

FOREIGN DIRECT INVESTMENTS AND THEIR INFLUENCE ON ECONOMIC GROWTH AND REGIONAL DEVELOPMENT

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Introduction

Years of totalitarian regime left their marks not only on the economic system but also on the people inhabiting this transforming region. The market economy principles of which have been governing our society since 1989 can function only under a prerequisite of existence of a non-corrupted and rational state executive. The principle of observance of contractual terms together with the principle of an independent judiciary are essential for the influx of modern capital in form of modern technologies and know-how to Slovakia.

The transformation from the planned to the market economy is accompanied by the decrease of the GNP and industrial production in almost all the countries of middle and east Europe. This decrease was influenced by a range of currently known facts such as deformed economic structure, loss of markets of the former CMEA, liberalization of trade and related forming of competitive environment.

It will be a very difficult and lengthy process to draw level with the developed EU regions. According to optimistic estimations of reputable economists the process will not last a decade, rather than that it will more likely last a period comparable to one human generation.

Material and methods

References were taken from the Internet sites of the SNB (Slovak National Bank), Statistic Office of the Slovak Republic, scientific books and anthologies.

This article analyzes economic development of Slovak regions based on the influx of foreign direct investment (FDI) with the help of models of neoclassical theory of regional development. The evaluation of economic level of regions and their underdevelopment was based on one complex and, in my opinion, relevant development indicator, which is the amount of foreign direct investment flowing to a specific region on the level of NUTS III (regions of the Slovak Republic). The most underdeveloped region of the Slovakia was the one with the lowest proportional influx of foreign direct investment in the relevant period of time. The point evaluation in the range of 0 through 100 is an average proportional expression of the condition of foreign direct investment monitored within a period of 6 years; the higher number is assigned, the better development has been achieved and therefore, logically, the lesser number indicates lower development of a certain region.

Standard mathematical-statistical methods and numerical calculations were used in the evaluation process.

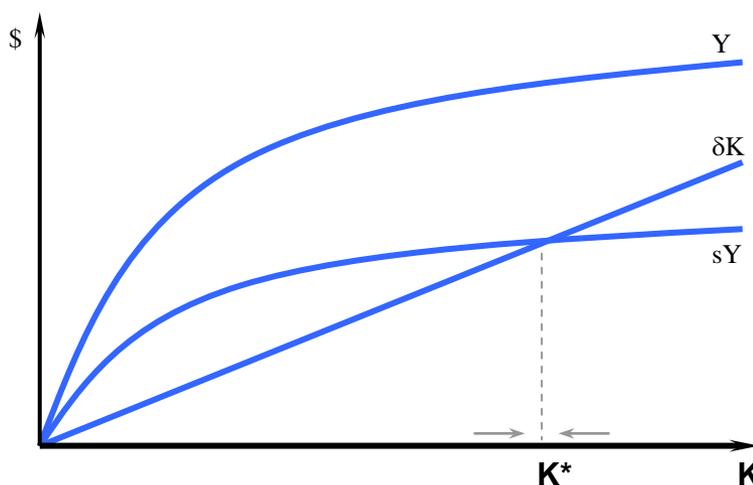
Results and Discussion

Neoclassical theory stems from an idea that in the situation of a deficit occur variances in the prices which create a possibility for a profit-making trade or increase of profitable rearrangement of production factors, and thus the attraction of investment. Economic subjects respond to these variances in prices in a pursuit of capitalizing on these possibilities until the

variances in prices and deficit situations are not balanced. This mechanism of searching for the balance spontaneously equalizes the inequalities.

Taking into consideration the regional aspect, it is possible to integrate regional-economic relationships into the general equilibrium models. By watching the development in a closed region, it will bring the picture of the basic model of neoclassical theory of regional growth, where capital is accumulated by means of savings and investment, with increasing amount of products and services. The dynamics of accumulation gradually decreases, until certain point in which the investments are possible to compensate for the depreciation and the stagnation of accumulation takes place.

Chart 1: **Equilibrium of capital facilities**



The Y curve presents the production function. Function sY presents the part of production that is capable of saving and investing. This function is created by multiplying the former function Y by the invariable s that represents the tendency towards saving. Function δK represents the amount of depreciation within different capital values K (anticipating constant amount of depreciation). From the shape of the function it is obvious that the point K^* marks the termination of capital increment. Net capital increment is equal to zero. Depreciation only compensates for the used capital. Further development can be brought about by exogenous technical development. If there is no technical development, the capital increment cannot cause a long-term development in economy. It will be stopped as a consequence of decreasing marginal capital product and increasing depreciation. Regardless of the fact that the neoclassical theory of growth is focused on one closed region, it implicitly contains an explanation of equalizing the differences between several regions. The lower level of capital facility the region has, the faster it accumulates capital, and therefore the regions with lower capital develop faster, thus equalizing the capital facilities and production.

After extending the neoclassical model of regional growth with the possibility of free flow of means of production between regions, it is possible to reach the tendency of balancing (convergence). The value of marginal product of means of production determines its price (earnings, interest, annuity). After that the mobile means of production (neoclassical theory

assumes that labour and capital are absolutely mobile) are shifted from a well-equipped region to a region that is lacking these means of production. If the production factor is in a particular region short of supply, it is valued in accordance with the value of the marginal product higher than in other regions. This evokes a net influx of lacking production factor and the shortage is gradually eliminated. This process causes the balancing of differences in capital facilities of a particular region and in remuneration. If this effect is combined with the process of accumulation that was mentioned earlier, the capital sub-standard region develops even faster.

If the relationships between regions are reduced to a simple exchange of products, it results in specialization of regions in such a production which is the region better equipped for. The consequence of each region using its comparative advantages is that the national economy is able to produce more from the existing sources. The trade would be beneficial for all regions involved.

The significance of this theory for the regional economic policy lies in the fact that if all prerequisites of the neoclassical model are met, the economy heads to a balanced development without economic-political interference.

The task of the regional economic policy is to guarantee validity of prerequisites of the neoclassical theory, meaning increase in mobility of labour and capital, reducing administrative restrictions in accessing regional markets, creation of conditions for a better mobility of goods and services and improvement of the information flow and completing the infrastructure. However, the over-use of the means of regional economic policy is counterproductive since it disturbs the optimal development and usually results in the loss of prosperity.

The Slovak Republic can be characterized as a small open economy. There exist several resulting facts of this characteristics, one of them is that every development in the world is markedly projected in the economic development of Slovakia. Moreover, our economy is open to the flow of international capital in the form of foreign direct investment (FDI) or in the form of foreign portfolio investment (FPI). The globalization phenomenon resulted in the increase of the flow of the international capital in the 1990s, which was expressed by intensive involvement of small open economies in the process of globalization.

The international flow of the capital has the same reasons as the flow of the capital within an economy or economic coalition. Attracting a foreign investor to capital manifestation in our market is not an easy task and it demands fulfillment of the positive evaluation concerning 6 basic criteria (economic force, business ethics, degree of integration to the world economy, abundance of laws, investment climate and political stability). Foreign investors regard the relation between the current account deficit and the gross domestic product of a country as an important indicator of stability of an economy.

The foreign investor aspires for the domestic (local) market or for a share of the world market. In the first case, exports are minimal and the foreign business competes in the domestic market only, which most likely ends in emergence of a monopoly; the monopoly is, as is well-known, disadvantages for the economy of the host country. In the second case, exports are maximal and the foreign business competes with other businesses in the world market, which mostly leads to expansion of production and investment in the new technologies and innovation. This is manifested in better quality of goods and services.

Advantages of the influx of FDI for the host country are as in the following examples:

- the state budget income will increase in the long-term horizon,
- productivity of the productive factors will increase (it is an indirect effect named *spillovers*, which means swilling of technological knowledge and at the same time building of competitive pressure on the domestic producers),
- increase of employment in regions with high influx of FDI.

Disadvantages of the influx of FDI for the host country are as in the following examples:

- price production may decrease the export income,
- possible occasional negative influence on the natural environment (*resource-seeking*),
- in some cases of markets with cheap labour force, the final result of the influx of FDI might be the conservation effect: growth of the business is stopped.

The most recent theories of economic growth are based on the important dependency between the economic growth and the state of domestic technology, considering the rest of the world. Economic growth rate is explained as a “*catch-up*“ process, considering the technology state of the home country. In the model of the economic diffusion, the economic growth rate of an underdeveloped country depends on the degree of accepting and implementing new technologies used by foreign businesses.

According to the neoclassical model of Trevor Swan and Robert Solow (*theory of absolute convergence*), the Nobel Prize 1987 laureate, the underdeveloped countries should develop faster than the developed ones. This is in contrast with Lenin’s theory of imperialism that claims that the rich countries grow at the expense the poor countries. On the other hand, the Solow-Swan model is able to explain the growing international differences conditioned by the convergence, where the economic growth depends on other factors – amount of savings which is higher in the rich states than in the poor ones. This means that the rich states converge to a different point than the poor states, and thus they may grow faster. The convergence should be valid within countries themselves as well as between countries with approximately the same economic parameters, as for example individual states of the USA or states of the OECD.

Foreign direct investment (FDI) are considered to be the most important instrument of the transfer of new technologies. In addition to that some studies present the so-called complementarily effect on the economic growth of a country evoked by FDI.

In the current economy, there are two best-known theoretical models which explain the flow of foreign investment. The first one is the gravitational model that claims that the flow of investment is influenced positively by the extent of the market and negatively by the distance of the host country. The second is the agglomerative model of economy stressing the fact that international businesses locate their capital in the same place (or the same region, respectively) as their competition does, thus creating the so-called synergic effect.

The form of investment is also determined by the protection of intellectual property in the host country. On this basis the business decides whether it is an investment on the green meadow,

joint venture or the transfer of older technology only. The degree of protection has crucial influence on the transfer of investment in the form of the so-called hi-tech products and goods.

The assessment of under-development of individual Slovakian regions on the level of NUTS III (region), on the basis of the above-mentioned theoretical information, used only one economic indicator; it is the amount of foreign direct investment stated in Slovak currency. This decision was based on the fact that the foreign direct investment (FDI) is in the world of globalization considered to be the most sensitive sensor of the economic development.

Development of FDI in individual regions of the Slovak Republic is presented in the following table 1.

Table 1: Amount of foreign direct investment (FDI) for regions of SR during 1999-2004

NUTS III	currency	1999	2000	2001	2002	2003	2004*
Bratislava	in mil SKK	57 082	99 068	146 484	224 663	245 040	259 925
Region	in mil USD	1 350,5	2 090,5	3 022,3	5 611,5	7 443,5	7 999,7
Trnava	in mil SKK	8 539	9 674	11 569	13 512	17 564	21 850
Region	in mil USD	202,0	204,1	238,7	337,5	533,5	672,5
Trenčín	in mil SKK	6 473	6 749	7 099	9 137	11 943	12 999
Region	in mil USD	153,1	142,4	146,5	228,2	362,8	400,1
Nitra	in mil SKK	3 645	4 503	7 626	8 606	10 652	11 413
Region	in mil USD	86,2	95,0	157,3	215,0	323,6	351,3
Žilina	in mil SKK	3 392	8 527	10 316	12 241	14 106	16 458
Region	in mil USD	80,3	179,9	212,8	305,7	428,5	506,5
Banská Bystrica	in mil SKK	4 759	5 440	8 180	8 337	8 892	9 051
Region	in mil USD	112,6	114,8	168,8	208,2	270,1	278,6
Prešov	in mil SKK	4 233	4 743	5 532	5 874	6 003	6 386
Region	in mil USD	100,2	100,1	114,1	146,7	182,4	196,5
Košice	in mil SKK	7 915	38 437	37 590	32 793	34 106	34 423
Region	in mil USD	187,3	811,1	775,6	819,1	1 036,0	1 059,4
Overall	in mil SKK	96 038	177 141	234 396	315 163	348 306	372 505
Amount of FDI	in mil USD	2 272,2	3 737,9	4 836,1	7 871,9	10 580,4	11 464,6

Source: Slovak National Bank

Note: * amount of FDI up to 9.30.2004

The data in the Table 1 show that the amount of the foreign direct investment to the Slovak Republic increased each year. The influx of FDI in last four or five years in the Slovak Republic is characterized by two central features. The first feature shows that the influx of FDI in the time period covered mostly building of distributional webs (year 1999) and privatization goals of the government concerning especially telecommunication (year 2000), bank and insurance sector (year 2001) and some branches of power industry (year 2002). These investment strengthened the infrastructure in a broader sense, this being one of the prerequisites of increasing of the competitiveness of the economy as a whole. However, investments into the processing industry were modest. This could not be sufficient from the point of view of the FDI influx for the increasing of the competitiveness in this sector of the economy.

The second feature of the Slovak economy is that there is outweigh of FDI searching for expense advantages, which is typical for the so-called export oriented FDI.

From the sectoral point of view, it is possible to stress the capital entries of foreign investors to telecommunication, metal processing and oil processing. More than 40 per cent of all the influx of FDI for the year 2000 was allotted for the selling of 38 per cent parcel of shares of the Slovak telecommunication to Deutsche Telekom. Another important transfers of investment were the entry of U.S. Steel to steelworks VSŽ Košice (volume of 485 mil USD), selling of shares of the Slovnaft refinery to a Hungarian company MOL (270 mil USD) and the entry of the Neusiedler company to papermill SCP Ružomberok (80 mil USD).

Among the most important entries of foreign investors in 2001 the selling of the Slovak Savings Bank to an Austrian Erste Bank (380 mil USD), selling of VÚB to an Italian financial group IntesaBci, privatization of 49 per cent of shares of the Slovak Gas Industry by the Russian concern Gazprom, French Gaz de France and German Ruhrgas (2.7 bil USD) as well as the capital entry of the Yukos company to Transpetrolcan be considered. In this year, the decision was made about selling of distributing energy companies, with the German energy concern E.ON Energie owning 49 per cent of shares of ZSE, s.c., the German company RWE Pluis owning 49 per cent of shares of VSE, s.c. and the French company EdF owning the 49 per cent of shares of SSE, s.c.

The flow of the foreign investment into the Slovak economy within sections are not stable. There are branches with a relatively strong position of foreign investors (industrial production, wholesale and retail, finances and insurance, transport and storage), on the other hand, there are branches with a marginal proportion of foreign investment (agriculture, raw material mining, building industry, hotels and restaurants, health services and social services, etc.).

The Slovak Republic started to concentrate on the automobile industry, however, economists point out possible risks. By the entry to the European Monetary Union, the possibility of the so-called asymmetric shocks is increasing. Thus, if there is a crisis in the automobile industry, the small Slovak market tied to this industry might fall into recession, but the monetary instruments of the European Central Bank might be directed in an opposite direction.

The high volume of investment is what distinguishes companies with the foreign capital from companies of Slovak owners. Foreign investors located their investment to companies which were above average productive and profit making. After acquisition of such a company, they increased the productivity by investing in technologies, distribution channels and work systematization. This is different with domestic companies which will not be able to compete with the foreign companies in a long period of time.

On the basis of this fact, it is possible to state that the gap between the foreign and domestic producers will be widening, which will result in putting of the Slovak economy into the position of a dual economy. On one hand, this will result in prosperous and growing companies tied to foreign capital, yet on the other in under-capitalized domestic companies (mostly former big state businesses and corporations) with unsolved terms of ownership. As a consequence of such vertical differentiation of production, such situation will lead to non-competitiveness of products of Slovak-owned companies on the European market. This will have an important influence on the price level of production of Slovak-owned companies and foreign-owned

companies, as well as on the possibility of export of the production and amount of earnings of their employees. There is only one resulting conclusion: if the monetary rate and average earnings are adjusted to the level of hardly surviving domestic producers, the growth of the Slovak economy will be lower than it could be, especially if the monetary rate and average earnings were converging to the level of monetary rate and earnings of developed European economies.

Table 2 presents development of FDI in comparative expression on the level of individual regions of NUTS III (region); it is possible to observe the centralization of FDI in the Bratislava region.

Table 2: Amount of foreign direct investment in comparative expression in 1999-2004 (%)

NUTS III (region)	1999	2000	2001	2002	2003	2004*
Bratislava region	59,44	55,93	62,49	71,28	70,35	69,78
Trnava region	8,89	5,46	4,94	4,29	5,04	5,87
Trenčín region	6,74	3,81	3,03	2,90	3,43	3,49
Nitra region	3,80	2,54	3,25	2,73	3,06	3,06
Žilina region	3,53	4,81	4,40	3,88	4,05	4,42
Banská Bystrica region	4,96	3,07	3,49	2,65	2,55	2,43
Prešov region	4,41	2,68	2,36	1,86	1,72	1,71
Košice region	8,24	21,70	16,04	10,41	9,79	9,24
Amount in %	100,00	100,00	100,00	100,00	100,00	100,00

Source: Slovak National Bank, own calculations

Note: * amount of FDI up to 30.9.2004

The tendency towards concentration of FDI in the most developed regions is not a problem of the Slovak Republic only. In spite of that, differences in the influx of FDI are considerable in Slovakia. In the Czech Republic, 52 per cent of the amount of FDI is concentrated in Prague, which is in average of 10 per cent lower than the share of the Bratislava region of the overall amount of FDI in the Slovak Republic.

Apart from the unfinished infrastructure, the non-existence of industrial zones and parks is one of the key factors of considerable regional differences. While this kind of infrastructure construction is considerably supported in Hungary and the Czech Republic, in Slovakia the support is minimal. In Hungary, the state supported construction of 40 industrial parks in the eastern part, in Slovakia, nonetheless, state supported only one. The success of this park, however, shows the profitability and necessity of such investments. It is possible to suppose that without realization of these key measures, it is hardly possible to expect any change in the tendency of concentration of investment in the western Slovakia (mostly the Bratislava and Trnava regions).

Picture 1 presents the location of regions of Slovakia considering the geographical location of neighboring states. Emphasized by colour is the Prešov region, the most under-developed region of Slovakia.

Picture 1: NUTS III (region) regional division of the Slovak Republic



The future trends are not progressing favourably. Regardless of the declarations of the Slovak government about the effort to shift the investment more eastward, the steps realized are not sufficient and do not diminish growing regional differences. In the first half of 2004, the SARIO agency helped to locate from 16 reported projects more than 95 per cent into the territory of the western Slovakia and the Žilina region. In the second half of 2004, one major investment in the Košice region was reported. It will be an investment of the Ford company which is supposed to create 1000 work places. In the Prešov region, which is the most under-developed region (see Table 3), no considerable investment was reported. In contrast with that, the amount and number of investment expected in the western Slovakia is much higher. A considerable part of investments is coming to Slovakia without any help of the government and these investments are heading predominantly to Bratislava and the western Slovakia, which is confirmed by official numbers by the Slovak National Bank on the influx of FDI.

Table 3: Development of regions of Slovakia according to economic indicator of FDI in point expression

NUTS III	1999	2000	2001	2002	2003	2004*	Final	Final
	points	listing						
Bratislava region (BA)	59,44	55,93	62,49	71,28	70,35	69,78	64,88	1
Trnava region (TT)	8,89	5,46	4,94	4,29	5,04	5,87	5,75	3
Trenčín region (TN)	6,74	3,81	3,03	2,90	3,43	3,49	3,90	5
Nitra region (NR)	3,80	2,54	3,25	2,73	3,06	3,06	3,07	7
Žilina region (ZA)	3,53	4,81	4,40	3,88	4,05	4,42	4,18	4
Banská Bystrica region (BB)	4,96	3,07	3,49	2,65	2,55	2,43	3,19	6
Prešov region (PO)	4,41	2,68	2,36	1,86	1,72	1,71	2,46	8
Košice region (KE)	8,24	21,70	16,04	10,41	9,79	9,24	12,57	2

Source: Slovak National Bank, own calculations

Note: * amount of FDI up to 30.9.2004

On the basis of the stated methodology for evaluation of economic level of regions and their under-development, a complex relevant indicator of development was used. It reflects the amount of foreign direct investment flowing into the particular region on the level of NUTS III (regions of Slovakia). From the analysis it is obvious that the most under-developed region in

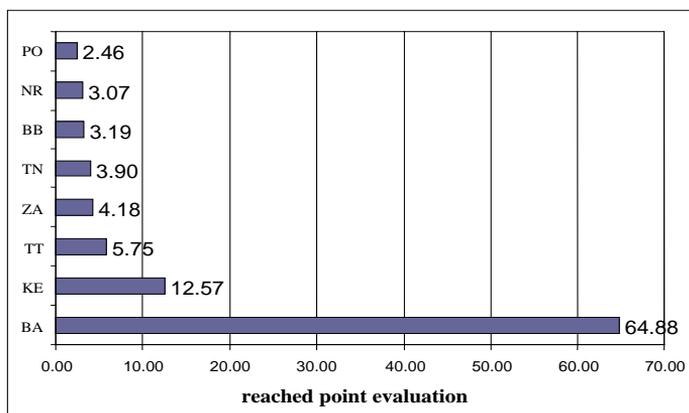
the particular time period is the Prešov region and the most developed region is the Bratislava region. The listing of regions is shown in the table 3.

From the analyzed data it is possible to observe following trends in the regional development of Slovakia on the level of NUTS III (region):

- Even greater widening of differences on the level of FDI between regions with high share of FDI and those with low share of FDI as a result of the so-called agglomerative model of economy,
- Growing trend in the amount of FDI in regions with growing infrastructure,
- Fall of FDI in Prešov, Nitra and Banská Bystrica regions stemming from non-existence of functional industrial parks and zones.

The chart 2 shows the level of regional development of individual regions of the Slovak Republic according to acquired points on the basis of determined methodology. The points expression is in the interval of 0 to 100; it is a proportional expression of the amount of foreign direct investment in the observed time period of 6 years. On the first place is BA – the Bratislava region (the centre of the region is the capital of Slovakia – Bratislava), which attained an average of 64.88 per cent of all foreign direct investment coming to Slovakia during the observed time period of 6 years. Second place is taken by KE – the Košice region which during the observed time period attained an average of 12.57 per cent of all FDI. Third is TT – the Trnava region, with an average of only 5.75 per cent of all FDI. Followed on the fourth place by ZA – the Žilina region (4.18 per cent), fifth TN – the Trenčín region (3.90 per cent), sixth BB – the Banská Bystrica region (3.19 per cent), seventh NR – the Nitra region (3.19 per cent) and the last eighth place is PO – the Prešov region, with an average of only 2.46 per cent of all foreign direct investment.

Chart 2: Level of regional development of Slovakia according to FDI



It is important to note that the considerable differences in amount of FDI are influenced by the methodology of the calculation of FDI that stated the influx of foreign direct investment according to the place of residence of the company. Thus Bratislava “officially” attained

considerably higher amount of FDI. This was the case of privatization of big state businesses like for example the Slovak Gas Industry or the Slovak Telecommunication.

If we apply the neoclassical model of Trevor Swan and Robert Solow (theory of absolute convergence) on regions of the Slovak Republic, than from the long-term point of view the underdeveloped regions would come nearer to developed regions. According to professional assessment, this process of convergence should have measurable impact early in 2013 at the latest, when the road infrastructure should be completed (motorway web) and the development of the industrial parks and zones should be in progress. Until then the dream of a fast growth of economic under-developed regions of the Slovak Republic is just an illusion bordering with inappropriate populism.

The process of bringing the underdeveloped regions closer to the developed ones can be hastened by various economic stimuli that would be activated not only foreign investors, but domestic companies, too. Taking into consideration that the Slovak-owned companies have the highest resources in investment into the production, following 4 to 6 times increase of domestic investment would surely hasten the transformation process of the Slovak economy and thus support faster approximation of under-developed regions to the developed ones.

Conclusion

The main reasons of the low influx of FDI to the Slovak economy are insufficient political stability, low abundance of law, unclear property-legal relations, low attractiveness of the economic environment and the unfinished process of transformation. The amount of foreign direct investment mirrors the above-mentioned flaws of the Slovak economy which still does not fulfill the necessary level that would hasten the transformation process of the business industrial sphere and thus also the growth of the Slovak Economy.

The underdeveloped regions meet many obstacles. Low pensions lead to low savings; low savings slow down the capital growth; insufficient capital impedes introduction of new technologies and fast growth of productivity; low productivity leads once again to low pensions. The question that scares countries in this century is how to break this bewitched circle. One of the ways is to prepare conditions for influx of the foreign capital (new technologies and know-how) in form of foreign direct investment and thus hasten the process of economic transformation and convergence of under-developed regions to the level of the developed one.

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Summary

Z hľadiska vývoja slovenského hospodárstva sme sa za posledných pätnásť rokov od začiatku transformačného procesu preklenuli cez nie ľahké obdobie, charakteristické riešením viacerých zložitých ekonomických problémov. V súčasnosti do popredia ostro vystúpil problém pomalého ekonomického rastu zaostalých regiónov Slovenska. Preto je potrebné poohliadnuť sa za novými myšlienkami a riešenia hľadať v nových prístupoch a prepracovanejších koncepciách regionálnej politiky.

Z obsahového hľadiska článok analyzuje ekonomický rozvoj regiónov Slovenska členených podľa krajov, na základe prílivu priamych zahraničných investícií (PZI) za pomoci modelov neoklasickej teórie regionálneho rozvoja.

Na základe stanovnej metodiky pre hodnotenie economickej úrovne regiónov a ich zaostalosti bol použitý komplexný relevantný indikátor rozvoja, ktorým je výška priamych zahraničných investícií plynúcich do daného regiónu na úrovni NUTS III (kraje Slovenska). Z analýzy vyplynulo, že najzaostalejším regiónom počas sledovaného obdobia je Prešovský kraj a najvyspelejším regiónom je Bratislavský kraj.

Poradie jednotlivých regiónov je nasledovné. Na prvom mieste sa umiestnil BA - Bratislavský kraj (strediskom kraja je hlavné mesto Slovenska - Bratislava), ktorý za sledované obdobie 6 rokov dosiahol v priemere až 64,88 % z celkových priamych zahraničných investícií, ktoré prišli na Slovensko. Na druhom mieste sa umiestnil KE - Košický kraj, ktorý za sledované obdobie dosiahol v priemere 12,57 % z celkových FDI. Tretie miesto obsadil TT - Trnavský kraj, ktorý v priemere získal už iba 5,75 % z celkových FDI. Ďalej na štvrtom mieste sa umiestnil ZA – Žilinský kraj (4,18 %), na piatom mieste TN – Trenčiansky kraj (3,90 %), na šiestom mieste BB – Banskobystrický kraj (3,19 %), na 7 mieste NR – Nitriansky kraj (3,19 %) a na poslednom ôsmom mieste PO – Prešovský kraj, ktorý si v priemere odniesol len 2,46 % z celkových priamych zahraničných investícií.