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INFLUENCE OF FOREIGN DIRECT INVESTMENT ON TOURISM IN CROATIA

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Abstract:
Tourism is one of the most rapidly growing industries in the world. Many developing countries consider it as possibility for raising export earnings. Most important role in the internationalization of production has foreign direct investment. This paper investigates the contribution of FDI (Foreign direct investment) on economic growth, how does it reflect on tourism in Croatia. FDI are important for development of technology, unfortunately most foreign investment went to infrastructure, in terms of high unemployment and stagnating exports priority should be investment in the industrial structure since they have the greatest multiplier effect overall economic growth. Croatian export structure is obsolete. The share of technologically advanced products is small.

Key words: FDI, GDP, tourism in Croatia, foreign investors

1. INTRODUCTION

Croatia is in group with small and open economies which are very connected to other foreign markets. There are several aims which Croatia wants to fulfill: market oriented economy, macroeconomic stability, stable and sustainable economic growth, increase employment etc. Tourism in Croatia is well developed industry, more than 150 years old. Tourism in Croatia begun with construction of first hotels designed for tourists, such as those in Opatija, Dubrovnik etc.. It is often metioned as one of the key roles in croatian economy. In a period between 1965–1975 year was the Golden time of croatian tourism expansion of constructing accommodation facilities. Till 1975 about 69% of all facilities were built and over than 72% of all complementary capacity which were on Croatian disposal in the year 1990. Based on statistical evidence on the whole Croatian territory, including parts of Italy the largest tourism turnover was in 1938, when it was recorded a total of 500 000 tourists who made about 3 million overnight stays, of which 61% related to foreign tourist traffic. Strong involvement of the

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Croatian international tourist exchanges dating from the mid-1960s when the former Yugoslavia comes to the liberalization of travel abroad and a stronger orientation towards commercial tourism instead of the then prevailing social tourism. Since 1991–1995 year it was imposible to develop tourism cause of war, after 1995 tourism again starts to revive. Since independence, the Croatian state by the end of the twentieth century began the privatization and restructuring of tourism offer. Earning from tourism are parts of GDP as it follows: in 1996 9,95%, in 1997 11,38%, in 1998 10,76%, 1999 7,51%, in 2000 10,37%, in 2001 12,03%, in 2002 11,16%, in 2003 16,58%, in 2004 14,74%, in 2005 15,10%, in 2006 14,6%, in 2007 14,09%, in 2008 14,13%, in 2009 12,46%.

Table 1. Tourism in numbers since 2000–2010

	Accommodation capacities, situation as on 31 August				Tourist arrivals, '000			Tourist nights, '000		
		Beds[3]								
	Rooms[2] – total	Total	In collective accomm. facilities	In private accomm. facilities	Total	Domestic tourists	Foreign tourists	Total	Domestic tourists	Foreign tourists
2000.	282921	759057	479232	279825	7137	1305	5832	39183	5138	34045
2001.	289388	786027	480958	305069	7860	1316	6544	43405	5021	38384
2002.	282900	804436	470138	334298	8320	1376	6944	44692	4981	39711
2003.	291904	840706	483069	357637	8878	1469	7409	46635	5312	41323
2004.	299669	871178	496532	374646	9412	1500	7912	47797	5281	42516
2005.	312751	909210	499142	410068	9995	1528	8467	51421	5434	45987
2006.	304022	925882	510734	415148	10385	1726	8659	53007	5985	47022
2007.	326792	944076	512289	431787	11162	1856	9306	56005	6431	49574
2008.	332060	968610	514979	453631	11261	1846	9415	57103	6478	50625
2009.	333237	969726	523372	446354	10935	1600	9335	56300	5799	50501

Source: Statistical Yearbook of the Republic of Croatia for 2010

2. FOREIGN DIRECT INVESTMENT

According to the classification of the IMF and the OECD sub-division of foreign investment is: foreign direct investment, portfolio investment and other foreign investment. Most important role in the internationalization of production has foreign direct investment. Many countries try to reach minimal level of economic development and create supportive business environment in order to attract foreign investors, Croatia is not an exception. What is foreign direct investment? If investor buys at least 10% of stocks in foreign country in order to ensure a lasting interest in an enterprise and considerable influence on its management that could be named as foreign direct investment (Pavlovic 2008). It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. We have two basic types of investing: "brownfield" investments (these are investments in existing companies) and "greenfield" investments (establishments of new enterprises). Depending on the percentage share of foreign investor/owner business investments are variously called a) branch if company is in absolute ownership, b)

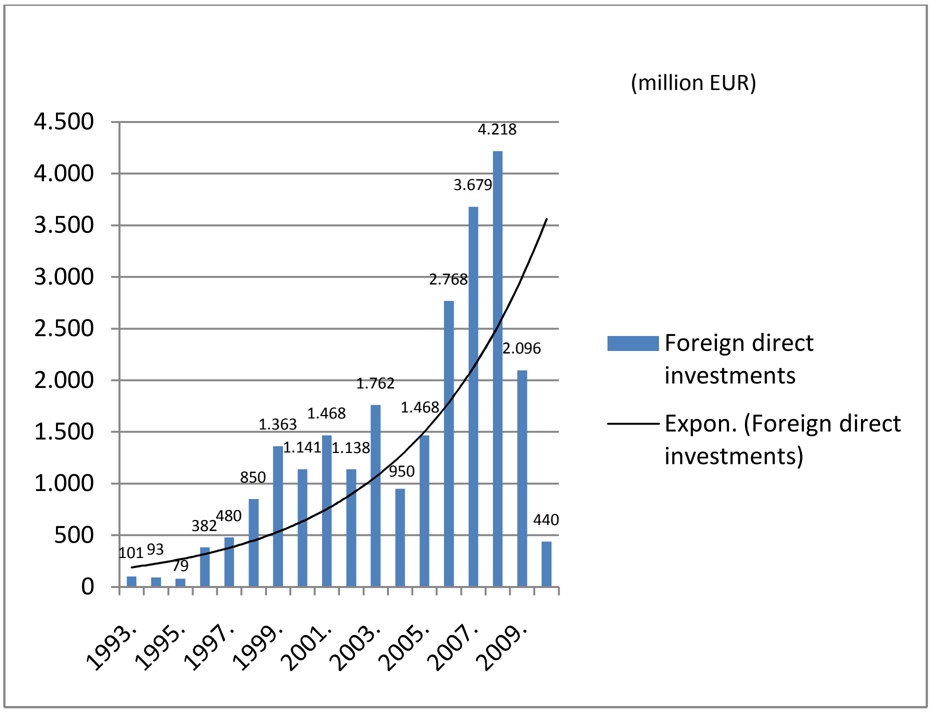
[2] Including moorings since 1991, apartments since 2002 and camping sites since 2004.
[3] Permanent and temporary beds.

subsidiary when company is owned more than 50% and c) associate when a share is 10-50% direct ore indirect ownership abroad (Sisek 2005). What are the essential prerequisites of FDI? Important determinants of country attractiveness to foreign investors are: a good basis infrastructure, connectivity with other countries economy, political stability and legislation of the country, the stability of the tax system and incentives (Skabic and Zubin 2009). What are the advantages of foreign direct investment? FDI stimulates economic growth more than other types of capital inflows. They offer: modern technologies, know-how, they ensure a number of employment opportunities. The most important global investors are economically the strongest companies in developed countries. What are portfolio direct investments? Portfolio direct investments are those investments in which an investor buys securities or shares of each company, but up to 10% of the total enterprise. For an example some products, like cars for instance, there is now almost impossible rationally to produce all the components (of which the car is consisted of) only in one country because there was such internationalization and specialization of production that is no country in which they produce all the parts needed for installation in such a complex product. Other foreign investments include foreign (financial and trade) credits residents between of two or more countries (Sisek 2005). Difference can also be made between horizontal and vertical foreign direct investment. Horizontal foreign direct investment is investment where firms duplicate roughly same activities in multiple countries, distinguished from vertical FDI where firms locate different stages of production in different countries (Ramkishen and Kenneth 2008).

3. FOREIGN DIRECT INVESTMENT IN CROATIA

In the nineties the government sold state enterprises to domestic investors, the shares distributed to different categories of citizens or at minimal charge, because of lack of knowledge of many business enterprises are ruined, the workers were dismissed and the company sold assets, consequence off all was the decrease: in industrial production, GDP and a large fall in employment. After 1995 years comes to the growth of FDI in portfolio in GDP in Croatia. By the rapid growth of FDI in Croatia's portfolio is the result of the privatization process by 1995 years after they invaded the largest Croatian companies and banks (Pavlovic 2008). In graph 1below it can be seen foreign direct investment in Croatia from 1993 until 2010. Croatia is in group of countries that have attracted most FDI per capita. The highest growth was recorded between 1995 and 1996 – 483% when FDI soared from 79 mln € to 382 mln € in the corresponding period of the greatest investment has been made in 2008 about 4 billion 218 mln in 2009 that amount dropped to 50% to 2 billion 96 million €. In 2010 it was felt even greater decline from previous year by 80% to just 440 million €. In the period from 1999–2007 there was 15.6 billion € invested or 88% from 1993, this is not unusual because in that period large companies such as Croatian Telecom and banks were privatized.

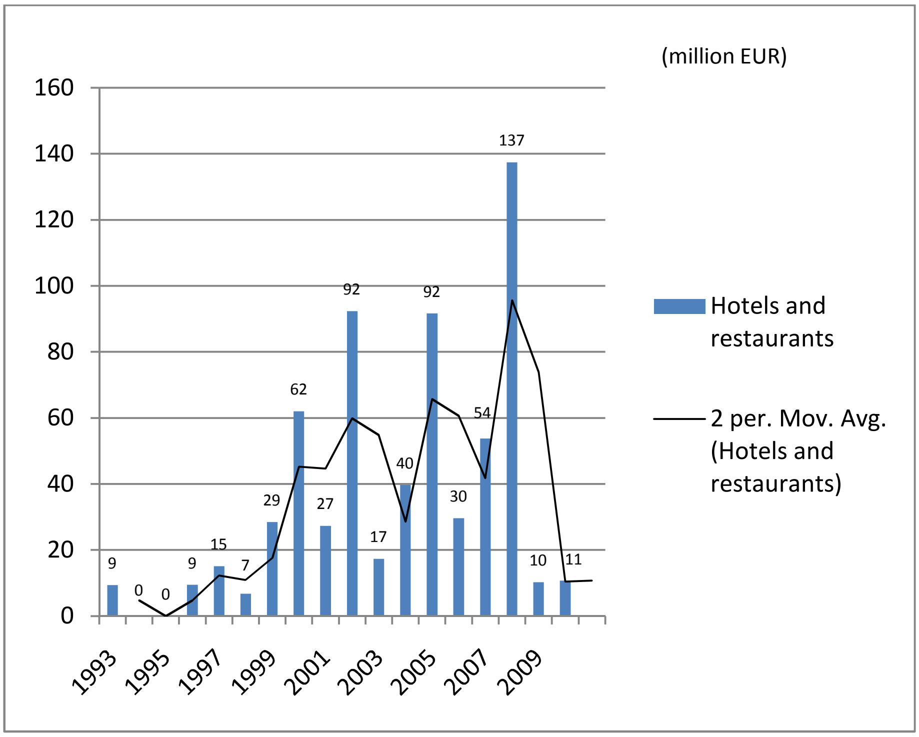
Figure 1. Foreign direct investment in Republic of Croatia



Considering FDI in Croatia sorted by activities it can be concluded that most investments in the period 1993 to 2010 went to financial intermediation, (except insurance and pension funds) 35.2%, followed by wholesale trade and commission trade 11.37%, manufacture of coke refined petroleum products 6.53%, real estate activities 5.74%, Post and Telecommunications 5.11%, Retail trade, (except of motor vehicles and motorcycles) 4.87%, manufacture of chemical products 3.13% also in manufacture of other non-metallic mineral products, hotels and restaurants 2,62% since 1993- 641mln € invested. Manufacture of food products and beverages 1,49% about 365 mln € invested. Structural investment continues to be unsatisfactory. Production and export make up only 21% of investment in fixed capital. If the export is analyzed it can be noticed that only 19,8% in 1999 and 28,2% in 2007 of export is consisted of medium and high technology products (OECD classification) unlike EU 6[4] where it is 38,8% in 1999 and 45,4% in 2007 (Council 2008). Graph 2 below shows the value of investing in period 1993-2010 year. It can be concluded that investments in restaurants and hotels, gradually grow, in 2008 reaching its maximum investment of 137 mln € in 2009 and 2010 the fall in investments of only 10 mln €, but for 2010 these are preliminary data.

[4] EU 6 selected countries: Slovenia, Hungary, the Czech Republic, Slovakia, Bulgaria and Romania.

Figure 2. Foreign direct investment in Croatian Hotels and restaurants



4. FOREIGN INVESTORS

There are several motives that encourage foreign investors: market- seeking, efficiency-seeking, resource- seeking, asset-seeking. Market-seeking means that investors can penetrate new markets or maintain existing ones. Resource seeking means investments which seek for factors that are more efficient than domestic factors for example countries that are looking for cheap labor or natural resources like (oil, coal, gas, petroleum etc.). Efficiency seeking are investments which take advantage of lower cost structure for example offshoring other words optimizing by moving company to locations where lower costs are and where access to export markets is. It is considering that transfer of technology and knowledge from developed countries that comes with FDI will increase efficiency of domestic companies and based on that have positive impact on economic growth. According to the table 2 shown below; Austria is the leader according to the level of foreign direct investment in Croatia, one of the most important Croatian partners in the area of foreign trade, direct investment, tourism and financial and banking cooperation. Austrians in Croatia mostly invested in Croatian financial sector, telecommunications, manufacturing, sanitary ceramics, concrete and gypsum, in insurance sector and in trade, there is also growing number of strategic investors in the industry and in tourist services.

Table 2. TOP 10 foreign investors in Croatia by country of origin since 1993

		(million EUR)	
1	AUSTRIA	**6.226,2**	25,4%
2	NETHERLANDS	**3.706,0**	15,1%
3	GERMANY	**2.930,6**	12,0%
4	HUNGARY	**2.330,2**	9,5%
5	LUXEMBOURG	**1.371,3**	5,6%
6	FRANCE	**1.369,7**	5,6%
7	ITALY	**1.178,4**	4,8%
8	SLOVENIA	**1.155,5**	4,7%
9	NETHERLANDS ANTILLES	**885,7**	3,6%
10	BELGIUM	**538,3**	2,2%
	OTHER	**2.783,0**	11,40%

Source: http://www.hnb.hr/statistika/hstatistika.htm (accessed 08.01.2011)

5. RELATIONSHIP BETWEEN GDP, FDI AND UNEMPLOYEMENT RATE

Data were collected in the range of years from 1996 to 2010 from Croatian central bank (GDP, GDP per capita, GDP annual growth rate in €, FDI, share FDI in GDP and unemployment rate), during that period it is analyzed the ratio of foreign direct investment relative to GDP. If we look last 10 years GDP has doubled, it can also be noticed that biggest growth of GDP is achieved in 2008, as a result the economy grew in 2008 at a rate 2,4% which is below the average of Central and Eastern European (CEE) countries of 4,7% and also below the growth rate of 6% for the neighboring countries in Southeastern Europe (SEE). Similar results are evident when analyzing the period from 2005 to 2008. The Croatian economy grew at average annual rate of 4,8% while SEE countries grew at average annual rate of 5,7% and CEE countries grew at a rate of 6,2%.

Unemployment has declined from 16% in 2000 to only 8,4% in 2008. Correlation between unemployment rate and foreign direct investment is calculated by Pearson correlation coefficient formula (1).

$$r = \frac{\mu_{11}}{\sigma_x \sigma_y} \tag{1}$$

When the Pearson linear relationship (correlation) is +1 it is perfect positive, when it's negative it means higer score in one variable means a lower score in the second variable. In our case it is -0,4 it is moderate negative correlation (Cohen 1988). According (Hunya i Skudar 2006) impact of FDI on employment does not exist employment generally fell at foreign acquired companies in the first years after acquisitions. Correlation between Gross domestic product and foreign direct investment is 0,86 by Cohen it is positive and very large.

Table 3.: GDP, FDI and unemployement rate in Republic of Croatia

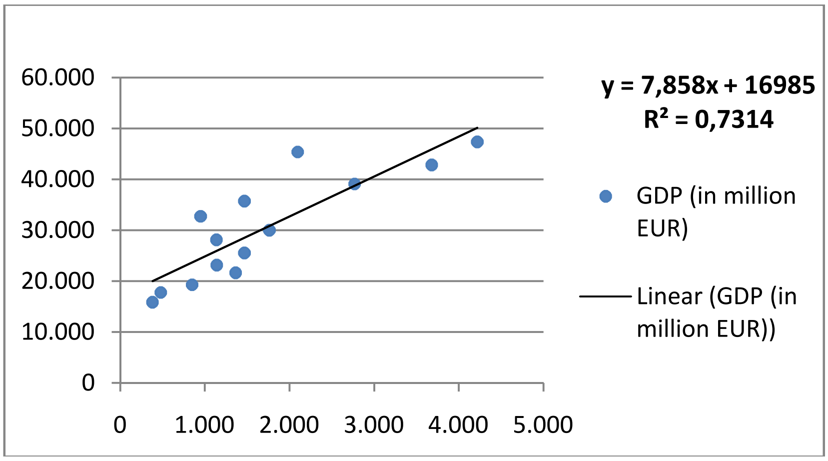
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP (in million €)	15.869	17.790	19.281	21.638	23.146	25.538	28.112	30.011	32.725	35.725	39.102	42.833	47.370	45.379
GDP per Capita €	3.531	3.891	4.284	4.751	5.229	5.752	6.331	6.759	7.380	8.043	8.807	9.656	10.683	10.245
GDP (ann. growth rate in €)	5,90%	6,80%	2,50%	-1,50%	3,00%	3,80%	5,40%	5,00%	4,20%	4,20%	4,70%	5,50%	2,40%	-5,80%
FDI (in millions €)	382	480	850	1.363	1.141	1.468	1.138	1.762	950	1.468	2.768	3.679	4.218	2.096
Share FDI in GDP	2,41%	2,70%	4,41%	6,30%	4,93%	5,75%	4,05%	5,87%	2,90%	4,11%	7,08%	8,59%	8,91%	4,62%
Unemployement rate (by definition of ILO)	10,0%	9,9%	11,4%	13,6%	16,1%	15,8%	14,8%	14,3%	13,8%	12,7%	11,2%	9,6%	8,4%	9,7%

Source: http://www.hnb.hr/statistika/hstatistika.htm (accessed 08.01.2011)

In the graph 3 it is shown regression analysis foreign direct investment impact on gross domestic product. The result of regression coefficient β is 7,858 which would mean for an increase of FDI by 1% it would affect by increase GDP by 7,858%

R^2 is often called the coefficient of determination, it is defined as the ratio of the sum of squares explained by regression model and the "total" sum of squares around the mean. Coefficient of determination shows that the simple linear regression model explained 73,14% of all deviations. The model is more representative as the coefficient of determination is close to number 1(Sosic 2004).

Figure 3. Linear regression (influence FDI on GDP)



CONCLUSION

Foreign direct investment in Croatia did not bring positive effects as we expected. Most of the foreign investments in Croatia mainly were directed to mergers and acquisitions of existing companies. Look back in history (last 17 years) of Croatian economy: financial intermediation (except insurance and pension funds), wholesale trade and commission trade, post and telecommunications, retail trade (except of motor vehicles and motorcycles), hotels and restaurants this five service industry make the sum of 59,2% total foreign direct investment in Republic of Croatia. Only a small part of investment went to Greenfield investments most of the investment went to Brownfield investments. Main aim of Brownfield investments is to make company more profitable and the easiest way is downsizing (reducing the number of employees) best example in Croatia is HT company (Croatian telecom), 1999 Deutsche Telekom bought 35% of HT company for 850 mln $ and after 2001 another 16% for 500 mln $ (Deutsche Telekom total has 51% stocks) it has a plan till 2014 have 5000 employees, just to remember in 2002 it had 11300 employees. Nevertheless these mergers and acquisitions did not lead to expansion the regional markets and did not contribute any significant increase in employment, because increase in foreign direct investment does not mean positive impact on economic growth, but it depends on a various number of other factors for example; human capital, development of the financial system or the flow of FDI in the secondary sector. It can be concluded that foreign direct investment makes difference in the improvement or deterioration of certain economic variables it depends are they Brownfield or Greenfield investments. Due to the small share of Greenfield investments there is absent of the expected positive results except that cause of failure lies also in the overall economic system in the absence of a strategy and vision. Considering the poverty of available domestic saving and new investment cycle in large part to rely just on direct foreign investment, one at the same time make additional capital for development and transfer of technology and knowledge.

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