5. THE IMPACT OF FOREIGN DIRECT INVESTMENTS ON HOST COUNTRY'S EXPORTS

By Tiia Vissak

Introduction

Foreign trade and foreign direct investments (FDIs) play an essential role in the process of international integration and globalization. Both are vehicles for achieving economies of scale and expanding markets for enterprises, for providing a broader choice and lower costs for consumers and the transmission of modern technology and efficient management practices essential to economic efficiency and development (WTO Communication …, 1997, p. 2). Many developing and transition countries have relatively small domestic markets – on the one hand, because of their low *per capita* income, and on the other, because of small populations. In order to ensure a sustained rise in the investment rate and high productivity growth, they need imported capital goods and technology. For obtaining foreign exchange, a steady expansion in exports is required (WTO, Addendum 1, 1997, p. 8). One way to gain it is through FDIs.

The relationship between foreign direct investments and exports has got considerable attention due to the opening up of Central and Eastern European countries and their future integration into the European Union. Trade deficit is one of the most urgent issues in this region. Only Russia had a positive

trade balance in 1999. In most transition countries, foreign trade deficit has been increasing (UNECE 2000, p. 171). Lack of information about export markets may be one of the largest obstacles to exporting (Moini, 1997, p. 70). After the collapse of the Communist system of central planning, most former foreign trade ties broke up, and firms had to find new customers and suppliers quickly (Meyer, 1998, p. 3). In addition, many new enterprises were created that had almost no direct contacts abroad and only little knowledge of their potential partners and competitors on foreign markets.

The main objective of this chapter is to show how foreign direct investments can give to many Estonian local firms access to multinationals' networks, and through that the necessary information and other resources they need in order to start exporting successfully. Many countries in Central and Eastern Europe have skilled, low-cost labour, cheap physical capital, a supportive political environment and a perspective to join the EU that should attract resource-seeking investors. In addition, the region offers opportunities for market-seekers: a potentially large market with a good growth potential, high consumer awareness of Western products, and a favourable investment climate (Healey, 1994, pp. 6–7). Thus, in the future, FDI flows into this region are likely to grow.

Direct and indirect impacts of FDI on exports

It is obvious why many firms export – it generates additional income and profits, enables them to produce more, reduce risks, specialize, and become more competitive (Branch, 1994). The problem is, exporting is not easy even if companies have products that could be successful abroad. Getting FDI may help solve this problem: as several authors have shown, firms with foreign capital usually export more than those based on local capital. There is such evidence from the Czech Republic (CzechInvest, 1998, p. 2), the Czech Republic, Slovakia and Hungary (Hunya, 1998, p. 12), the Czech Republic, Hun-

gary and Slovenia (Rojec, 1998, pp. 20–22), Singapore (Yue, 1996, p. 708), transition economies and developing countries (Narula *et al.*, 1995, pp. 15–16), the whole world and some countries, in particular (United Nations 1999, pp. 234–239). It has also been suggested that Central and Eastern European exports have been upgraded through FDI and the resulting links with primarily EU firms through joint ventures, subcontracting, and outward processing trade (Lauter *et al.*, 1999, p. 44).

On the other hand, exports in general, and manufacturing exports in particular, are a significant determinant for high-FDI recipient countries. Export orientation may even be the strongest explanatory variable for attracting foreign direct investment flows. Thus, successful exporters (for example, Hungary and Poland) attract more FDI inflows (Singh *et al.*,1995, p. 2, Manzocchi, 1997, p. 19).

The impact of FDI on the host country's exports depends on motivations behind it. Investment decisions can be either factor-driven (access to materials, technology, lower-cost labor) or policy-driven (WTO Addendum 3, 1997, p. 2). The former is called vertical FDI, the latter horizontal FDI. Vertical FDI clearly expands trade. Horizontal FDI (the same stages of the production process are located in a number of countries) is impelled by trade barriers, high transport costs, the need to either adjust products to local standards or to acquire information about local competitors. Empirical studies of outward FDI tend to confirm that even in this case the overall effects on trade are positive (WTO The Relationship …, 1998, p. 5).

FDIs can be divided into three categories. For "distribution" projects, the primary role is to be a sales base, promoting exports from plants in the rest of the world to the local market. For "local supply" projects, it is production for the supply of local or regional markets. The primary function of "export supply" projects as a production base, on the other hand, is to supply markets outside the region. All these projects differ in

the average size, sales orientation and cost structure (Lankes *et al.*, 1996, pp. 337–338).

It is also possible to distinguish between four different types of FDI according to the different objectives of the involvement of multinational companies (MNCs) (Dunning, 1994, p. 39; WTO Addendum 1, 1997, pp.9–12):

- Natural-resource-seeking FDIs generate a stream of exports of natural resources that would otherwise not have occurred. As a rule, such FDIs are accompanied by a flow of imports of capital goods, specialized intermediate inputs, and consumer goods.
- If market-seeking FDIs have been caused by formation or strengthening of regional groupings, they may generate a new stream of exports from host countries. In other cases, they may be smaller. They also stimulate local entrepreneurship.
- Efficiency-seeking FDIs give rise to exports from host countries. They improve cross-border networking and in many cases help diversify the composition of host- country exports towards manufactures. The recipient country may frequently end up exporting some brands of the product and importing others, at lower cost to the consumer.
- Strategic-assets-seeking FDIs lead to exporting high-skill labor services. They also provide access to foreign markets and/or sources of supply.

In Table 5.1, nine possible relationships between FDIs and exports are presented (Wilamoski *et al.,* 1999, p. 31). In five cases, the host country's trade balance is likely to worsen, in four cases, on the contrary, to improve.

In addition to a direct effect on exports from the host countries by affiliates themselves, FDIs have an indirect impact on the host countries – the host country's local firms may start exporting, as well or increase their exports (Blomström, 1990, p. 5; Williams, 1997, p. 135), especially if they are located near a

Table 5.1

Possible impacts of FDI on exports

	Effect on host nation's exports*	**Effect on home nation's exports****
Host nation's production requires home nation's capital goods	***	Positive
Host nation's affiliate production requires inputs from parent firm	***	Positive
Host nation is a low-cost source of production for sale in host nation (substituting for home production)	***	Negative
Host nation is a low-cost source of production for sale in home nation (substituting for home production)	Positive	***
FDIs raise demand for parent firm's product	***	Positive
Host nation's affiliate production raises demand for higher-end products from home nation	***	Positive
As host nation's supplier network grows, inputs from parent firm decrease	***	Negative
Transfers of technology and management skills increase competitiveness of host nation's firms	Positive	Negative
FDIs raise host nation's growth rate	***	Positive

* FDIs should have a similar effect on home nation's imports.
** FDIs should have a similar effect on host nation's imports.
*** The impact of FDIs on exports is not completely certain.

Source: Wilamoski *et al*., 1999, p. 31.

Table 5.2

The impact of MNCs on host country exports

Direct effects	Indirect effects
In the processing of locally produced raw materials, MNCs may have a better export potential than the local firms, because of their business contacts abroad, marketing skills, superior technology both in product and processes, and greater general know-how. MNCs have also been firm supporters of common markets, customs unions, and free trade areas, since these arrangements enable firms to rationalize small-scale facilities and develop exports. Local firms seeking to expand their exports to developed market economies face difficulties in setting up a distribution network, keeping up with rapid changes in consumer tastes, mastering the technicalities of industrial norms and safety standards, and shaping a new product image. In many cases the design, packaging, distribution and servicing of the products are as important as being able to produce them at or below the ruling prices in world markets. The success of many developing country firms entering world markets is gained because foreign firms help them by providing links to eventual buyers.	Local firms may increase their exports by observing the export activities of MNCs and by making use of the infrastructure of transport, communications, and financial services that develop to support those activities. Firms investing abroad must have some firm-specific advantages such as technology, management, and marketing competencies that enable them to operate in foreign countries. By entering new markets, MNCs take their firm-specific assets abroad, thereby forcing local firms to adopt more efficient methods and become more competitive.

Direct effects	Indirect effects
Exports of labour-intensive components within vertically integrated industries are almost by definition dependent on the participation of MNCs. Here, a host country must not forget that this type of production is relatively ”footloose” and often implies large imports of unfinished and intermediary goods.	If export-oriented foreign subsidiaries increase their purchase of inputs from the host country firms as the subsidiary matures, the host country’s trade balance will improve. Such relationships between a foreign subsidiary and its local suppliers are also important potential sources for technology spillovers.

Source: Blomström, 1990, pp. 5–9.

multinational exporter (Aitken *et al.*, 1997, p. 128). Both of these effects are described in Table 5.2.

5.2. Exports and FDIs: a network perspective

The term "network" is used to describe very different phenomena, ranging from national economic systems and multinational corporations to small entrepreneurial firms, service organizations, professional and career networks, electronic data and communication systems, and social networks (Achrol, 1997, p. 56). Herein the term stands for a "business network", denoting the relationship of entrepreneurs and their businesses with the outside world (Donkels *et al.*, 1997, p. 13).

Through networking, firms can find new export and/or import partners, learn from one another, lower production and transportation costs, specialize in more profitable product and market niches (Ebers *et al.*, 1997/98, p. 4). In fact, much of the activity involved in internationalization could be characterized as network activity, as relationships with foreign intermediaries, customers, alliance partners, suppliers, government officials, and other entities need to be established, maintained, and extended (Welch *et al.*, 1996, p. 13).

On most markets, business networks play an important role – there is considerable inertia amongst buyers who feel more secure with suppliers from familiar sources and locations (Welch *et al.*, 1988, p. 52), especially if sales are customer-specific and products customized (Meyer, 1998, p. 3). Small and medium enterprises (SMEs) are affected by lack of networking most directly, because they themselves typically do not have enough resources and management capacity to export successfully (Malecki *et al.*, 1999, p. 249). Moreover, SMEs often fail to establish marketing networks or strong market relationships with their customers without some outside assistance (ITC, 1999, p. 11).

The network approach views foreign direct investments as the construction of a link between a domestic and a foreign network (Gupta *et al.,* 1991, p. 770). The parent allows the affiliate to use its brand names and have access to its global technology and marketing networks, controls its investment, technology and sales decisions, and sees it as a part of its global strategy. The affiliate may additionally get an access to foreign markets, technical know-how, equipment, management, marketing and other skills (Lall, 1993, p. 96). Multinational corporations are the most efficient organizational forms to transfer knowledge across borders (Kogut *et al.,* 1993, p. 625). This is very important because many of the resources crucial for international business are knowledge-based. They include knowledge on how to do international business, awareness of local markets, business practices, etc. (Meyer *et al*., 2000, p. 5).

The model. It is assumed that all companies behave rationally (they want to maximize their profits), their products are internationally competitive (even if we consider transportation costs, trade barriers, etc.) and they have sufficient production capacities for exporting. Thus they are actively seeking new markets and partners abroad to export more (if exporting promises greater returns than domestic production or if their local markets are too small). In addition, it is supposed that firms will win from network relationships more than they will lose. Under these conditions, one (necessarily not the most competitive) firm makes a foreign investment (Vissak, 2000, p. 430).

A company may invest abroad (become a “parent”) for several reasons. However, the affiliate receives not only capital, but also new ideas, technology, skills, contacts with the parent’s partners abroad, information about foreign markets, etc. and will become more competitive both nationally and internationally. This is particularly the case if the parent is already internationally successful and if the affiliate has something to offer to the parent in return.

After getting FDI, the affiliate may start exporting (or increase its exports) to three types of partners – the parent company itself, other firms in the parent's home country, and firms in other countries (see Figure 5.1). Exporting to the parent is profitable if, for example, production costs are much lower in the host country or if the parent company does not produce the products/details itself. In the second case, the affiliate may have known about the buyer before (it may even have been a reason for the FDI), or it may find a partner only thanks to the information provided by the parent company (for example, if it is a parent's subcontractor). In the third case, the affiliate may increase its exports to the existing buyers, find new customers abroad itself, or start exporting to the parent's foreign affiliates or other (trade) partners.

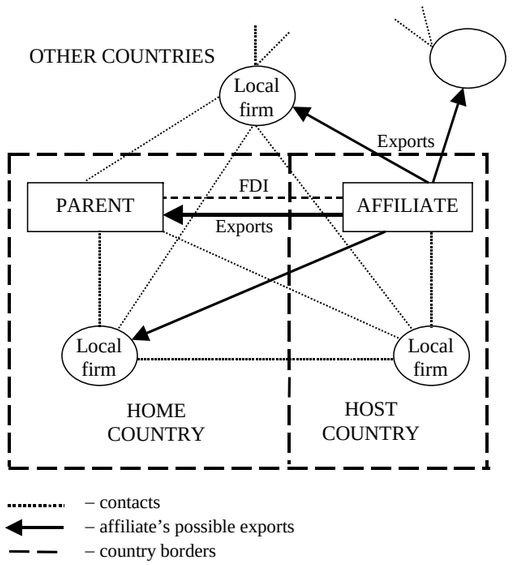


Figure 5.1. Impact of foreign direct investments on the foreign affiliate (Vissak, 2000, p. 449).

In addition, several local firms in the host country may gain from FDI (see Figure 5.2). They may start subcontracting for the affiliate or increase their existing volume of production. Small domestic firms often act as important suppliers of key components and spare parts for large firms (WTO Addendum 4, 1997, p. 8). Also, as they acquire new information, skills, etc. from the affiliate, or in some cases, from the parent, they may start exporting themselves (or increase their existing exports) to the affiliate's parent, and to the local firms in both the parent's home country and/or to some firms in other countries.

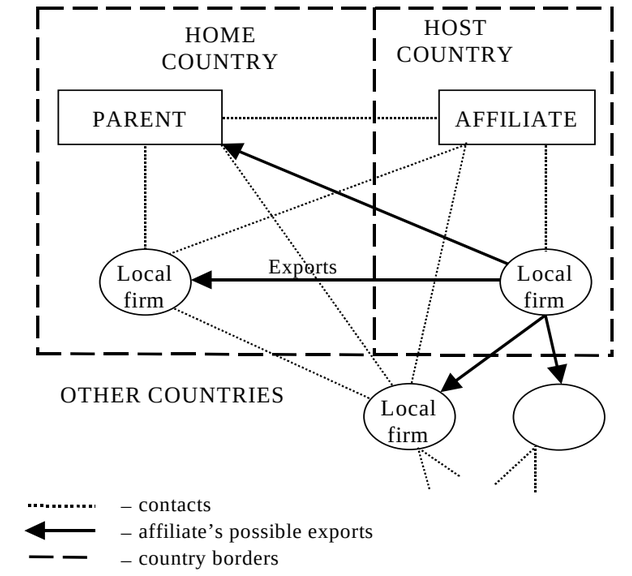


Figure 5.2. Impact of foreign direct investments on the local firm in the host country (Vissak, 2000, p. 450).

Those local suppliers that succeed in serving foreign investors operating in their country will often develop a capacity to directly supply other clients overseas (Battat *et al.*, 1996, p. 20). Foreign affiliates are a natural conduit for information about foreign markets and technology, and a natural channel through which domestic firms can distribute their goods (Aitken *et al.*, 1997, p. 128). FDI inflows also reduce the local firms' risks, and increase local investments (Manzocchi, 1997, p. 5). Although the increased competition in the host country product and factor markets tends to reduce profits of local firms, the linkage effects to supplier industries may reduce input costs and raise profits (Markusen *et al.*, 1999, p. 335).

Foreign direct investments may also increase home country exports. The parent may start exporting (or increase its exports in) both components and finished products (e.g. machinery) to the affiliate, but it may also gain from the affiliate's (new) contacts and start selling its production to some local firms in the host country and/or in other countries. In addition, some local firms in the parent's home country may start exporting (or increase their exports) to the affiliate, to some local firms in the host country and/or in other countries. They may also start selling (most of) their products to the parent company itself. Local firms in other countries may gain from FDIs, too. If they had previous contacts with the parent, they may start exporting to the affiliate; if they had contacts with the affiliate, they may start exporting to the parent. Also, due to the information they get from the parent or the affiliate, they may start exporting to the local firms in their home countries.

In conclusion, the affiliate may gain from the FDIs (it gets information about local firms in both parent's home country and, often, in other countries), but the parent may also win (it gets information about the host country's market and local firms in the host country and, possibly, in other countries). Many local firms in all the three countries involved may also gain.

5.3. FDIs and exports: implications for CEE

In several CEE countries, FDIs have been instrumental in starting new export-oriented industries with privileged access to export markets within MNC systems and advantageous access to markets due to linkages with multinational corporations. In addition to exports, local purchases and subcontracting of parts and components by foreign manufacturing affiliates have an impact on host economies by helping local entrepreneurs to establish links with international markets (United Nations, 1995, p. 214). Besides the advantages related to technology and knowledge of the market, multinationals also possess the service and distribution systems, which local firms would otherwise have to set up from scratch (WTO Addendum 1 1997, p. 12). For example, a significant share of Hungary's domestic activity has been incorporated into global networks due to foreign investors' participation in them (Kaminski, 2000, pp. 2–3).

In addition to increasing exports, FDIs can lead to upgrading of technology, introduction of new product lines, and sales increase (see Figure 5.3). The flow of FDIs from countries at higher stages of economic development to those who are at lower stages will also result in a more efficient use of production factors. Recipient countries utilize their surplus labour and accumulate capital, technology and management skills, advancing their industrialization (Hiley, 1999, p. 83). Finding a foreign strategic investor can also strengthen corporate governance and introduce new skills in marketing and business strategy, while linking the enterprise into a global network of trade and finance (EBRD, 1999, p. 167).

From the above, it could be easily concluded that encouraging FDI inflows is a promising way to increase the export competitiveness of the CEE countries. On the other hand, different types of investment impact on host countries differently and, besides increasing a host country's exports, FDI inflows may have a similar effect on its imports — the affiliate may start

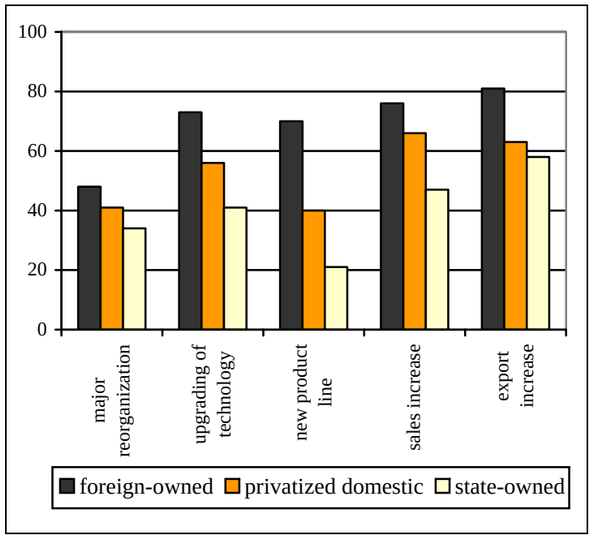


Figure 5.3. Ownership and restructuring in CEE, percentage of firms reporting activity over the last three years (EBRD 1999, p. 168).

importing intermediate, semi-processed goods (Swamidass, 1993, p. 681), and may even out-compete the local firms that export more and import less (Dunning, 1994, p. 47). It has been suggested, too, that as trade balance forms a division of a country's balance of payments, and the sum of all balance of payments' accounts is always zero, then a surplus in capital balance (large FDI inflows) will automatically lead to foreign trade deficit (Krugman, 1996, p. 42). Also, very large FDI inflows may cause a significant real appreciation of the currency, discouraging exports. Non-traditional (new) exports are the first to be discouraged. However, it does not mean that FDIs are undesirable; it means that in some cases they may need to be phased in at a slower rate than that determined solely by market forces (WTO Addendum 1, 1997, p. 14).

Only countries with established industrial infrastructure and capability, and a pool of low-cost (skilled) labour and other resources have an advantage over others in attracting export-oriented FDIs (Kumar, 1994, p. 149). FDI projects in more advanced CEE countries (including Estonia) are more likely to be export-oriented, more integrated into the parent's production process and more likely to exploit the comparative advantage of the host economy than projects in less advanced countries (Lankes *et al.*, 1998; Brenton *et al.*, 1998, p. 15).

5.4. FDIs and exports in Estonia

Trade deficit is Estonia's great concern. Estonia is a net importer of goods and a net exporter of services, but the latter does not cover the former. As a way to reduce its trade deficit, the Estonian government considers encouraging more FDIs (and has already been quite successful). The current situation is presented in Figure 5.4.

It can be concluded from the financial data of about 10 000 Estonian enterprises (Database "Estonian …", 2001) that foreign-owned firms have a larger export share than domestic-owned firms. Foreign-owned private enterprises also have the highest exports per employee (see Figures 5.5 and 5.6). Note that in this database, firms are classified as foreign-owned (or Estonian privately owned) only if the share of foreign capital (Estonian private capital) constitutes more than 50%.

The situation varies in different industries. In the wood, chemicals and non-metallic minerals industries foreign affiliates have considerably larger exports than local enterprises, whereas it is the other way round in the wearing apparel and dressing industries (except in 1999) (see Tables 5.3 and 5.4). It is also interesting that the results differ considerably for different years. To some extent, it may be due to the fact that in different years different firms were selected and many firms' ownership changed.

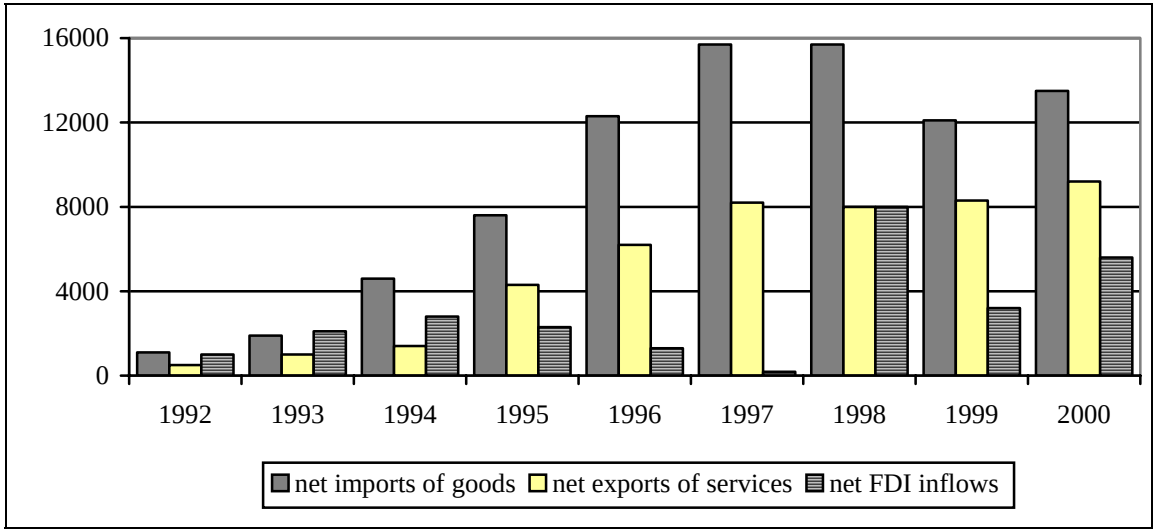


Figure 5.4. Net imports of goods, net exports of services, and net FDI inflows into Estonia in 1992–2000, in million EEK (Balance of Payments 2001).

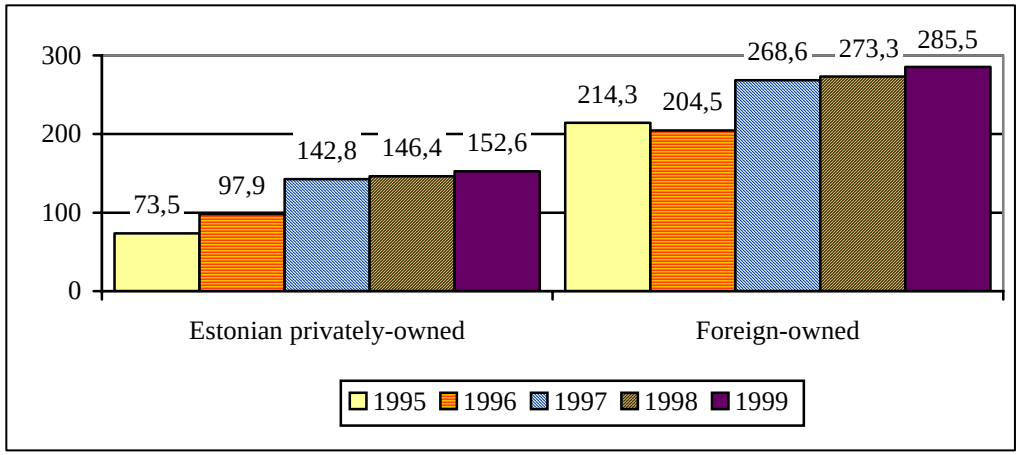


Figure 5.5. Exports per employee (thousand EEK) by type of ownership in enterprises with more than 50 employees (Database “Estonian ….”, 2001).

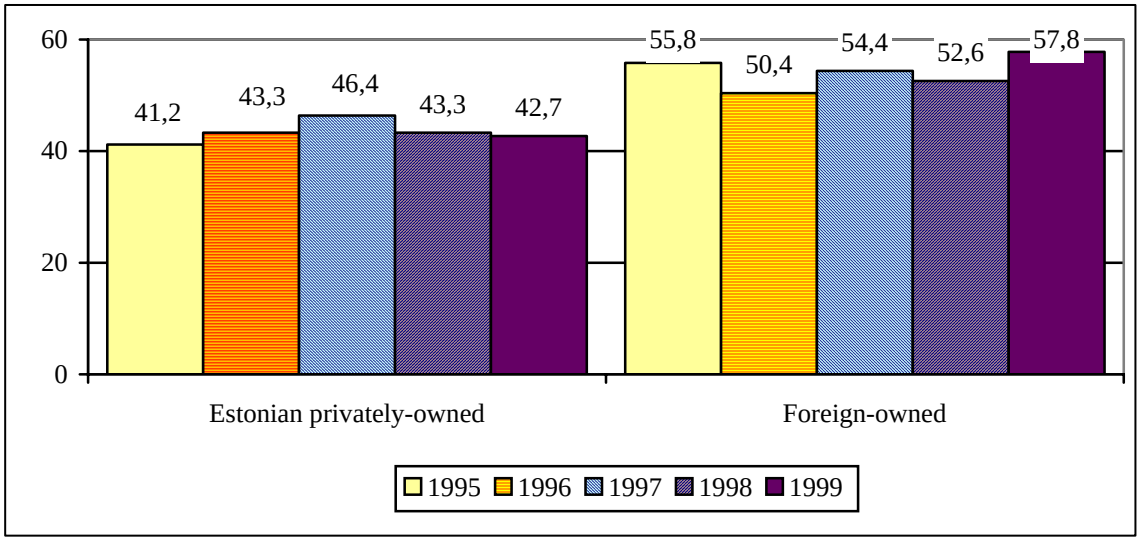


Figure 5.6. Share of exports (%) in turnover by type of ownership in enterprises with more than 50 employees (Database “Estonian ….”, 2001).

Table 5.3

Estonian exports per employee by type of ownership*
in selected industries (thousand EEK)

	Owner**	**1995**	**1996**	**1997**	**1998**	**1999**
Total manufacturing	P	74	98	143	146	153
	F	**214**	**205**	**269**	**273**	**286**
Textiles	P	30	67	113	174	225
	F	**153**	**99**	**152**	134	122
Wearing apparel, dressing	P	42	68	85	108	93
	F	9	19	33	34	**197**
Food products and tobacco	P	93	124	166	132	112
	F	**137**	**220**	**288**	**309**	**269**
Wood	P	126	156	238	236	314
	F	**1284**	**211**	**306**	**375**	**431**
Chemicals, coke and petroleum	P	133	139	201	195	263
	F	**615**	**729**	**941**	**685**	**623**
Other non-metallic minerals	P	44	11	37	41	24
	F	**191**	**268**	**429**	**364**	**398**

* – in enterprises with more than 50 employees.
** – P – Estonian privately-owned, F – foreign privately-owned.
Source: (Database “Estonian ….”, 2001).

Table 5.4

Share of exports in turnover by type of ownership
in selected industries (%)

	Owner	**1995**	**1996**	**1997**	**1998**	**1999**
Total manufacturing	P	41	43	46	43	43
	F	**56**	**50**	**54**	**53**	**58**
Textiles	P	20	48	57	61	66
	F	**54**	32	35	32	32
Wearing apparel, dressing	P	48	64	68	69	69
	F	24	28	43	40	**71**

	Owner	1995	1996	1997	1998	1999
Food products and tobacco	P	32	35	36	27	23
	F	22	29	29	**28**	**26**
Wood	P	62	58	65	58	51
	F	**96**	**83**	**74**	**81**	**78**
Chemicals, coke and petroleum	P	35	44	44	42	49
	F	**77**	**73**	**75**	**68**	**63**
Other non-metallic minerals	P	33	8	17	14	8
	F	**59**	**67**	**69**	**45**	**47**

Source: (Database "Estonian ….", 2001).

There is also some evidence from Hungary, the Czech Republic and Slovenia showing that in some sectors, local firms are more successful exporters (see Table 5.5). It was true in case of Slovenian wood industry and Hungarian chemical industry.

Table 5.5

Share of exports in turnover by type of ownership in selected countries (%)

	Owner	Slovenia*		Hungary		Czech Rep.
		1995	1996	1995	1996	1994
Total manufacturing	P	45	46	22	22	31
	F	**64**	**65**	**37**	**40**	**41**
Textiles	P	56	62	27	24	45
	F	**83**	**80**	**53**	**52**	**50**
Wearing apparel, dressing	P			44	38	53
	F			**70**	**74**	**76**
Food products and tobacco	P	12	12	16	15	9
	F	**17**	**17**	**20**	**23**	**14**
Wood	P	51	51	14	17	42
	F	**64**	49	**38**	**50**	**77**

	Owner	Slovenia*		Hungary		Czech Rep.
		1995	1996	1995	1996	1994
Chemicals, coke	P	58	58	37	18	33
and petroleum	F	**61**	**67**	25	**27**	**61**
Other non-me-	P	38	36	8	16	40
tallic minerals	F	**43**	**49**	**25**	**24**	**46**

* – For Slovenia, data for textiles, wearing apparel and dressing are presented together.

Source: Database on Foreign …, 1998.

However, this data does not allow us to tell whether the firms started exporting after they had got FDIs or whether they got FDIs because they were already successful (exporters). Thus, it would be important to get more information about foreign affiliates. Some more information about the impact of FDIs on Estonian exports can be gained from the surveys Foreign Investor ’96–99 and Exporter ’97–98. In 1997, from Foreign Investor ’96, data of 46 exporting and 27 non-exporting foreign-owned firms were gained. In 1998, from the Foreign Investor ’97 and Exporter ’97 competition, data of 85 exporting affiliates and 56 local exporters were received. In 1999, 63 exporting affiliates and 61 local exporters responded to the surveys Foreign Investor ’98 and Exporter ’98. In 2000, we received data from 84 exporting affiliates from Foreign Investor ’99.

The results of the survey Foreign Investor ’96 show the following (Vissak, 1998, p. 119):

- exporting firms have invested in Estonia on average 50% more (respectively, 21.4 and 32.7 million EEK by firm) and they have fewer employees (327 and 159 per firm) than the non-exporting ones;
- firms with more foreign capital export more than the others;
- exporters have fewer problems than non-exporters.

Figure 5.7 shows the rate of foreign capital's influence on exporting investors' decisions. In Estonia, foreign investors want to gain full ownership or, at least, an absolute majority — only in a few firms (3 out of 76 in 1998 and 2 out of 74 in 1999) the share of foreign capital is less than a half. The same conclusion can be drawn on the basis of the results of Foreign Investor '96 (Vissak, 1998, p. 115), '97 (Vissak, 1999, p. 168) and '98.

At the same time, foreign affiliates remain quite autonomous (see Fig. 5.8) – the parent mainly makes only decisions about financing. This is a positive sign for Estonia because subsidiaries which carry out a wider range of value-added activities and are in the position of taking strategic decisions in important areas of business strategy, such as product and process design and marketing, will in most cases be more likely to bring about a favourable impact upon the host economy (Williams, 1997, p. 136). Until now, exporting affiliates have got mostly unprotected technology and know-how from the parent (see Fig. 5.9).

Information about firms' export markets is presented in Figure 5.10. The results show that 68 exporting affiliates had on average 3.4 export markets. They mainly exported to Finland and the Baltic States (Latvia and Lithuania). This does not completely accord with Estonian foreign trade structure as a whole — after Finland, Sweden and Germany, Latvia is 4th and Lithuania 7th (Exports …, 2001).

The relationship between the investor's country of origin and the firm's export markets is presented in Table 5.6. The capital's country of origin seems to have a strong influence on the firm's choice of export markets – e.g. firms with Finnish capital often start exporting to Finland, firms with Swedish capital to Sweden, etc. This may corroborate the idea presented in Figure 5.1 that foreign affiliates may often start exporting to the parent itself or to other firms in the parent's home country with which the parent has close contacts. In addition, the Baltic States are important as (main) export markets, too, since

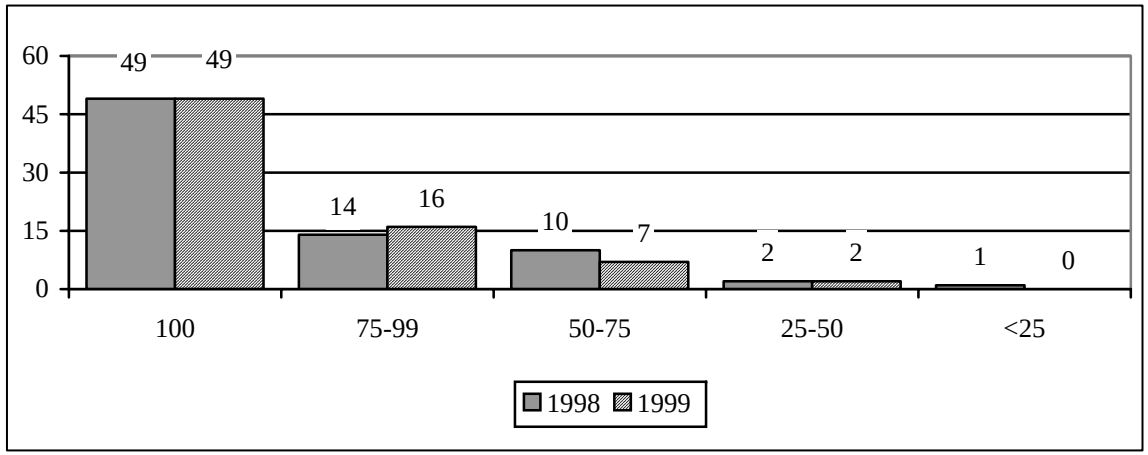


Figure 5.7. Foreign investors' voting right (number of firms belonging to each category) (Foreign Investor '99; author's calculations).

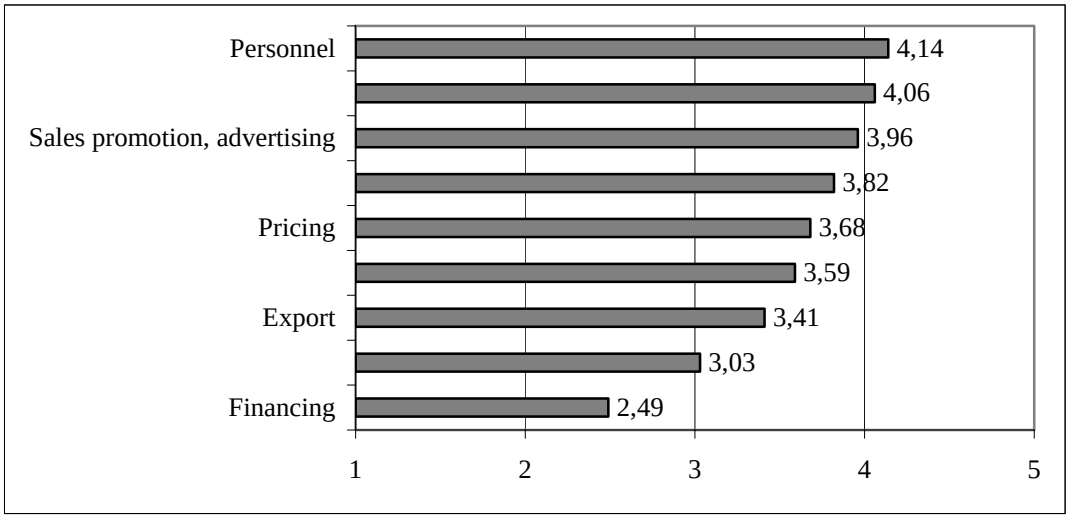


Figure 5.8. Share of decision-making by the foreign investor and the Estonian affiliate* (Foreign Investor ’99; author’s calculations).

*1 – foreign investor makes all decisions; 2 – foreign investor makes most; 3 – joint decisions; 4 – foreign affiliate makes most; 5 – foreign affiliate makes all.

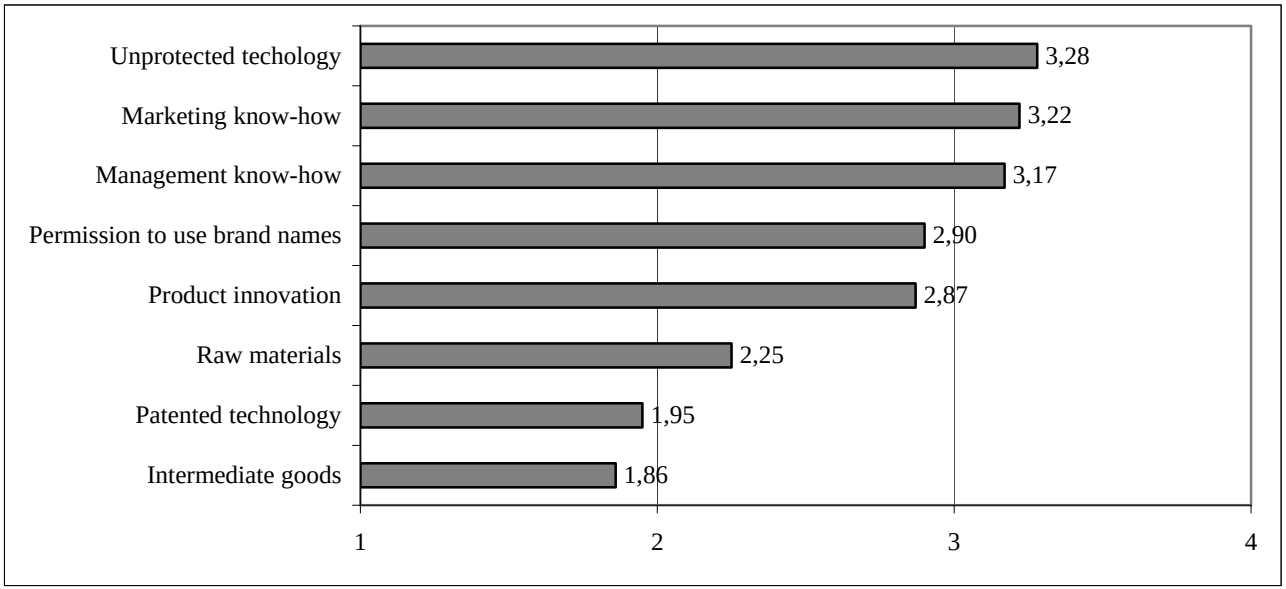
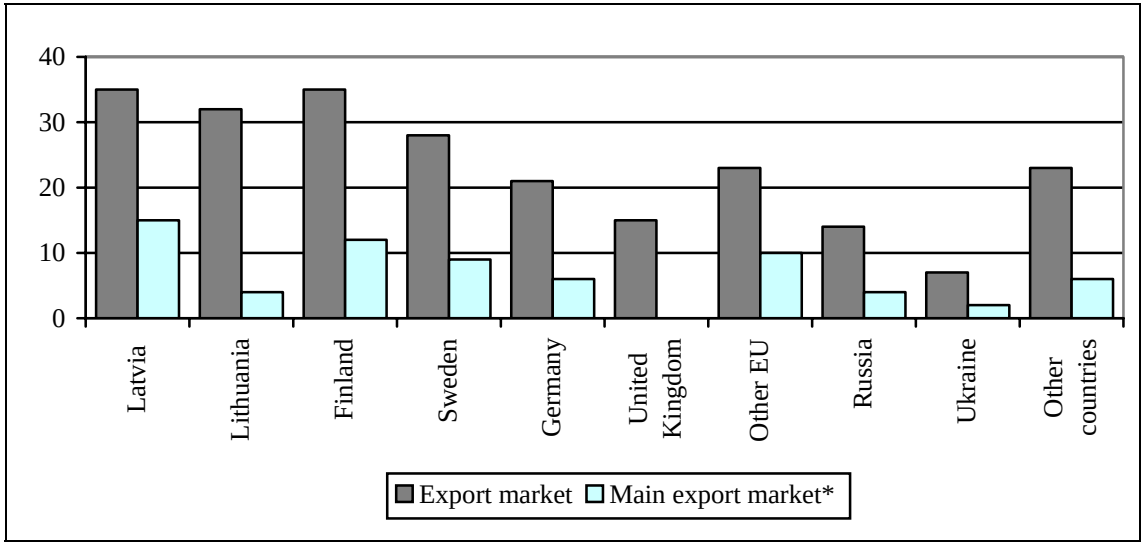


Figure 5.9. Transfer effects accompanying FDI* (Foreign Investor ’99; author’s calculations).

* 1 – no transfer; 2 – unimportant transfer; 3 – important transfer; 4 – very important transfer; 5 – extremely important transfer.



* – the market to which a firm exports the largest share of its production.

Figure 5.10. (Main) export markets of exporting affiliates (Foreign Investor'99; author's calculations).

Table 5.6

(Main) export markets of exporting investors by the investments country of origin*

Export partner	Main investor							Total
	Finland	Sweden	Germany	Denmark	UK	Other EU	Other/ unknown	
Finland	20 (8)	5 (1)	0 (0)	3 (1)	0 (0)	1 (1)	6 (1)	35 (12)
Sweden	9 (3)	10 (6)	0 (0)	2 (0)	0 (0)	2 (0)	5 (0)	28 (9)
Germany	6 (1)	3 (1)	1 (1)	3 (0)	0 (0)	2 (1)	6 (2)	21 (6)
UK	6 (0)	2 (0)	0 (0)	2 (0)	1 (0)	2 (0)	2 (0)	15 (0)
Other EU	4 (0)	4 (1)	0 (0)	6 (5)	1 (1)	3 (1)	5 (2)	23 (10)
Russia	3 (0)	4 (1)	0 (0)	2 (0)	0 (0)	0 (0)	5 (3)	14 (4)
Ukraine	3 (1)	2 (1)	0 (0)	1 (0)	0 (0)	0 (0)	1 (0)	7 (2)
Latvia	16 (9)	7 (2)	1 (0)	2 (1)	1 (0)	1 (1)	7 (2)	35 (15)
Lithuania	17 (3)	7 (1)	0 (0)	2 (0)	0 (0)	0 (0)	6 (0)	32 (4)
Other	9 (0)	3 (1)	0 (0)	1 (1)	1 (1)	3 (0)	6 (3)	23 (6)
Total	93 (25)	47 (15)	2 (1)	24 (8)	4 (2)	14 (4)	49 (13)	233 (68)

* – Main export markets are given in brackets.

Source: Foreign Investor’99; author’s calculations.

foreign firms invest in one of them and then start exporting to the others. The same relationship was also shown by the previous surveys (Vissak, 1998, p. 118; Vissak, 1999, p. 169).

Foreign-owned companies, in turn, have strong relationships with local firms (as shown in Figure 5.2). For instance, in 2000, 57 of them mentioned having local subcontractors (on average, 21.9 per company). If the latter improved their negotiating skills and increased their production capacity, they could gain even more from FDI.

Figure 5.11 presents the future export markets of firms. In total, the exporting investors (24) mentioned 31 countries and areas (on average, 1.3 per firm). For these firms, the main future markets were the Baltic States and the European Union, especially the Nordic countries.

The future expansion plans of firms are presented in Table 5.7. It shows that exporting investors are more interested in expanding their existing facilities than local firms. The same result can be seen from Foreign Investor ’97 (Vissak, 1999, p. 170). On the other hand, rather surprisingly, local exporters are more eager to introduce new products — as indicated by Table 5.8, they are more hindered by all problems than exporting investors. In 1998, the latter had fewer problems with gaps in the legislation and the slow pace of the land reform. Both exporting investors and exporters are strongly influenced by the strong competition on the world markets. For local exporters, all the problems seem more formidable. For example, while lack of information and shortage of financial resources heavily influence local firms, these have no significant impact on exporting investors.

As seen above, there are many differences between exporters and exporting investors. However, it is not possible to see whether there is a direct relationship between FDI inflows and exports. FDI is only one factor that influences exports directly, but indirect effects (like introducing new skills, technology, etc. to local firms) must also be considered. This is probably

the area where foreign investments' impact on Estonian exports may be the largest.

Table 5.7

Firms' future expansion plans in Estonia*

	Exporting investor			Local exporter	
	2000	**1999**	**1998**	**1999**	**1998**
Expanding the existing facility	88	79	81	60	73
Introducing new products	49	51	53	69	73
Entering a new field of activity	34	16	27	27	19
Acquisition	16	9	19	11	17
Finding new production location	14	2	3	9	19
Other plans	0	2	3	7	8

* – % of firms who mentioned at least one kind of future expansion plan.

Source: Foreign Investor '97, '98 and '99, and Top Exporter '98 and '99; author's calculations.

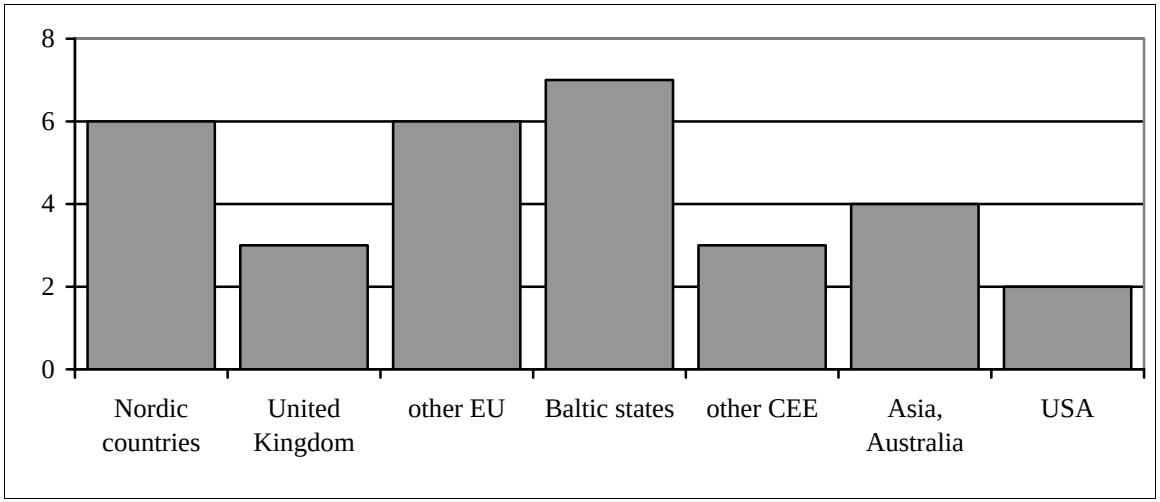


Figure 5.11. Exporting affiliates' potential new export markets (number of firms that mentioned a specific country or area) (Foreign Investor '99; author's calculations).

Table 5.8

Problems hindering exporting affiliates and local exporters*

	Exporting affiliates			Local exporters	
	2000	**1999**	**1998**	**1999**	**1998**
Problems hindering development and/or extension plans					
Quality of labour force	2.40	3.04	3.07	3.51	3.06
VAT payment/rebate procedures	2.82	2.92	3.15	3.57	3.64
Gaps in legislation	2.74	2.57	2.88	2.69	2.77
Slow pace of the land reform	N/A	2.45	2.64	2.51	2.60
Unfair competition	N/A	2.30	2.61	2.92	2.73
Scarcity of raw materials	1.96	1.90	2.02	2.06	2.54
Problems hindering exports					
Strong competition on the world market	3.54	3.73	3.27	4.43	3.94
High costs of production	2.50	2.98	2.38	3.40	3.21
Standards and quality requirements on the foreign markets	2.34	2.27	N/A	3.23	N/A
Shortage of skilled labour	2.28	2.72	2.24	2.83	2.45
Foreign countries' trade barriers	2.27	2.42	2.82	3.09	3.43
Lack of information about target markets	2.22	2.62	2.37	3.20	2.80

	Exporting affiliates			Local exporters	
	2000	**1999**	**1998**	**1999**	**1998**
Insufficient production capacity	2.18	2.21	N/A	2.40	N/A
Shortage of financial resources	2.16	2.53	2.26	3.63	3.28
Shortage of innovative products	1.89	2.26	1.96	2.71	2.51
Low quality of production	1.65	2.16	1.93	2.82	2.47

* 1 – no influence at all; 2 – no significant influence; 3 – a significant influence; 4 – a strong influence; 5 – a very strong influence.

Source: Foreign Investor ’97, ’98 and ’99, and Top Exporter ’98 and ’99; author’s calculations.

Conclusion

Foreign direct investments play an important part in world economy. Studies have shown that FDI inflows affect not only the parent and the affiliate. In fact, many other firms in the home, host and other countries may also gain — they can get linkages to new networks, find new customers abroad or increase their exports to the existing ones. This, in turn, may probably help several of their partners.

Although foreign direct investment inflows without a doubt increase the competitiveness of some firms, their impact on the host country is not that simple. FDIs may bring in capital and technology, furthermore, they can lead to export and, through that, GDP growth. However, their role should not be over-idealized. Whether the result for the host country is a trade deficit or surplus is not absolutely certain yet. Several authors have found that foreign affiliates export more than local enterprises, but, on the other hand, there is some evidence stating that host country imports may grow more than exports (and that, in turn, can lead to a larger foreign trade deficit).

More advanced CEE countries (like Hungary, the Czech Republic, Slovenia and Estonia) could possibly take advantage of the potential benefits of foreign direct investment inflows, and increase their exports. Less advanced ones, on the other hand, should develop their infrastructure, and invest in human resources, or they will get only “low-quality” FDIs, which will not increase their international competitiveness that much and from which local firms will gain less. Still, all CEE countries should welcome export-oriented foreign direct investments, especially if they bring in new technology and knowledge.

The internationalization process is very complex. This chapter covered only a few issues. Much research remains to be done. In order to show whether local firms became more competitive (got more export partners, increased their turnover, etc.) due to

FDIs or whether FDI came into such firms that were already more successful, firm-level data should be gathered. Hence the situation in the same firms before and after FDI (for example, the number of the affiliate's, parent's or local firm's contacts in all country types, their exports and turnovers) should be compared. Such a comparison might give a much better picture of FDI impact on exports.

References

1. **Achrol, R.S**. Changes in the Theory of Interorganizational Relations in Marketing: Toward a Network Paradigm. – Journal of the Academy of Marketing Science, 1997, Vol. 25, No. 1, pp. 56–71.
2. **Aitken, B., Hanson, G. H., Harrison, A. E**. Spillovers, foreign investment, and export behavior. – Journal of International Economics, 1997, Vol. 43, Issue 1/2, pp. 103–132.
3. Balance of Payments, 2001 [http://www.ee/epbe/sdds/ bp_short_eek.html.en].
4. **Battat, J., Frank, I., Shen, X**. Suppliers to Multinationals, Linkage Programs to Strengthen Local Companies in Developing Countries, FIAS Occasional Paper, 1996, No. 6, 32 p.
5. **Blomström, M.** Transnational corporations and manufacturing exports from developing countries. New York: UN Centre on Transnational Corporations, 1990, 124 p.
6. **Branch, A. E.**. Elements of Export Marketing and Management. 2nd ed. London: Chapman & Hall, 1994, 339 p.
7. **Brenton, P., Di Mauro, F., Lücke, M**. Economic integration and FDI: an empirical analysis of foreign investment in the EU and in Central and Eastern Europe. Kiel Institut für Weltwirtschaft Working Paper, 1998, No. 890, 43 p.
8. CzechInvest. The Czech Republic's Foreign Investment Track Record, 1990–1998. Factsheet, 1998, No. 3, 2 p. [http://www.czechinvest.com/fact-sheets/sheet-03.html].
9. Database "Estonian Manufacturing Industries 1995–1999", Tallinn: ESO, 2001.
10. Database on Foreign Investment Enterprises in Central European Manufacturing. Austria, the Czech Republic, Hungary, Slovakia, Slovenia 1993–1996. – Vienna: The Vienna Institute for International Economic Studies (WIIW), 1998, 202 p.

11. **Donkels, R. Lambrecht, J**. The Network Position of Small Businesses: an Explanatory Model. – Journal of Small Business Management, 1997, Vol. 35, No. 2, pp. 13–25.
12. **Dunning, J.H**. Re-evaluating the Benefits of Foreign Direct Investment. – Transnational Corporations, 1994, Vol. 3, No. 1, pp. 23–51.
13. **Ebers, M., Jarillo, C**. The Construction, Forms, and Consequences of Industry Networks. – International Studies of Management & Organization, 1997/1998, Vol. 27, No. 4, pp. 3– 21.
14. EBRD, 1999. Transition Report 1999. Ten Years of Transition. London: EBRD.
15. Exports by main partner countries at current prices, 2001 [http://www.ee/epbe/ makromajandus/13.6.html.en].
16. **Gupta, A.K., Govindarajan, V**. Knowledge flows and the structure of control within multinational corporations. – Academy of Management Review, 1991, Vol. 16, Issue 4, pp. 768–792.
17. **Healey, N.M**. Doing business with Eastern Europe; a situational analysis. – European Business Review, 1994, Vol. 94, No. 3, pp. 3–8.
18. **Hiley, M**. Industrial Restructuring in ASEAN and the Role of Japanese Foreign Direct Investment. – European Business Review, 1999, Vol. 99, No. 2, pp. 80–90.
19. **Hunya, G**. Integration of CEEC manufacturing into European corporate structures by direct investments. – Vienna: The Vienna Institute for International Economic Studies (WIIW), 1998, 18 p.
20. ITC. New Challenges for Trade Promotion: Export Strategies for Small Firms. – International Trade Forum, 1999, No. 1, pp. 9–13.
21. **Kaminski, B**. Hungary's Integration into EU Markets: Production and Trade Restructuring. – World Bank Policy Research Working Paper, 2000, No. 2135, Washington, D.C.
22. **Kogut, B., Zander, U**. Knowledge of the Firm and the Evolutionary Theory of the Multinational Corporation. – Journal of International Business Studies, 1993, Vol. 24, No. 4, pp. 625–645.
23. **Krugman, P**. A Country is not a Company. – Harvard Business Review, 1996, Vol. 74, No. 1, pp. 40–48.
24. **Kumar, N**. Determinants of export orientation of foreign production by U.S. multinationals: an inter-country analysis. –

Journal of International Business Studies, 1994, Vol. 25, Issue 1, pp. 141–56.
25. **Lall, S**. Promoting technology development: the role of technology transfer and indigenous effort. – Third World Quarterly, 1993, Vol. 14, Issue 1, pp. 95–108.
26. **Lankes, H.P., Stern, N**. Capital flows to Eastern Europe and the former Soviet Union, EBRD Transition Working Paper, 1998, No. 27 [http://www.ebrd.org/english/region/WORKINGP/ wp27.htm].
27. **Lankes, H.P., Venables, A.J**. Foreign direct investment in economic transition: the changing pattern of investments. – Economics of Transition, 1996, Vol. 4, No. 2, pp. 331–347.
28. **Lauter, G.P., Rehman, S.S**. Central and East European trade orientation and FDI flows: preparation for EU membership. – International Trade Journal, 1999, Vol. 13 Issue 1, pp. 35–52.
29. **Malecki, E.J., Poehling, R.M**. Extroverts and Introverts: Small Manufacturers and their Information Sources, Entrepreneurship & Regional Development, 1999, Vol. 11, No. 3, pp. 247–268.
30. **Manzocchi, S**. External finance and foreign debt in Central and Eastern European countries. IMF Working Paper, 1997, No. 134, 28 p.
31. **Markusen, J.R., Venables, A.J**. Foreign direct investment as a catalyst for industrial development. – European Economic Review, 1999, Vol. 43, Issue 2, pp. 335–356.
32. **Meyer, K.E**. Multinational Enterprises and the Emergence of Markets and Networks in Transition Economies, CEES Working Paper No. 12, 1998, 28 p.
33. **Meyer, K.E., Tind, A., Jacobsen, M.K**. National Internationalization Processes: SME on the way to Eastern Europe, CEES Working Paper No. 37, 2000, 23 p.
34. **Moini, A.H**. Barriers Inhibiting Export Performance of Small and Medium-Sized Manufacturing Firms. – Journal of Global Marketing, 1997, Vol. 10, No. 4, pp. 67–93.
35. **Narula, R., Wakelin, K**. Technological competitiveness, trade and foreign direct investment. – MERIT Working Paper, 1995, No. 95–019, 26 p.
36. **Rojec, M**. Restructuring and efficiency upgrading with foreign direct investment. – Phare-ACE Research Project “Impact of foreign direct investment on efficiency and growth in CEEC manufacturing, 1998, No. P96–6183r, 26 p.

37. **Singh, H., Jun, K**. Some new evidence on determinants of foreign direct investment in developing countries. World Bank Policy Research Working Paper, 1995, No. 1531, 42 p.
38. **Swamidass, P.M**. Import Sourcing Dynamics: an Integrative Perspective, Journal of International Business Studies, 1993, Vol. 24, No. 4, pp. 671–692.
39. UNECE, Economic Survey of Europe, 2000, No. 2/3, 175 p.
40. United Nations. World Investment Report, 1995: Transnational corporations and competitiveness, 439 p.
41. United Nations. World Investment Report, 1999: Foreign direct investment and the challenge of development, 541 p.
42. **Vissak, T**. Do foreign direct investments have an impact on Estonian exports? – Transformation of economic and political systems in the Baltic Sea region. Selected student papers I, Tartu, 1999, pp. 165–173.
43. **Vissak, T**. FDI and export performance in CEE: A network perspective. – Corporate and Organizational Restructuring. CREEB Sixth Annual Conference, Buckinghamshire, 2000, pp. 424–454.
44. **Vissak, T**. Otseste välisinvesteeringute mõju ekspordile. – Allikas, A., Hein, P., Hellermann, K., Pikk, H., Reiljan, E., Sõro, H., Varblane, U., Vissak, T. Otsesed välisinvesteeringud Eesti majanduses. Tallinn, 1998, pp. 103–119.
45. **Welch, D.E., Welch, L.S**. The Internationalization Process and Networks: A Strategic Management Perspective. – Journal of International Marketing, 1996, Vol. 4, No. 3, pp. 11–28.
46. **Welch, L.S., Luostarinen, R**. Internationalization: Evolution of a Concept. – Journal of General Management, 1988, Vol. 14, No. 2, pp. 34–55.
47. **Wilamoski, P., Tinkler, S**. The trade balance effects of U.S. foreign direct investment in Mexico.– Atlantic Economic Journal, 1999, Vol. 27, Issue 1, pp. 24–37.
48. **Williams, D**. Strategies of Multinational Enterprises and the Development of the Central and Eastern European Economies. – European Business Review, 1997, Vol. 97, No. 3, pp. 134–138.
49. WTO Working Group on the Relationship between Trade and Investment, Communication from the OECD. – 7. August 1997, 19 p.
50. WTO Working Group on the Relationship between Trade and Investment, Implications of the Relationship Between Trade

and Investment for Development and Economic Growth. Work Undertaken in Other Intergovernmental Organizations. Addendum 1.–26. September 1997, 30 p.
51. WTO Working Group on the Relationship between Trade and Investment, Implications of the Relationship Between Trade and Investment for Development and Economic Growth. Work Undertaken in Other Intergovernmental Organizations. Addendum 3.–24. September 1997, 16 p.
52. WTO Working Group on the Relationship between Trade and Investment, Implications of the Relationship Between Trade and Investment for Development and Economic Growth. Work Undertaken in Other Intergovernmental Organizations. Addendum 4.–10. October 1997, 8 p.
53. WTO Working Group on the Relationship between Trade and Investment, The Relationship Between Trade and Foreign Direct Investment: Foreign Direct Investment Originating in Developing Countries. Note by the Secretariat. – 6. March 1998, 6 p.
54. **Yue, C.S**. ASEAN strategies of foreign direct investment and prospects for ASEAN-India investments. – Journal of Asian Economics, 1996, Vol. 7, Issue 4, pp. 701–721.