Phare

Sector paper

# Investment promotion, export development and tourism

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Sector paper

# Investment promotion, export development and tourism

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# Foreword

This paper is part of a series which covers each of the main areas of Phare activity. It describes the nature of the problems faced in Phare's partner countries during their transition from planned to market economies. It goes on to examine actions undertaken to date, and to assess their impact on the transformation process.

There is clearly a need to ensure that the approach being taken in any given sector is relevant to the longer-term goals of economic transformation. For this reason, these papers contain the thinking of those responsible for operating Phare on actions for the future and how Phare should contribute to the next phase of the transition.

The papers do not reflect any official position of the European Commission. They have been written by the Phare operational units and are intended as a stimulus to discussion for all those involved in the debate on economic transformation in central Europe.

Sipke Brouwer

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# What is Phare?

The Phare Programme is a European Union initiative which supports the development of a larger democratic family of nations within a prosperous and stable Europe. Its aim is to help the countries of central Europe rejoin the mainstream of European development through future membership of the European Union.

Phare does this by providing grant finance to support its partner countries through the process of economic transformation and strengthening of democracy to the stage where they are ready to assume the obligations of membership of the European Union.

In its first five years of operation to 1994, Phare has made available ECU 4,248.4 million to 11 partner countries, making Phare the largest assistance programme of its kind.

Phare works in close cooperation with its partner countries to decide how funds are to be spent, within a framework agreed with the European Union. This ensures that Phare funding is relevant to each government's own reform policies and priorities. Each country takes the responsibility for running its own programmes.

Phare provides know-how from a wide range of non-commercial, public and private organisations to its partner countries. It acts as a multiplier by stimulating investment and responding to needs that cannot be met by others. Phare acts as a powerful catalyst by unlocking funds for important projects from other donors through studies, capital grants, guarantee schemes and credit lines. It also invests directly in infrastructure, which will account for more Phare funds as the integration process progresses.

The main priorities for Phare funding are common to all countries, although every one is at a different stage of transformation. The key areas include restructuring of state enterprises including agriculture, private sector development, reform of institutions, legislation and public administration, reform of social services, employment, education and health, development of energy, transport and telecommunications infrastructure, and environment and nuclear safety.

For countries which have signed Europe Agreements, Phare funding is focused on meeting the conditions required for eventual membership of the European Union. In particular this concerns preparation for participation in the European Union's internal market and development of infrastructure, especially in border regions.

# Executive summary

This sector paper presents an overview of Phare's activities in the fields of investment promotion, export development and tourism, and examines strategic orientations for future action.

The first part of the paper analyses the role of investment promotion, export development and tourism in central Europe and briefly describes the background to the development of these activities. Although export and tourism were not entirely unknown in the partner countries, the approach was very different to that used in established market economies. Investment promotion, however, is an entirely new area, since foreign direct investment was not encouraged before 1989. The need for know-how is analysed in the light of recent political and economic activities.

The second part of the paper gives an overview of Phare's activities in the three areas, and describes the work undertaken by country and by activity. One of Phare's key objectives is to provide the necessary foundations to allow development to continue once Phare support ceases.

The third section assesses the Phare Programme in the three areas. The programmes are all designed to have a lasting effect on the overall economy and it is thus too early to estimate fully their successes. However, good progress is evident at institutional level where many improvements have already been made and, especially in the field of foreign investment, entirely new institutions have been set up over the last three years.

The fourth part evaluates the existing constraints in the three programmes. Their establishment and implementation have been a challenge owing to inadequate policies at government and regional levels. This naturally influences the choice of future orientations which depend on future government commitment with regard to both general policy backing and funding; it has so far been difficult to obtain sustained budgetary commitment from the partner governments for the programmes.

Phare support for these programmes is limited in time and governments will have to cover most of the costs in the future. Although some contribution from the private sector can be expected in the export development and tourism sectors, investment promotion has to be funded from the public purse.

In future, both governmental policies and Phare programming will have to take a more integrated approach to all programmes concerned with economic development. This will mean that programmes such as investment promotion, export development and tourism will have to be closely interlinked and integrated with small and medium-sized enterprises (SMEs) and regional programmes. An overall economic policy in central European countries which integrates the development activities currently supported by Phare would be a step in the right direction.

# Introduction

To develop a strong, dynamic private sector, economies in transition need to attract foreign investment and develop their export capacities. In many cases, a strong tourism industry is crucial. Its labour-intensive nature makes it an excellent provider of jobs and it brings in much foreign exchange. Even in mature economies, like those of the European Union (EU), foreign investment and revenue from exports and tourism are major contributors to the economy.

It is only recently that these facts, seen as self-evident truths by economists the world over, have been recognised in central Europe. Communist regimes viewed foreign investment with deep suspicion if not outright opposition. Exports to open economies were few and were handled exclusively by secretive state-owned foreign trade organisations (FTOs). Tourism was seen as a social benefit, not an economic activity, and, with the possible exception of Bulgaria, no government made any serious attempts to use it as a hard-currency revenue-earner.

The collapse of the command system ushered in some much-needed changes. Today, governments want to attract foreign investment. But there are obstacles: a residual fear of foreigners taking over the family silver and a significant lack of experience. Policy and legislation are rarely designed to attract foreign investors. Governments do not always define clearly the objectives needed by administrators to select target sectors and to set goals for the promotion of foreign investment. Likewise, the promotion of a country's exports and the development of tourism are areas were the will is still greater than the skill, as anyone receiving the brochures of certain national tourism offices can testify.

Investment promotion, export development and tourism all involve international collaboration. This is a benefit of a more intangible nature than hard cash, but is nevertheless almost as important for the countries concerned. Enlightened self-interest now means that cross-border relationships are being developed at all levels - a far cry from the "go-it-alone" spirit that proved a natural reaction throughout the region to forty years of enforced socialist brotherhood.

All three sectors have been a priority for Phare since its inception. Phare-funded activities have been undertaken by every partner country, either alone or as collaborative ventures. A major element of the resulting work has dealt with strategy and policy formulation. Why? Governments usually decide to promote foreign investment, develop export capacities or attract tourists to boost a sector, a region, or even the country's economy as a whole. Initiatives tend to be included in overall economic development plans which often set themselves the goal of curbing unemployment and boosting growth. Government support tends to be required because the activities involved are on a national scale, are too costly for industry bodies to finance alone and because they frequently require institutional and legislative change, something Phare is ideally placed to support.

This paper tackles all three subjects together because of their similarities. For a start, achieving results in any of the three involves promotion. Attracting foreign investors and encouraging exports are closely related: exports can lead to the customer investing in the supplier, and the ability to export competitively will be boosted by investment. Tourism, finally, needs foreign capital as much as it needs expertise and is likely to be a country's largest source of invisible exports.

# Background

## Investment promotion, export development and tourism: keys to reform

### Investment promotion

Foreign direct investment is essential to ensure the successful transition to a prosperous market-based system. There are many reasons for this. To start with, capital is a scarce and expensive commodity in central Europe. External financial resources are vital to the capitalisation of the region's companies. Direct foreign investment carries a bigger commitment than equity, loan or portfolio instruments. Foreign investors bring in foreign managers and thus managerial skills. Their investment facilitates the transfer of know-how and brings new skills to the workforce. Acquiring new technologies through foreign direct investment is almost always cheaper and easier than getting them in any other way, all the more so because they are often provided along with the know-how required to use them. Foreign partners provide access to existing distribution channels, and there is an important ripple effect as local companies become subcontractors to the foreign venture. Finally, they generate jobs.

In order to attract an investor's capital, policies must be in place which allay his greatest worries: security and profitability. Constantly changing policies and economic instability are factors which will deter the investor. Recognising this, most of the region's countries have developed a legal framework to safeguard investments and have defined sound macro-economic and institutional policies.

Foreign direct investment is a sensitive issue in central Europe. The foreign investor is too often seen as a sly exploiter, getting rich through the unfair acquisition of a country's industrial pride and joy. The storm of indignation that swept through Britain at the news of BMW's purchase of Rover shows that these reactions are not limited to economies in transition. Nevertheless, their governments will generally have greater difficulties explaining the virtues of foreign investment to their populations.

### Export development

Healthy exports are essential to any country. They are important enough to large, more self-contained economies such as that of the United States, but become absolutely vital to medium-sized and small countries like those in central Europe, whose dependence on imports for essential goods must be financed in some way. There are other benefits too. Exports contribute to the general economic development of a country, they boost competitiveness by stimulating the development of new products, new distribution channels and new marketing skills, and they help new companies to establish themselves by giving them ready access to foreign markets. Finally, bigger exports nearly always mean more jobs, an important benefit as privatisation and the cut and thrust of competition throw unproductive labour onto the streets.

### Tourism

Most Phare partner countries have a wealth of lovely landscapes, quaint villages, ancient cathedrals, unique museums, towering castles, baroque palaces and friendly people - in other words, assets that could provide the foundations for a thriving tourism sector. However, this quintessential service industry can only be developed in a friendly environment, which, more often than not, means proactive government policies.

Traditionally, government tourism policy dealt with economic and social issues. In recent years, environmental issues have also risen to the fore and, today, the bulk of government intervention is focused on these three areas. Economic policies aim to maximise revenue. This means not only attracting more foreign visitors, but also attracting the right kind of visitor. Social policies, which are mostly there to promote domestic tourism, have the beneficial side-effect of limiting currency outflows. Finally, a decent environment, whether rural or urban, is essential to attract visitors. Research shows that this is a determining factor in most people's choice of destination, ahead of any other except price. Government policy will therefore aim to protect attractive environments and restore damaged ones.

Tourism has had a bad press in recent years, but it must not be forgotten that it is an industry with many positive side-effects. Spanish resorts notwithstanding, tourism generally encourages and rewards good environmental management. It attracts foreign exchange and provides jobs. As an industry composed mostly of SMEs, tourism can help more budding entrepreneurs get their feet onto the first rung of the enterprise ladder than almost any other sector. Together, these effects turn tourism from a mere industry into a powerful catalyst for economic reform.

Although tourism's benefits have been recognised by several central European countries, most governments have yet to formulate a coherent development policy. In particular, the need to coordinate basic infrastructural investments, such as roads, with the needs of the industry still needs to be fully recognised.

# Current situation

## Investment promotion

Before 1989, it was almost impossible to invest in central Europe. With the exception of Hungary, countries grudgingly accepted foreign investment only under conditions which were so restrictive that all but a few investors chose to ignore the region. Hungary's "goulash communists" changed their legislation in the late 1970s and early 1980s to encourage joint ventures, but the remainder of the central European countries did not adopt similar policies until 1990. Today, foreign investment is encouraged in a whole range of activities, from privatisation projects and joint ventures to 'green field' investments.

Consequently, net foreign direct investment (FDI) expanded in all 11 partner countries and was estimated to amount to US$ 9,826 million at the end of 1993. However, the figures per capita are still low, even by emerging market standards, as a comparison with Portugal shows.

### Table 1 - Foreign direct investment

| | | 1989 - 1994[1] | |
|---|---|---|---|
| | million US$ | % share of regional FDI | FDI per head of population per year[2] (US$) |
| Albania | 786 | 1.7 | 58 |
| Bulgaria | 1,028 | 2.2 | 22.8 |
| Czech Republic | 6,825 | 14.7 | 169 |
| Estonia | 702 | 1.5 | 87 |
| Hungary | 18,757 | 40.5 | 296 |
| Latvia | 768 | 1.7 | 56 |
| Lithuania | 315 | 0.7 | 17 |
| Poland | 9,013 | 19.4 | 48 |
| Romania | 2,584 | 5.6 | 22 |
| Slovakia | 995 | 2.1 | 58 |
| Slovenia | 4,578 | 9.9 | 383 |
| Total | 46,351 | 100 | |
| Portugal[3] | | | 675 |

Source: OECD

1 1994: registered projects. These figures must be treated with caution: with the exceptions of Hungary and Slovenia, none of the countries listed report figures for the full six-year period.
2 averaged out over the number of years for which each country reports figures.
3 1993 only.

The recession in the early nineties adversely affected the growth of foreign investment. It led to a global decrease in FDI as companies shelved investment plans. This particularly affected central European countries and, even today, investors are still very cautious when evaluating the region.

Other factors impede the growth of FDI. They include the following.

- Risk. For many investors, the potential return is not high enough to offset the perceived economic and political risks of investing in central Europe.
- Legislation and procedures. There is still too much antiquated legislation on the books, frightening investors with communist-era rules. Getting approval for an FDI project can be a lengthy and arbitrary process. Even in countries with up-to-date legislation, the judicial system is still not capable of dealing with potential conflicts.
- Operational environment. Investors don't like the lack of infrastructure, telecommunications, adequately trained staff, or fully functioning banks.
- The information gap. There is almost no information available to potential investors about the opportunities in central Europe. Market information, for example, has only been properly compiled for the last few years.

## Legal framework changes in central Europe

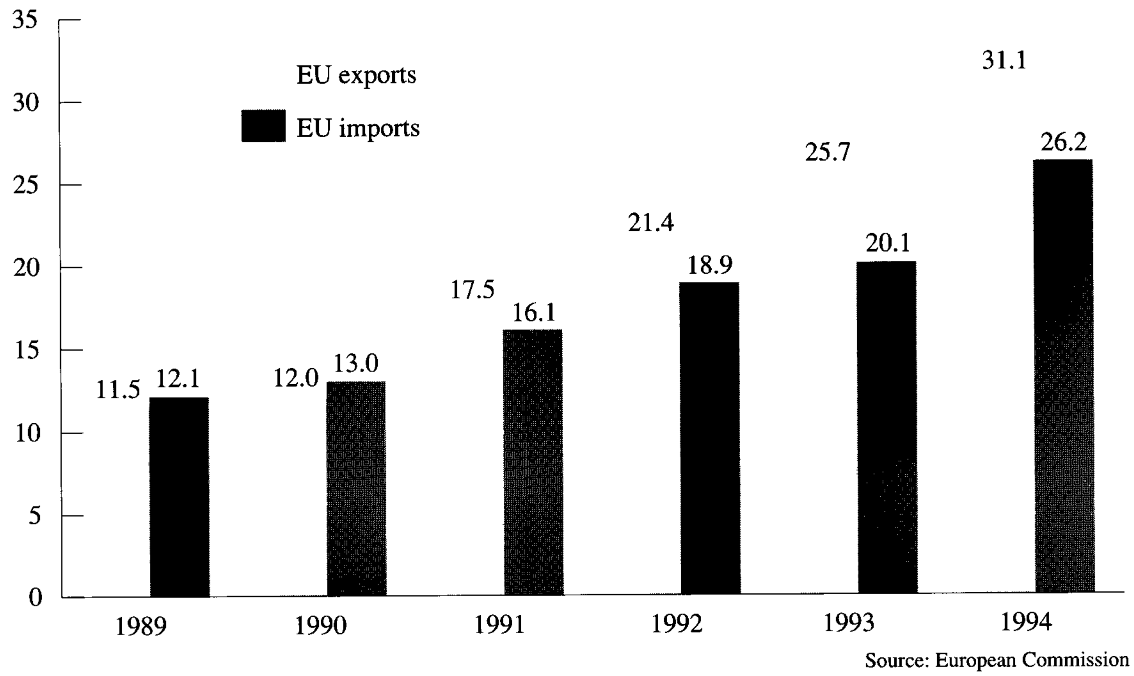
Several central and eastern European countries adopted new FDI legislation after 1989. Approaches vary from country to country.

Under Czech, Slovak and Magyar law, all registered companies are treated under the commercial code, irrespective of their ultimate ownership. Permission is needed to invest in specific sectors, but in most cases this also applies to domestic investors. Opening branches is already permitted, or will be in the near future.

Poland requires special permission for FDI in a number of sectors and does not yet allow the establishment of branches.

Romania and Bulgaria both permit branches to operate. Any foreign investment must follow set approval and registration procedures. Several sectors are excluded or restricted.

**Figure 1 - EU trade with Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia (billion ECU)**




Source: European Commission

## Export development

Until 1990, central European countries traded almost entirely within Comecon, all of whose members had centrally-planned economies. Because of the over-specialisation of producers, the lack of innovation and the emphasis on quantitative rather than qualitative production targets, only a limited number of Comecon goods could find buyers on open international markets.

Formerly, most trade from central European countries had been with the Soviet Union, and not between the countries themselves. Although volumes could be very high, this trade did not affect the west. The change since has been radical, with large increases in trade with the OECD countries, and in particular with the European Union.

A chain reaction led to this revolution in trading habits. The crumbling of Comecon led to the imposition of hard-currency trading, precipitating the collapse of trade with the USSR. This in turn led to a scramble to trade with the OECD, which was reinforced by the clamour for western goods from central Europeans hitherto starved of quality consumer goods.

Central European exporters now face radically new standards of competition. Price, quality and service are the new keys. However, despite the changes that have already taken place, exporters are still burdened by the legacy of the former economic system. The following factors prove particularly disabling.

- The legacy of the centrally-planned organisation of foreign trade. Foreign trade organisations (FTOs) alone conducted negotiations and exports, thereby restricting direct contact between the foreign customer and domestic supplier. As a result, after 1989 the only people to know anything at all about exporting were the employees of FTOs. The lack of in-house expertise is still hampering many potential exporters.
- Few market skills. Enterprises worked according to a plan which usually ignored demand and market needs entirely. Not surprisingly, marketing and customer service were unknown concepts, and are only now becoming established in the region.
- Lack of relationship between price and quality. Although the prices of export goods tended to be low (thanks to low wages, subsidised energy and bizarre accounting practices), they were often not low enough to offset the poor quality of the products, the unreliability of deliveries and the absence of customer service.
- Little support for exporters. Because FTOs were state-owned, there was never any need to develop export guarantee or credit insurance schemes. Expertise in these fields, essential when trade is mostly between private parties, was absent and remains so to a large extent. Exporters are further hampered by the undeveloped banking sector.

## Table 2 - Foreign trade of central European countries[1]

| | Exports to (%) | | Imports from (%) | |
|---|---|---|---|---|
| | **1989** | **1994** | **1989** | **1992** |
| EU | 21 | 44 | 19 | 42 |
| ex-Comecon | 51 | 28 | 51 | 29 |
| EFTA | 7 | 10 | 10 | 13 |
| USA | 2 | 3 | 1 | 4 |
| Japan | 1 | 1 | 1 | 2 |
| other[2] | 18 | 14 | 18 | 10 |
| **Total** | **100** | **100** | **100** | **100** |

Source: UNCTAD

1 Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia.
2 Includes unattributed trade.

## Tourism

The development of the central European tourism industry has so far been rather disappointing. The overall market share of central Europe is decreasing. In Bulgaria and Romania the number of foreign visitors actually fell after 1990. Hungary also experienced a fall. Tourism has remained static even in the Czech Republic, despite the deserved popularity of Prague.

Although tourism depends to a large extent on general economic conditions, there are regional reasons to explain these disappointing trends. Under communism, tourism, a social benefit, never became the sophisticated service industry known in the rest of the world. Though attempts were made in Bulgaria and Romania to offer facilities of sufficient quality to attract western visitors, these were inadequate and forced both countries to compete solely on price. To build a strong tourism sector, standards in all areas, including service, management skills, and the environment, need major improvements.

With a few exceptions, such as former recreation centres for the military and some health resorts, little was invested in tourism. Facilities are thus fairly basic. The state of the infrastructure doesn't help either: poor transport and communications links make getting out of capital cities hard. Hotels, restaurants, information centres and other facilities specifically designed for visitors are being upgraded only sporadically and slowly, if at all. Foreign investment has so far been disappointing.

If it is to grow, central European tourism will need support. Its future health requires the rapid development of the necessary infrastructure, which means not only roads, airports, water supply and so forth, but also proper legislative, institutional and promotional frameworks. For example, certification systems, to be effective, will need to be set up, monitored and enforced with governmental support.

Other areas of positive governmental intervention include training and promotion. Governmental institutions, whether national or regional, are probably the only organisations in the region which have the structures required to deliver decent training products, but lack the commercial skills to do so effectively. Some useful western European practices - governmental initiatives to promote the country abroad, the government and private sector cooperating through national tourism boards - are still underdeveloped in central Europe. Governments will have to become more active and need to develop policies that genuinely respond to the sector's needs. This is beginning to happen in Poland and, to a lesser extent, in Romania and Hungary, but is proving to be the exception rather than the rule.

### Table 3 - Tourism development in central European countries

| | Arrivals (million passengers) | | Year-on-year change (%) | | Market share | |
|---|---|---|---|---|---|---|
| | 1991 | 1993 | 91/90 | 93/92 | 1991 | 1993 |
| Bulgaria | 4 | 3.8 | -11.1 | 2 | 1.4 | 1.3 |
| Czech Republic & Slovakia | 8.2 | 8.1 | 1.2 | 0.8 | 2.9 | 2.7 |
| Hungary | 21.9 | 22.8 | 6.6 | 12.9 | 7.9 | 7.7 |
| Poland | 3.8 | 4.2 | 11.8 | 5.1 | 1.4 | 1.4 |
| Romania | 5.4 | 5.8 | -18 | -7.9 | 1.9 | 1.9 |
| Ex-USSR | 6.9 | 6.2 | -4.3 | -9.6 | 2.5 | 2.1 |
| CEECs | 50.1 | 51 | -0.3 | 3.6 | 18 | 17.2 |
| **Total Europe** | **279.8** | **287.6** | **-2.2** | **1.5** | **100** | **100** |

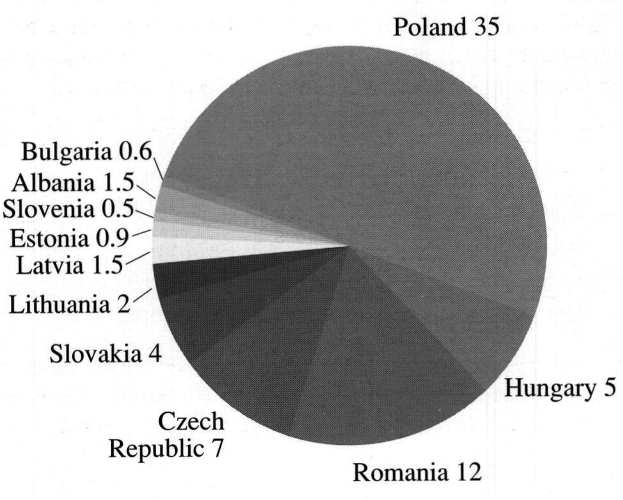
Source: World Tourism Organisation

# The role of Phare

By December 1994, Phare, responding to requests from its partners, had committed ECU 70 million to programmes supporting investment promotion, export development and tourism (see figure 2). Although the activities undertaken were tailored around the policies, strategies and needs of each partner, certain requests were common to most countries. Policy design, the setting up of institutional frameworks, and the design of promotional, industrial, public relations and marketing strategies have been particularly popular.

Some countries chose not to ask for dedicated Phare programmes for these sectors. This does not mean they were ignored by Phare. In most cases, they received indirect support through other means, such as Phare programmes primarily designed to support the growth of the private sector, SMEs or regional development (figure 2 reflects this).

### Figure 2 - Phare support for investment promotion, export development and tourism by country (1990-1994)




## Phare programmes for investment promotion

Phare recognised the capital importance of foreign investment to the economic transformation of the region early on. To encourage foreign investment, it was essential to help ministries and other bodies design and use good investment promotion policies. One of the first concrete steps was to help launch foreign investment agencies (which Phare still supports today). Their job is to help investors find their feet, help with red tape and, by the mere fact of their existence, advertise a government's willingness to do business. The best of these agencies have become integrated "one-stop shops", able to help the investor with everything from finding a local partner to navigating the local regulatory eddies.

At a later stage, an agency's growing expertise will allow it to refine its role to highlight investment opportunities in specific sectors, providing a more subtle tool than direct subsidies to allow governments to salvage certain industries.

Phare's work will be complete when it leaves behind a strong agency able to wield the best promotional tools to attract foreign investors. To achieve these aims, Phare has generally financed the following programme components.

- Strategic and institutional assessment. The first stage of any decent investment promotion programme, this assesses existing policies and institutions to make policy recommendations. In some ways, it is an easy task, because most countries have no institutions outside the direct control of government capable of promoting investment. Phare will almost always recommend that an autonomous agency, headed by a board responsible for strategic decisions, be set up.
- Advisory support. Short- and long-term advisers are then provided to help design the appropriate institutional framework. They will "shadow-manage" the agency once it is established and help in other specified ways.
- Marketing and promotional support. Support is offered to develop marketing strategies and techniques and, sometimes, to provide direct financial support for operational objectives, such as the production of brochures and newsletters, to develop databases, launch promotional campaigns or participate in trade fairs etc.
- Research and strategic studies. Phare will finance the research required to supply the agencies with the first-class data about selected industries, regions and sites needed to satisfy the investor's thirst for information. Because data about comparative advantages can be derived from the results, the research also allows the agencies to develop a more proactive approach to investment promotion.
- Training. Not surprisingly, agencies have great difficulties finding experienced employees with the relevant background. Most people recruited are therefore in dire need of training. Phare delivers training in several ways: on-the-job through the long-term advisers and/or short-term trainers, or at business schools and development agencies abroad. Because this latter option is expensive, it will be gradually phased out as other options become available: competent training bodies, for example, are becoming established throughout the region.

- Supply of equipment. Phare does not normally supply equipment, and needs to hear convincing arguments before considering it. In practice, it only happens if the goods are essential to the success of a programme. For example, Phare might pay for personal computer networks for the agency to share data, track investors and publish promotional material.

## Phare programmes for export development

People working in export development want to help companies sell their products abroad. To do so, they might carry out a blanket exercise designed to promote an entire country's products. Alternatively, they might be more selective, highlighting companies active in a particular sector or region. Although it is their main job, promotion is not the only thing export developers do. They can also offer services such as training a company's staff, helping it develop products tailored to specific foreign markets or boosting a marketing department's abilities.

Export developers work at both enterprise and government level. Companies need better access to finance in order to function in an international environment and to cultivate the expertise they need. Governments must ensure not only that the necessary private sector support services are developed, but also that their different departments understand the needs of exporters.

In addition to raw technical skills, what is often required is a subtler change, within the corporate cultures of exporters and governments alike. That, in a nutshell, is what Phare tries to provide: a judicious mix of the technical, financial and cultural. Phare tries to offer the right package of support measures, whether they are required to install international distribution channels, design successful products or analyse the needs of export markets. The main tools available to achieve these aims are training, the transfer of management skills and credit systems to offer low-cost funding to companies with good export potentials.

Governments have valuable roles to play. They need to develop coherent foreign exchange and tax relief policies for exporters. They also need to develop suitable policies for the former state-owned foreign trade organisations, which house a wealth of export know-how that should be profitably used. Finally, they need to develop export guarantee and credit insurance schemes.

The most important tool available to any Phare-funded export development programme is training. The packages of individual courses are of course adapted to local needs, but almost all are likely to come from the following menu.

- International distribution. These courses are designed to teach the key concepts of international commercial logistics. The value chain, the methodologies of logistics analysis, the influence of logistics on strategic relations, the cost of logistics, introductions to just-in-time production concepts, the optimisation of distribution strategies and basic project management tools are covered.

- Product design and development. Buyers have to want products. That their design, and thus their development, is the basis for competitive strength is not always well understood in the region, hence the need for these courses, which deal with both technological and marketing issues. Course components will include models for the development of projects and ideas, and teach guidelines for the analysis of needs and how to specify projects and demands. Issues of product development covered include testing, evaluation, and the steps to be taken before full production can be reached.

- Export market analysis. This course explains what data to collect in order to select a target market, and how to collect it. It also teaches how to identify competitors and how to evaluate their strengths and weaknesses. Lastly, it deals with the analysis of the structure and availability of distribution channels.

Phare helps in other ways too. The most important of these are the following.

- Strategy and institutional assessment. Phare helps national authorities to establish an appropriate policy framework and to provide services which, because of their scale, can only be offered by government.

- Advisory support. Phare helps chambers of commerce and other bodies learn how to help companies develop their export skills.

- Marketing and promotional support. Most Phare-funded export development programmes offer help to develop promotional materials, participate in international trade fairs and exhibitions or conceive new marketing strategies.

- Company support. Phare helps selected companies directly by providing experts who are seconded to that company to help it develop its export strategies. Some experts are provided on a less exclusive basis and can be consulted through chambers of commerce.

- Transfer of financial know-how. Phare helps develop export guarantee scheme. Other Phare programmes are also involved here, particularly JOPP, the Joint-venture Phare Programme, which helps joint ventures between small or medium-sized companies from EU Member States and the partner countries.

- Product development. Support is provided to develop packaging, design, standards, and certification to international quality standards through the appropriate institutes.
- Company training. Topics covered in these courses include export management, international distribution, financing, marketing and others.

## Phare programmes for tourism

When dealing with tourism, Phare follows three tracks: institutions, training and product.

On the first track, the idea is to remove institutional weaknesses sufficiently to let the partner country deal with the problems identified earlier. To do this, Phare may help design new institutional frameworks, set up organisational structures or draft new legislation.

On the second, Phare tries to put in place training systems adapted to local needs.

On the third track, Phare helps develop new strategies, products and services designed to contend successfully in a competitive global environment. Phare will tend to focus on service quality.

All or part of the following components are used in Phare's tourism programmes.

- Strategy and institutional assessment. Phare helps reorganise the relevant state offices and set up national tourism authorities (NTAs). It may also help draft a national tourism policy and reform the financial framework.
- Advisory support. Long- and short-term advisers are provided to help with policy formulation, product development and training.
- Marketing and promotion. Phare provides support to develop promotional material and participate in major tourism fairs.
- Legal and regulatory framework. Phare helps to design an adequate new legal and regulatory framework.
- Product development. Support is provided to upgrade existing products and to develop new ones.
- Training. "Training of trainers" programmes in hotel and restaurant management, travel agency skills and operating tours are particularly popular. Phare also helps establish certification systems for hotels, restaurants and the like, which are usually linked to the training programme.

## Commitments by country and by area of activity

Phare has sponsored the establishment of local foreign investment agencies (FIAs), export bodies and national tourism authorities. The size of these organisations and the scope of their tasks obviously vary according to local needs.

In Hungary, Latvia and Slovenia, export development and investment promotion are carried out by a single development agency. Others have chosen to have separate programmes instead, which may themselves be on a national or regional level. Some countries have yet to embark on an active export development programme.

Tourism programmes are generally separate from the other two programmes and tend to be implemented by a national tourism authority or board.

Financially, the future of all these programmes will depend on a mix of public and private money. Although the FIAs, export organisations and national tourism boards will eventually become independent of Phare support, western experience suggests that they will nevertheless require ongoing public sector support. Export promotion and tourism agencies should be able to raise a substantial proportion of their funds from private sources, but foreign investment agencies are unlikely to be able to do the same. Almost by definition, FIAs cannot charge investors for their services (although they may charge a nominal fee for providing specific information). International comparisons are not encouraging in this respect, as western FIAs obtain almost all their money from public funds.

**Table 4 - Phare support for investment promotion, export development and tourism, 1990 to 1994 (ECU million)**

| Country | Investment promotion | Export development | Tourism |
|---|---|---|---|
| Albania | 0 | 0.3 | 1.2 |
| Bulgaria | 0.2 | 0 | 4 |
| Czech Republic | 5 | 2 | 0 |
| Estonia | 0.5 | 0 | 0.4 |
| Hungary | 5 | 0[1] | 0 |
| Latvia | 1 | 0[1] | 0.5 |
| Lithuania | 1.5 | 0 | 0.5 |
| Poland | 12 | 10 | 13 |
| Romania | 5.5 | 2 | 4.5 |
| Slovakia | 4 | 0[1] | 0 |
| Slovenia | 0.5 | 0 | 0 |
| **Total** | **35.2** | **14.3** | **24.1** |

1 Export development activities combined in one programme under investment promotion heading.

# Phare's results

All three sectors under discussion are being reformed through programmes that are long-term in nature and depend on many outside factors for their ultimate success. It is therefore quite difficult to evaluate the impact these programmes have had so far. However, their mere existence indicates progress. They began at a later stage than the core economic reform measures and depended to a large extent on the success of these measures. Core Phare programmes dealing with banking, privatisation and new legislative frameworks were well under way by the time programmes were designed for tourism, exports and investment promotion.

## Investment promotion

The following foreign investment agencies have been established with Phare support.

| | |
|---|---|
| Czech Republic | CzechInvest |
| Estonia | Estonian Foreign Investment Agency (EFIA) |
| Hungary | Investment and Trade Development Agency (ITD) |
| Latvia | Latvian Development Agency (LDA) |
| Lithuania | Lithuanian Investment Promotion Agency (LIA) |
| Poland | State Foreign Investment Agency (PAIZ) |
| Romania | Romanian Development Agency (RDA) |
| Slovakia | Slovak National Agency for Foreign Investment and Development (SNAFID) |
| Slovenia | Bureau for Foreign Investment Promotion and Trade Development[1]. |

In all eight countries where Phare has helped set up FIAs, the following services have been provided: strategy elaboration, institutional assessment, advisory support, help with marketing, research and drafting of strategy studies, training and the supply of equipment. The exception is Latvia, where the training element was provided by the UK's Know-How Fund rather than by Phare.

It is not yet possible to assess the impact that the FIAs are having on investment flows. Their first tasks were to establish themselves and train their staff. For some, this means that the period of full operational readiness has so far been very short. Furthermore, it can take years from first contact for foreign investors to commit themselves.

Wherever Phare has helped set up FIAs, both policy-making and institutional capabilities are improving. However, a faster rise in foreign investment now depends to a large extent on factors outside the control of FIAs, such as the appropriate laws being adopted.

Despite these limitations, some successes are already discernible. In particular, Phare-financed programmes have achieved the following.

- Eight FIAs have been established. Even the laggards have already conducted their first serious attempts to attract and help foreign investors.
- Some agencies have established themselves clearly on the international market and receive more requests for assistance than they can handle with their current capacity (e.g. the Czech Republic and Slovakia).
- Several FIAs have succeeded in attracting sizeable projects.
- The skills of the staff of FIAs show a dramatic improvement, notably in the Czech Republic, Hungary, Poland and Slovakia.
- The promotional material produced by the FIAs is rapidly improving in quality and is becoming widely available (Poland, Hungary, the Czech Republic, Slovakia, Latvia).
- Several FIAs have become polished performers and exhibitors at trade and investment fairs, and all are improving their track record at such events.

CzechInvest is a good example of what can be achieved with skilful use of Phare support. CzechInvest's involvement has so far resulted in eight projects yielding US$ 150 million, safeguarding or creating over 3,500 jobs. The case of Philips is typical. The Dutch multinational first met CzechInvest at a trade fair in Germany. Philips, looking for investment opportunities in central and eastern Europe, was sufficiently impressed by this first contact to ask CzechInvest for help in scouting out possible locations for a plant, in identifying investment opportunities and in negotiating local regulations and institutions. This relationship eventually resulted in Philips setting up Philips Mecoma Ceske SRO in Ceske Budejovice. The company is using the buildings of a former Tesla factory and the new plant is supplying parts for use both inside and outside the company. By late 1995, over 120 people will be employed there.

1 Currently at the Ministry of Economie Relations and Development, but scheduled to because an independent agency in late 1995.

The impact of Phare tourism programmes is becoming evident in the marketing efforts and organisation of the tourism trade in several central European countries.

The national tourism boards that have been established in a number of central European countries are independent bodies bringing together representatives from the industry and the government. Legislation to regulate the activities of operators is either being rewritten or drafted from scratch. Certification systems for hotels, restaurants, travel agents and the like, without which it is almost impossible to promote a country as a destination on the international market, are being established with Phare's help in a number of countries, notably the Baltic States. Phare is also helping most countries participate in specialist fairs and is helping them produce better promotional material.

# Current constraints and the future

Although investment measured as a proportion of gross domestic product (GDP) was quite high before the transformation to a market economy, it was based on a system of central allocation and a distorted price structure, and was thus very inefficient. Not only did much of the capital stock become redundant after 1989, but investment also declined sharply. In order to expand the capital stock to support future growth, new investment is essential. The success of economic transformation and recovery in central Europe will depend to a large extent on achieving sustained high rates of investment.

In the long run, the most important source of productive investment will have to be domestic savings. These are, however, currently very low as a proportion of GDP and are likely to remain so for some time, despite the arrival of policies designed to encourage savings and to improve the efficiency of financial intermediaries. Foreign investment will thus remain very important in the current reform phase. Sadly, inward investment flows have been disappointing throughout the region (with the possible exception of Hungary).

This is likely to change in the near future, however. Most of the region is beginning to experience strong growth, and the European Union has recovered from the recession of the early nineties. Both these factors, combined with the liberalisation of trade sweeping the region, will encourage investment. The conclusion of the Uruguay Round, the entry into force of the Europe Agreements, the Essen pre-accession strategy, and the decisions to open European Union markets to central European products more quickly than originally planned, will all help. The further integration of the EU and central European markets is of course absolutely crucial, but the importance of the regional integration of central European economies must not be underestimated. Most export growth in the near future is likely to be within the region, and both these evolutions will in due course lead to greater investment flows.

However, two major problem areas are still slowing down investment flows: poor infrastructure and inadequate banking systems. Both are being tackled by a variety of Phare programmes which, because of their importance and multiplicity, cannot be described adequately here. There are also other problems harming investment flows, perhaps less important than the two mentioned above, but whose resolution will nevertheless be absolutely crucial in creating the healthy environment that investors favour. The strategies described below are the most likely to be effective and will hopefully be implemented soon.

## Government commitment and policy

As indicated throughout this paper, the lack of targeted and comprehensive policies for investment promotion, export development and tourism is hampering long-term growth.

Developing investment promotion programmes has been fraught with difficulties. Many places have restrictive foreign investment laws in place. Ministries and other agencies are fighting turf battles over responsibilities. The link with privatisation has not helped, while populists have sometimes used the topic for their own ends, casting the debate in emotional terms replete with condemnations of treacherous politicians selling the "family silver" to foreigners.

The debate about export promotion may be less emotional, but it is still lively. Theological arguments about the proper role of governments and the private sector in export development have in some cases precluded any clear decisions.

The creation of national tourism boards, with representatives from both the public and private sectors, has in most countries obstructed the real debate about policy in the tourism industry. This initially surprising result is due to the novel idea of the private and public sectors working together to define policies and design strategies. There is still very little trust between the two sides.

It is important to remember that the three development initiatives covered by this paper are closely linked, and should be addressed in one integrated economic development policy, at both national and regional levels. However, so far only a few central European countries have created this kind of comprehensive economic development policy.

## Phare and the Europe Agreements

A comprehensive policy in the areas of investment promotion, export development and tourism is therefore essential to the future transfer of Phare know-how, even if limited progress has been made so far. It is even more important in the context of the Europe Agreements (in force with Poland, Hungary, the Czech Republic, Slovakia, Romania and Bulgaria, signed but yet to be ratified with the Baltic States and being finalised with Slovenia), which recognise the importance of these topics.

With regard to investment promotion and protection, the Europe Agreements are very clear:

"Cooperation will establish a favourable climate for private investment (both domestic and foreign) which is so essential to economic and industrial reconstruction.

The specific aim of the cooperation will be

- for the partner country to establish a legal framework which favours investment, this could be achieved where appropriate by the Member States and the partner country extending agreements for the promotion and protection of investment
- to implement suitable arrangements for the transfer of capital
- to bring about better investment protection
- to carry out deregulation and improve economic infrastructure
- to exchange information on investment opportunities in the form of trade fairs, exhibitions, trade weeks and other events."

As far as export development is concerned, the provisions under the European Agreements dealing with industrial and economic cooperation relate in general to the development of the economy and thereby to the development of exports from central Europe. The EU is supporting the central European countries through a number of initiatives under Phare, facilitating exports to the EU as well as further afield. Customs are obviously of prime importance to achieve smooth export flows. Regarding customs, the Europe Agreements say that... "the aim of the cooperation shall be to guarantee compliance with all the provisions scheduled for adoption in connection with trade and to achieve the approximation of the partner countries' customs to that of the European Union, thus helping to ease the steps towards liberalisation planned under this agreement."

The Agreements deal with tourism directly, saying that "The parties shall increase and develop cooperation between them, notably by

- supporting the tourism trade
- increasing the flow of information through international networks, data banks, etc.
- transferring know-how through training, exchanges, seminars
- studying the opportunities for joint operations such as cross-frontier projects, town-twinning, etc."

## Regional policies and priorities

National policies are obviously key conditions for the development of all three sectors. However, they are not enough. Regional priorities must also be considered. Disadvantaged or underdeveloped regions need investment promotion, export development and tourism programmes even more than the countries to which they belong. Their importance is not exclusive, however, and there are several other issues which need to be addressed.

Governments should therefore adopt more proactive regional policies and target particular regions for future Phare support. Other Phare programmes, dealing with topics as diverse as SME development, agriculture and telecommunications, frequently have regional variations that must be taken into account when developing these policies. As regional development institutions are created and grow, ways of integrating aspects of these national programmes into regional initiatives should be considered.

## Investment promotion

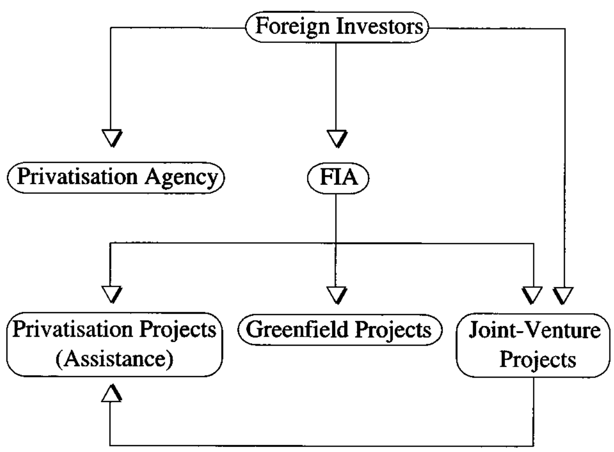
Almost all the programmes have identified a need for the promotion of foreign investment as a support to foreign investors and to help indigenous companies find suitable foreign partners. Most programmes have developed a model whereby such services are provided by an autonomous government agency funded from the national budget. This model should be expanded at regional level and developed in the Phare countries that do not yet have such an agency.

The future funding of the foreign investment agencies has already been identified as a problematic issue. Phare support is meant to help governments set up the agencies during the initial phase. Thereafter, the governments' budgets should cover the full costs of the agencies' operations. Governmental contributions currently range from 10 to 90 per cent of the overall budget, with Phare picking up the rest of the bill.

Though some success has been achieved in setting up the investment agencies in eight of the Phare countries, the efficiency and impact of the agencies vary enormously from country to country.

The approach varies, but, overall, the role of the agencies is to attract foreign investment into the country. In countries where the privatisation process is further advanced, the agencies concentrate more on 'green field' and joint venture projects. In countries where the privatisation process has not yet taken off, the agencies tend to concentrate on privatisation projects, because of the political pressures involved in foreign investment. This results in a diversion of resources away from potentially more worthwhile projects and creates conflicts between the privatisation and the foreign investment agencies. Ideally, the relationships between investors and the two agencies should look as follows.

## Figure 3




Keeping and attracting staff to the agencies after the initial start-up phase has proven difficult, owing to restrictions on government salaries. In a very few cases, it has been possible to establish a system similar to one common in the west, in which staff hired by independent government agencies are remunerated differently from civil service staff and do not have tenured status. However, a number of agencies have suffered critical losses of staff.

There is definitely scope for much better coordination between the various programmes covered by this paper and other economic development programmes targeted at SMEs, banks, regions, etc. Some of the central European countries have already begun planning along these lines, but, in general, attention is still focused on individual programmes.

Co-financing, another promising implementation method, has so far only occurred in a few investment promotion programmes. The financing of promotional activities designed with a particular target country in mind is a particularly promising area for co-financing with other donors.

Traineeships for foreign investment agency staff in western European development agencies have already begun. It will be important for staff to have the opportunity of receiving a traineeship in at least one European Union agency, and preferably two, in order to experience different types of promotion strategies and operations.

## Export development

Most of the export development programmes supported by Phare are co-financed by both the government and Phare. Additional funds are coming in from participating companies. In most cases, companies are asked to contribute between 25 and 30 per cent of the cost, but a number of companies have found even this to be beyond their resources. Since a willingness to pay for a service is a sign of genuine commitment, there are no plans to reduce this amount. However, to ensure the success of future programmes, it is important to discover why so many companies hesitate. Obviously, a truly financial reason will lead to a different solution from a lack of programme appeal.

One factor limiting export performance in central European countries is the restricted access to export guarantees and low-cost financing. Phare has made funds available in some central European countries for the transfer of know-how to set up export credit and financing facilities and will continue to do so.

It is important that future export development programmes are established within the context of an overall development policy, and, through this, are interlinked with SME and regional development programmes at both national and regional levels.

There is not yet any substantial co-financing with other donors in this area, although a number of donors are active within larger or smaller programmes relating to export and trade. A few initiatives could be co-financed with Phare. This is true of the export development programme as well as of the trade missions and fairs.

However, in a separate development, a multi-country trade development programme has been launched to help solve pan-regional issues in trade policy and finance and to exchange trade-related information.

There is no clear pattern in the institutional creation of export development programmes in central European countries. In general, a number of bodies provide export services, including banks, chambers of commerce and public agencies. Owing to the lack of policy and strategy in this area, these institutions often overlap and their responsibilities are not always clearly defined. As the organisation of export development varies from country to country in western Europe, it is evident that no one single model can be transferred to central Europe. Models will have to be chosen on the basis of an evaluation of each individual country, taking the size of the country, geography, company structure and so on into account.

## Tourism

To date, the Phare tourism programme in central Europe has supported either newly-established tourism boards, or state departments for tourism. The aims of the programmes have been to encourage the establishment of tourism boards with representation from both the public and private sectors, and to obtain at least part of the required funding from the private sector. Latvia appears to be the only country so far to have established a proper tourism board, similar to those in western Europe. Attempts have been made in a number of other countries but have, for various reasons, met with little success. The exception is Poland, where the thinking at least is well advanced.

The main problem seems to be the combination of the public and private sector in the organisation and funding. The fact that the private sector is involved in developing policy and strategy has led a number of parliaments to conclude that the private sector should fund the activities on its own. This attitude seems to arise from the fact that a number of countries still do not regard tourism as an important revenue-earning sector, and from the misconception that the tourism sector can survive on its own.

Again, as elsewhere, a strategy for the integration of economic development policies will have to be established before clear measures can be embarked upon. A clear economic development policy incorporating tourism is required, in order to address the infrastructure needs of tourism both directly (for example, hotels) and more generally (such as transport and communication links). It is necessary for investment in infrastructure to be extensive in terms of funding and time, and it has to be developed carefully in order to obtain financing. Investment promotion will also have a key role to play in the creation and upgrading of tourism facilities.

There has been considerable co-financing of the tourism programmes from other donors. For example, to support participation in tourism fairs, Phare makes funds available for travel, and the country in question has often made funds available for the actual stand and participation costs. There is room to extend cooperation between the tourism organisations of central Europe and the west European tourism corporations in order to develop regional tourism. This cooperation could include support from western European tourism organisations with training and joint promotion of regions and areas.

## Institutional issues

The fact that only one country has managed to establish a real tourism board indicates the poor level of development of this sector. In several countries, tourism development is still carried out by the old state departments of tourism. These have little credibility with either the private sector or with foreign tour operators.

The priority for the Phare Programme in future will be to support institutional development so that proper cooperation can develop between the public and the private sectors, and so that an adequate policy can be devised to address the needs of the tourism sector and economic development initiatives.

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