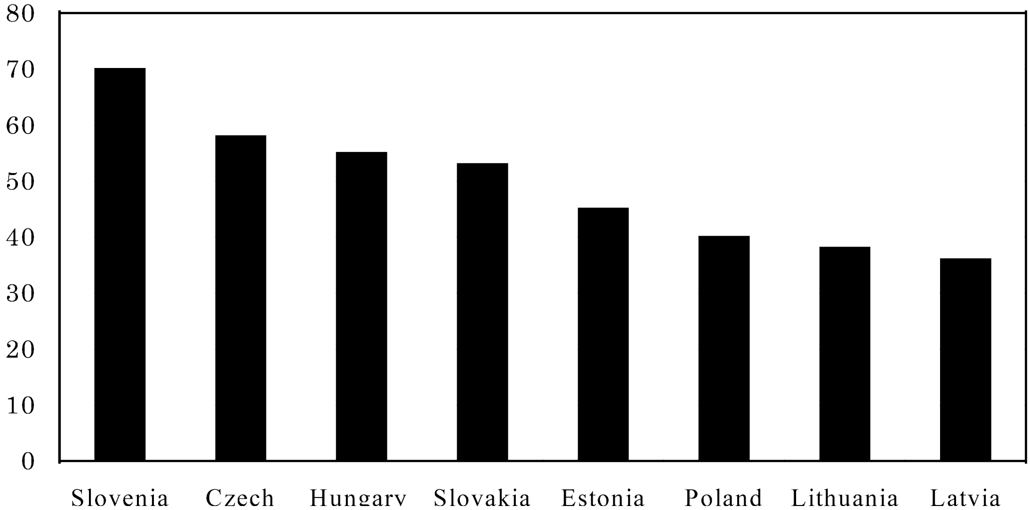
Figure 1.　Trade of AC-8 with the EU

（% of total, in 2002）



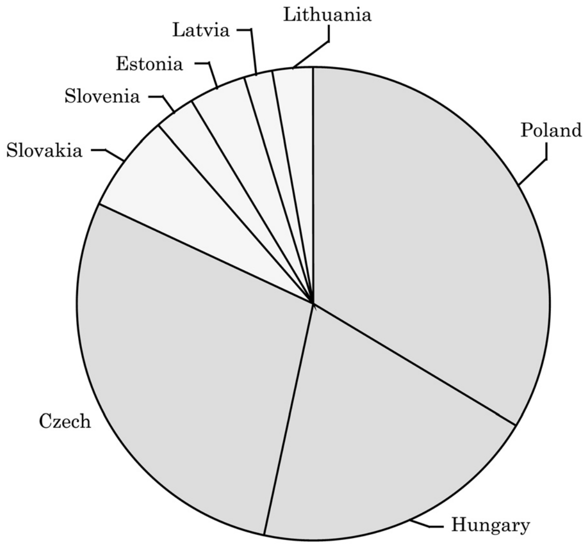
Source: The European Commission.

Figure 2.　GDP Per Capita as % of EU average in 2001



Source: The European Commission.

Figure 3. FDI in AC-8 (Stock base, 2002)



Source: JETRO 2003.

For the AC-8, consequently, there are greater potential benefits of accession for growth, such as (1) trade effects, i.e., removal of remaining barriers to trade (tariffs and quantitative restrictions) and reduction of transaction costs (opening of borders and standardization, certification, etc.); (2) single market effects, i.e., gains in efficiency through enhanced competitive pressure (decrease in price level via a reduction of mark-ups) and better access to larger markets (productivity gains via economies of scale); and (3) factor mobility, i.e., liberalization of capital and migration flows. For example, trade integration has already been achieved and higher FDI has already flowed into CEE (especially Hungary, Poland, and the Czech Republic).

In the short term after accession to the EU, FDI inflows to the AC-8 are expected to remain relatively high (See Figure 3). In the medium term, however, Greenfield FDI common among Japanese investors, inflows are likely to be uneven. In Hungary, most of the state enterprises have already been sold by foreign investors, and the high inflows of FDI have resulted in shortages of skilled labor in the country's western regions. In the Czech Republic, the direct sale of big strategic enterprises to foreign investors has almost been completed, and Greenfield investment is near the saturation level, as is the case in Hungary. The most serious problem in both countries is the shortage of skilled managers. In Poland, there is still room for investment since there remain many uncompetitive state sectors in need of restructuring and relatively young skilled workers are abundant.

2. Japanese Investment in CEE

2. 1 General Remarks

Japanese investors have a strong need to support and enhance global manufacturing structures. There are three regions in which they pursue strategies for developing their production and sales networks: Asia, North America, and Europe. There is much room for improving their networks in Europe, where the EU is the target market In the EU-15, already 886 Japanese companies have made investments.

The AC-8, especially the AC-3, is an ideal location for local production for the EU market for the following reasons: These countries have (1) a tradition of manufacturing; (2) many qualified and skilled workers; (3) qualified production managers; (5) advantageous geographical location for the EU market; (6) relatively well established infrastructure (roads, railways, electric power, etc.); (7) lower labor costs than EU-15 countries; and (8) FDI incentive programs (several years' tax holidays, duty free import of equipment, job creation grants, site development support, etc.). For the large Japanese companies, Europe is a major market, and the AC-8 is an ideal location to establish their facilities (See Figure 4).

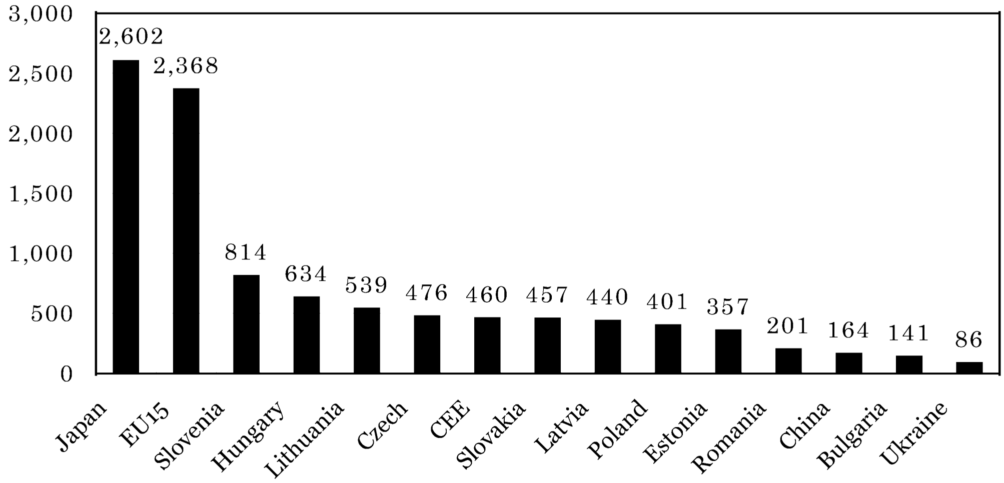
As mentioned above, Japanese investment in the AC-8 is basically dominated by manufacturing sectors. The distribution of Japanese FDI in this region is shown in the following table. In terms of proportional receipt of investment in the manufacturing sector, Hungary has been until recently the top runner among the AC-8 countries. In the latter half of the 1990s Poland followed. In 2000-2003, the Czech Republic surpassed Hungary and became the top recipient of Japanese FDI. The increase of Japanese investment in Czech in recent years is remarkable. However, although Japanese investment in the CEE region is concentrated in these three countries, Hungary and Czech are now facing gradual increases of wages, and a shift to further eastward countries such as Slovakia, Romania, and Ukraine seems to have begun. In the near future the preferential countries for Japanese investment could shift from Central Europe to Eastern Europe and Balkan countries (See Figure 5).

We can observe a variety of industrial sectors for Japanese investment in Western Europe, but in the case of CEE there is a strong concentration of automobile-related sectors and electric and electronics devices. In particular, investment related to the automobile industry has been very active in Central Europe and this region is becoming one of the centers for Japanese automobile manufacturing in Europe. The amount of Japanese investment in Czech in this sector is now the second largest in Europe next to that in the UK.

Next we examine the behavior of individual Japanese investors in CEE. Looking at the history of European business activities of the companies that have made investments in CEE, we see that many companies started their business operations in a Western European country before setting up operations in CEE. This means that a move to CEE for them is not a first experience in Europe, but rather an enlargement or transfer of their European business activities after operating in one or more other European country. Consequently, we can project that many future candidates for investment in CEE will be companies that already have facilities in Western Europe[2].

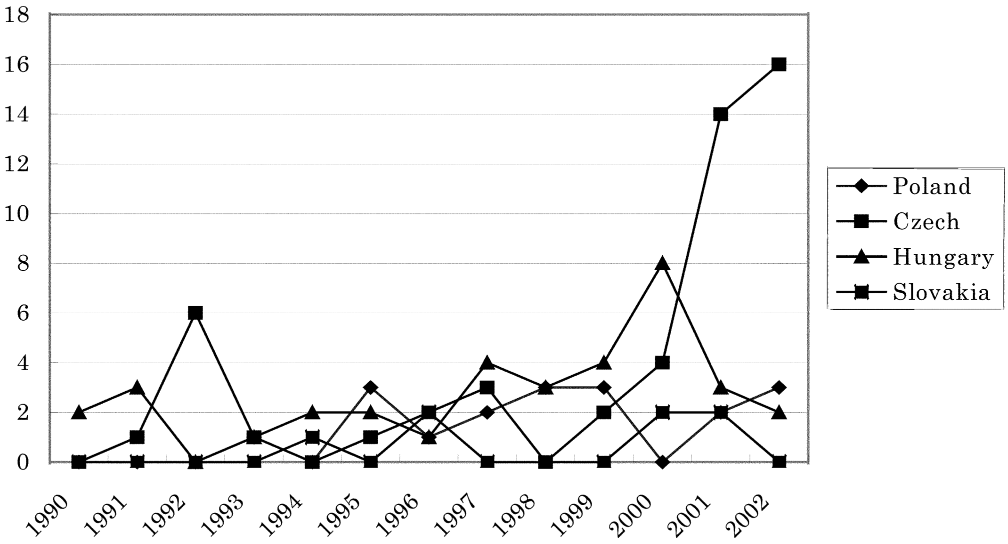
While in the case of consumer goods, market size can be estimated by population size and GDP, industries such as automobile parts have to have more specific customers. Their customers are not individual consumers but specific car manufacturers and large parts producers[3]. They need information about their potential customers for making a decision of investment. Investment in CEE by large Japanese manufacturers for their first European operations or the enlargement of their existing production capacities in Western Europe will not only induce large and medium-sized parts manufacturers to locate there, but will also encourage smaller parts manufacturers who do not have enough experience for doing business in Europe to come to CEE[4)].

Figure 4. Average monthly wages for worker ($)



Source: JETRO 2003.

Figure 5. Japanese Investment in Central Europe (number)



Source: JETRO 2003.

2. 2 Case Study (Czech Republic) [5)]

2. 2. 1 General Remarks

In the Czech Republic, there has been somewhat of a Japanese FDI boom recently, with 25 Japanese enterprises making investments over the two years just prior to the country's accession to the

EU (see above table).　For the purpose of this report, we therefore decided to focus on FDI in Czech, the reasons behind it, the processes, and other related issues.

Czech saw a relatively late increase in FDI compared to Hungary and Poland over the past decade.　A main reason why the FDI boom has come later to Czech is that the previous government's reform strategies were against introducing FDI incentive programs.　The former prime minister, Vaclav Klaus, was well-known as a monetarist and market-oriented economist, and he insisted that the industrial policy of the Czech Republic should be for the government to do nothing.

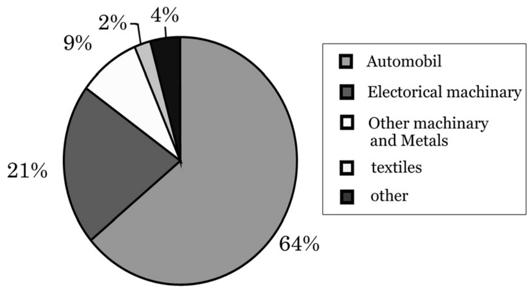
In 1998, following the monetary crisis of 1997, the Social Democrat Party replaced the previous cabinet and changed the strategy to one that regards industrial policy as important.　The same year, investment incentive programs were introduced, which provided for 10-year tax holidays, duty free import of equipment, job creation grants, site development support and the establishment of Czech Invest.

Just before the AC-10 joined the EU, Japanese investors, influenced by rapid globalization, were looking for good locations to invest in CEE.　It was difficult to find good locations in Hungary and Poland, since the investers who invested earlier could got best location, therefore it is difficult find good location for new comer. For example, Toyota had the two candidate locations of Poland (southern region) and Czech Republic (central region), and decided to invest their assembly facility in the Czech Republic with Peugeot[6)].

As mentioned, compared to FDI of other countries, Japanese FDI has mainly concentrated on the automobile and electrical machinery sectors.　When we look at the overall FDI per sector (volume base, 1990-1999), we can see 16% in the financial sector, 14% in trade and commerce, 6% in telecommunications, 6% in the automobile sector, and 6% in food processing.　For Japanese FDI alone (volume base, 1990-2002), we can see 58% in the automobile sector, 23% in electrical machinery, 2% in other machinery and metals, and 2% in textiles.　Looking at the share of FDI per country (volume base, 1990-1999), we can see the majority of FDI is from the EU, with 26% from Germany, 24% from Holland, 12% from Austria, 9% from the USA, 7% from Belgium, 4% from both the UK and France, and 1% from Japan.　The volume of Japanese FDI, however, has increased greatly, from US$133 million in 2001 to US$204 million in 2002, and the share of total investment (volume) is 9.8% (See Figure 6 and Figure 7).

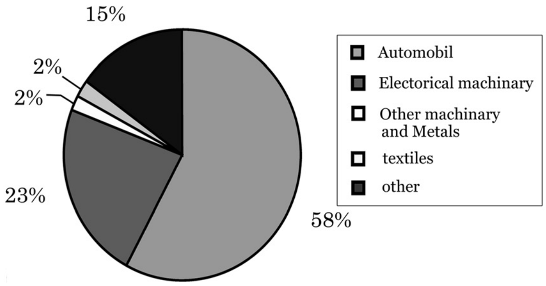
The frontier group for Japanese FDI consist of three major investors: Matsushita Electronic Components, Showa Aluminum, and Toray Textile. Their role has been and remains very important for encouraging subsequent investors. Matsushita's former president, Inoue, was one of the key persons to press the Czech government (both national and local government) to introduce investment incentive policies.　Heads of the other above-mentioned major investors have served as chairman of the Japanese Chamber of Commerce in Czech and are today still leading figures in the Japanese business circles there.　Inoue, in particular, is highly influential and respected, and is much sought after for advice on investing in the Czech Republic.

Fig. 6: Share of Japanese Investments (number) 2002



Source: JETRO 2003.

Fig. 7: Share of Japanese Investments (volume) 2002



Source: JETRO 2003.

2. 2. 2 FDI Incentives[7)]

The Czech Republic was the last country among the AC-3 to implement FDI incentives, and the country now offers incentives through several schemes to both newly incoming investors and ones already established, irrespective of their ownership, investment incentives and business support through several schemes. The most attractive incentives package is the National Investment Incentives Scheme offered by the government to investors for setting up manufacturing facilities, technology centers, and business support services. These include support through job creation programs, support for state enterprises, grants from local labor offices, tax relief, access to EU funds, and regional aid.

Standard incentives among AC-3 countries for manufacturing facilities are as follows:

(1) CORPORATE TAX RELIEF

Full tax relief for 10 years (for newly established companies).

Partial tax relief for 10 years (for expanding companies).

(2) JOB-CREATION GRANTS

Up to 200,000 CZK per employee in the district with the highest unemployment rate

(3) TRAINING AND RE-TRAINING GRANTS

Up to 35% of the costs of the training in the regions where the unemployment rate is higher than the country's average.

The total amount of the aforementioned investment incentives (with the exception of training and re-training) must not exceed 50% (65% in the case of state enterprises) of the investment made into long-term tangible and intangible assets.

Incentives for technology centers and business support services were introduced by the Czech in government in June 2001. These are unique incentives among AC-3 countries and are intended to create and develop high value-added sectors.

(1) TECHNOLOGY CENTERS

Technology centers are places that carry out innovative activities, in particular, those involved with periodic changes to products and technologies. They are assumed to be closely linked to production.

(2) BUSINESS SUPPORT SERVICES

Business support services are high value-added services and support employment of qualified experts in software development centers, expert solution centers, high-tech repair centers, shared services centers, customer support centers, and regional headquarters.

The content of support is as follows:

(1) SUBSIDIES FOR BUSINESS ACTIVITIES

Up to 50% of the eligible costs for “investment into tangible and intangible fixed assets purchased within the first five years” or for “two years of salaries of employees employed within the first three years.”

(2) SUBSIDIES FOR TRAINING AND RE-TRAINING

Subsidy up to 35% of specific training costs and up to 60% of general training costs. Maximum subsidy of 100,000 CZK or 150,000 CZK, respectfully, for one job position depending on the number of job positions created.

For Japanese investors it is important to be first granted the standard incentives, and after that, the most important incentives are those for business support services. Among the 51 current Japanese investors in Czech, 19 investors are being provided the standard incentives, and Matsushita succeeded to receive subsidies for business support services.

2. 2. 3　Toyota

Toyota has been aiming to increase its present 4% (as 2003) share of the European market. In 1998 the company decided to construct a new plant in France, and in 2001 it started construction of a new plant jointly with the Peugeot Group in the Czech Republic for the production of small cars. The facility is expected to begin operations in 2005.　Toyota is preparing for close cooperation between its existing British and Turkish plants and the new French and Czech plants.　In order to enhance distribution and production efficiency, it is also creating a wide-area supply network for components within the EU, with distribution centers located at four different locations.　And Toyota constructed a new plant in Poland to manufacture major components such as engines and steering wheels to cater to the French plant.　Production at the Polish plant started in 2003.　At present, components manufacturers are active moving towards investments in the Czech Republic and in Poland, largely due to the influence of Toyota.　As the number of units produced in Europe increases, there will be a need for a higher level concentration of components and raw material producers, such as that which is required in the American market.　There will certainly be a mutual supply of components with Peugeot Group and Toyota's affiliated components manufacturers will be given new business opportunities in supplying their products to the Peugeot Group and other automobile companies such as Mercedes Benz, BMW, and Volkswagen.

These above mentioned strategies might be for Toyota children to lead to restruct the present production network (Keiretsu). Toyota needs global suppliers, and if Toyota's affiliates follow its strategies or not, such as investing in CEE, is one of the crucial tests　for the company.　On the other hand, Toyota affiliates may need to find other clients and decrease their share of supply to Toyota gradually to survive themselves. For example, Denso (Czech) now supplies more than 50% of their products to German automobile companies. Toyota's affiliates must keep a good relationship with Toyota, and at the same time they must find new clients within the EU.

Finally we must point out the vitality of Toyota from the point of the decision of a joint venture with Peugeot. Toyota has already long established itself as a company with a famously sound management and product system (known as "The Toyota Way"). Generally, it is difficult to integrate businesses between those having quite different business cultures. In order to evolve, Toyota may intend to adapt European business culture, and in relation to this, Toyota regards its investment in the Czech Republic as the first important step into the Slavic world.

3. Final Remarks

By joining the EU, CEE countries will receive economic benefits in terms of increased FDI, more exports, and a subsequent rise in domestic demand. In the short term especially, increased FDI will contribute to develop the national economy of the Czech Republic. Czech Invest (an FDI service organization) is currently welcoming Japanese Greenfield FDI, which could contribute not only to the country's economy, but also to shape employment policy. However, under rapid globalization, it might be difficult to detain foreign investors in the long term. The life span of Greenfield investment is rapidly shortening; it used to be regarded as 30 years, but nowadays, it is just 15 years on average depending on the sector.

At this juncture, we should outline some points about FDI life spans. Japanese FDI for manufacturing can be categorized into the following three classifications:

(1) Labor-intensive sectors

These sectors involve quite simple labor techniques, such as for Onanba, Yazaki (Wire Harness) , and they can shift their production location in the short term depending on labor costs. These sectors are expected to shift eastward to countries such as Romania and Ukraine.

YAZAKI; Slovakia (94), Czech, Lithuania (2001), Romania, Ukraine (2003)

(2) Consumer-oriented sectors

Among Japanese investors such as Matsushita, these sectors are specialized in electronic machinery. These sectors are seeing two tendencies in terms of labor costs. First, a shift toward the east, and second, a shift in production structure from low value to high value added.

Matsushita; UK (1974 analog), Czech (1996 analog) ⇒ Czech (2004 digital), UK (will close)

(3) Client-oriented sectors

These sectors are composed of mainly machinery component suppliers in the automobile and electronics sectors, and include such companies as Toyota affiliates. Denso is located near not only Toyota but also German clients. Taiho is located quite near Matsushita.

Finally, we review the trends of Japanese FDI in CEE as follows:

(1) Japanese investors regard CEE as an ideal location for local production for the EU market.

(2) In contrast to Western investors, Japanese investors are focused in the manufacturing sectors

(mainly automobile and electronics sectors).

(3) After Toyota invested in Poland and the Czech Republic, many affiliate companies followed with investment in CEE.

(4) Japanese FDI will likely shift to the east, chasing lower labor costs.

(5) It is necessary for countries in CEE to introduce programs in addition to "standard" incentives to create high value-added sectors, as has been done in the Czech Republic.

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Note

1） I am very grateful to Prof. Masatake Wada (Teikyo University), Kiyoshi Okano (Rotobo) and Go Shimuta (JETRO) for their materials and comments.

2） Masatake Wada,"The present Situation of FDI and Its Impact for Their National Economy in CEE (in Japanese)," *The Structural Change of International Economic Relations in CEE*, Rotobo, 2002.

3） This is the comment of president Nakagishi, Denso(Czech).

4） Masatake Wada, *ibid*.

5） I thank the visited companies (Matsushita, Toyota, Showa-alumi, Aisan, Toray, Denso, Koito, Matsushita Communication and Onanba etc. in April 2003, October 2003)

6） But Toyota invested a transmission-pruducing center in the south of Poland.

7） Czechinvest www.ywbc.org/czechinvest/incentives/index.html

Main References

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