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FOREIGN DIRECT INVESTMENT IN THE POST-COMMUNIST MEMBER STATES OF THE EUROPEAN UNION - WHO ARE THE LEADERS?

Abstract

Joining the European Union has been treated as a chance for Poland and other post-communist countries to improve their economic growth and development. It was clear from the beginning that it was going to be a long and demanding process in which success is only possible if appropriate economic policies are pursued. That policy should provide stable frameworks to support business development, attract foreign direct investments (FDI), keep the discipline in public finances and assure the right institutional ability and managerial skills to absorb the EU funds. According to forecasts by The McKinsey Quarterly from 2004, 5% Poland's economic growth rate was to require around USD 10 billion of annual FDI inflow!

The aim of this study was identifying the leaders in attracting FDI among post-communist European Union member states in the period of 2004-2020.

The research showed a huge variation in attracting foreign capital among eleven post-communist EU members. Estonia, the Czech Republic, Hungary, Slovakia seem to be winners in this race, leaving Poland far behind.

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1. Introduction

Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. Finally, FDI is an additional source of funding for investment and, under the right policy environment, it can be an important vehicle for growth and development.

According to the Organisation for Economic Cooperation and Development (OECD benchmark definition, 1999) FDI is defined as investment by a resident entity in one economy that reflects the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprises and a significant degree of influence by the direct investor on the management of the enterprise. The ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used. Hence, control by the foreign investor (ownership of more than 50% of the voting power) is not required.

The accession of post-communist countries to the European Union opened new opportunities for intensive economic growth and development with the use of foreign capital, especially in the form of foreign direct investment. Hence, FDI has become an object of a strong competition among these states as the country's attractiveness to foreign investors is decided by many factors.

According to the United Nations Conference on Trade and Development (UNCTAD World Investment Report, 2002) these factors can be divided into three broad groups.

1. Policy framework for FDI which includes: economic, political and social stability, rules regarding entry and operations, standards of treatment of foreign affiliates, policies on functioning and structure of markets, international agreements on FDI, privatization policy, trade policy and coherence of FDI and trade policies, tax policy.

2. Economic determinants are as follows, depending on what investors are looking for.
 - In case of market-seeking FDI the most important are: market size and per capita income; market growth; access to regional and global markets; country – specific consumer preferences.
 - For resource/asset-seeking FDI decisive are: raw materials, low – cost unskilled labour; technological, innovatory and other created assets (e.g. brand names), including as embodied in individuals, firms and clusters; physical infrastructure.
 - In case of efficiency-seeking FDI, matter: cost of resources and assets listed under resource/asset – seeking FDI, adjusted for productivity of labour resources; other input costs, e.g. transport and communication costs to/from and within host economy and costs of other intermediate products; membership of a regional integration agreement conducive to the establishment of regional corporate networks.
3. Business facilitation encompasses: investment promotion (including image-building and investment-generating activities and investment-facilitation services); investment incentives; hassle costs (related to corruption, administrative efficiency, etc.) and social amenities (bilingual schools, quality of life, etc.); after-investment services.

The aim of this study is to identify the leaders in attracting FDI among post-communist European Union member states.

The research focuses on eleven post-communist countries of which: eight joined the EU in 2004 (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia), next two in 2007 (Bulgaria and Romania) and the last one in 2013 (Croatia).

The period under study covers the years 2004-2020. The analysis of FDI inflows/stock was made based on the data provided by the UNCTAD and converted from nominal into real values expressed in dollars of 2018 (Sahr, 2018).

The study is organized as follows. Section 1 shows the world FDI size and allocation in 2004-2020, section 2 examines FDI inflows and stock in the EU-11 post-communist states, section 3 considers the relationship between FDI and country's economic wealth expressed by GDP per capita. Section 4 provides conclusions.

2. Foreign direct investment - size and allocation in 2004-2020

According to the definition adopted by the United Nations Conference on Trade and Development (UNCTAD) FDI inflows comprise the capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or the capital received by a foreign direct investor from an FDI enterprise. FDI includes the three following components:

1. Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than that of its residence.
2. Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
3. Intra-company loans or Intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises intra-company loans.

Negative flows generally indicate disinvestments or the impact of substantial reimbursements of inter-company loans.

FDI stocks measure the total level of direct investment at a given point in time, usually the end of a year. The inward FDI stock is the value of foreign investors' equity in and net loans to enterprises resident in the reporting economy. Inward stocks are all direct investments held by non-residents in the reporting economy.

In the years 2004-2020 we were witnessing an intensive growth in the global FDI. Within this period the world FDI inward stock almost tripled in real terms (281%), it increased from 14.1 trillion 2018 USD in 2004 up to 39.6 trillion 2018 USD in 2020. A slightly weaker growth rate was observed for, so called "old" the EU countries (235%) as well as for eleven post-communist EU member states (216%). Total FDI inward stock in the EU-11 amounted to 399 billion 2018 USD in 2004 to rise to 862 billion 2018 USD in 2020.

Figure 1. Foreign direct investment inward stock in 2004-2020 (in trillions 2018 USD)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

As Figure 1 shows a significant proportion of the global FDI stock has been located in the EU countries. It should be noted, however, that “old” EU-15 member states host in average 31% of the global FDI inward stock, while new post-communist EU-11 members attracted just 3% of it.

When the annual FDI inflows are concerned, we can observe considerable fluctuations expressed by the annual growth rate (Figure 2). In 2004-2007 annual FDI inflows were increasing for the world economy by 31 - 44%. In turn, 2008 and 2009 saw large declines (25% and 16,5%, respectively) as a result of the global financial crisis that started in mid-2007.

Figure 2. The annual FDI inflows growth rate (%)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

Over the next five years, moderate fluctuations in the annual FDI inflows growth rate were observed, ranging from -9% to +12%. In 2015, there was a sudden explosion of foreign investors activity by 45%, only to fade in the following years, until the deep collapse in 2020 (-36%), which was certainly the result of the COVID-19 pandemic. In the analyzed period, fluctuations in the annual FDI flows to the EU-15 were much stronger than globally. For example, when in years 2005 and 2015 the global annual FDI growth rate amounted to, respectively, 32% and 45% than the FDI inflows to the EU-15 showed the annual growth rates at 146% and 170%, respectively. Many times a similar situation took place in the case of declines (see Figure 2).

3. Foreign direct investment in the EU-11 post-communist states in 2004 - 2020

Eight out of eleven analysed post-communist countries joined the European Union in 2004 (that are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia), Bulgaria and Romania joined the EU in 2007 and Croatia in 2013. Their system transformation, started in the early 1990s, resulted among others, in the introduction of various legal regulations which liberalised financial markets and brought them closer to the solutions adopted in the OECD countries. The principle of “*national treatment*” of foreign investors had initiated a period of intensive inflow of foreign capital in the form of FDI and so FDI become an object of competition among post-socialist countries on the one hand, and on the other – a new destination for the world capital flows searching for the most attractive allocations. In years 1993-2004, total FDI inward stock

attracted by analysed group of countries increased in real terms more than 15 times (from 26 billion 2018 USD in 1993 to 399 billion 2018 USD in 2004). During next years the dynamics of FDI inward stock growth was not so rapid. In the period of 2004 – 2020 the total FDI stock in the EU-11 post-communist states just doubled (see Figure 3).

Figure 3. The EU-11 FDI inward stock and inflows in 2004 – 2020 (in billions 2018 USD)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

At that period, the annual FDI inflows to the EU-11 fluctuated in the range from almost 88 to just 12 billion 2018 USD. The annual FDI inflows growth rate ranged between +170% and – 60%.

It should be stressed, however, that the distribution of the investment has been dramatically uneven. As the Figure 4 shows just four countries – Poland, the Czech Republic, Romania and Hungary – attracted about 70% of foreign capital, both in terms of FDI inward stock as well as FDI annual inflows.

Figure 4. The FDI inward stock and flow in the EU-11 post-communist states (average value of 2004-2020 in billion 2018 USD)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

Poland has been a leader in attracting foreign investment in the period 2004 - 2020 taking about 30% of the total FDI located in the EU-11 post-communist countries. Such statistics is often cited as an indicator of Poland's success as an attractive country for foreign capital. Unfortunately, Poland's position as a leader in attracting FDI looks completely different when we compare the data, expressed by numbers related to the number [of inhabitants or the area of the country. Such an approach shows Poland as a weak FDI host country.

Figure 5. FDI inward stock per capita (average value of 2004-2020 in billion 2018 USD)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

As presented in Figure 5, Estonia shows the highest accumulation of FDI stock per capita amounted to 15,5 billion 2018 USD. The second place belongs to the Czech Republic. It should be emphasized here that the Czech Republic also came second when we analyze the FDI stock and annual inflows in absolute terms. A similar situation applies to Hungary. It is very disappointing that Poland is falling to the penultimate place when we consider FDI stock expressed per capita. FDI stock per capita in Estonia is three times higher than in Poland, compared to the Czech Republic the difference is two and a half times.

The situation is similar when we consider FDI stock in relation to the country's acreage (see Figure 6).

Figure 6. FDI inward stock per square km (average value of 2004-2020 in billion 2018 USD)

Source: Own work on the basis of UNCTAD data converted to 2018 USD

The Czech Republic is a leader as the FDI host country when we consider the FDI stock per square kilometre. The Czech Republic is ahead of all other countries in this respect - the value of foreign capital per square kilometre amounts to 1.7 million of 2018 USD. Slovakia and Hungary are ranked second and third (1.12 and 1.06 million of 2018 USD, respectively). Poland is only in fifth place with FDI per square km amounted to 0.63 million of 2018 USD, close to Slovenia and Croatia.

4. Foreign direct investment and economic wealth

The relationship between the FDI and the economic wealth has two aspects: the FDI stimulates economic growth and development, but also reacts to economic growth and progress of positive transformation. Growth is generated by FDI through imported means of investment, new technologies and capabilities transferred by foreign multinationals and international networking. On the other hand, foreign investors react positively to the consolidation of market-economy rules and the resumption of economic growth (Hunya, 2000). High technology is of particular

importance as it supports technological development, value creation, enhancement of staff qualifications, improvement in management quality, better competitiveness of enterprises, regions, related sectors and the whole economy. The form of FDI is relevant just next to its sector structure – the variety of organisational forms contributes significantly to the creation of new jobs, structure of the economy and development of individual regions (greenfield investments are particularly desired as well as other export-supporting projects).

The relationship of economic wealth and FDI is demonstrated by the similarity of per capita GDP and per capita FDI. Outliers matter most in this case. Countries above the regression line have higher FDI stocks than the level of economic development would suggest.

Figure 7. FDI and economic development in the EU post-communist member states

Source: Own work on the basis of UNCTAD data converted to 2018 USD

Among ten new EU post-communist member states, four countries (Bulgaria, Hungary, the Czech Republic and Estonia) have higher than average FDI Stock related to GDP. Negative outliers, these are: Romania, Poland, Latvia, Lithuania and Croatia, attracted less FDI than their development level would allow. Slovakia lies exactly on the regression line (Slovenia was removed from the sample as an untypical observation).

Poland's FDI inward stock per capita was significantly too low as related to its size in terms of the GDP per capita indicator. Unfortunately, from this viewpoint, all the countries of the Visegrad Group, to which Poland is often and willingly compared, left Poland far behind.

5. Conclusions

The conducted research allows to formulate the following conclusions:

Within the period of 2004-2020 the world FDI inward stock almost tripled in real terms, but the allocation of investment is deeply uneven – the EU-15 member states hosted about 30% of the global FDI inward stock, while post-communist EU-11 members attracted just 3% of it.

The annual growth rate of FDI inflows showed deep fluctuations in the analyzed period, ranging from -36% to +45% for the world and from -74% to +170% for the EU-15.

As a result of system transformation in the post-communist countries and further accession to the EU, new recipients of FDI have emerged – the total FDI stock in these economies just doubled in years 2004-2020.

However, the allocation of FDI to the EU-11 was deeply uneven – just four countries (Poland, the Czech Republic, Romania and Hungary) attracted about 70% of foreign capital, both in terms of FDI inward stock as well as FDI annual inflows. Poland ranks first, gathering about 30% of the total FDI located in the EU-11.

The leadership in attracting FDI looks completely different if we take into account the relativized values:

- The highest per capita FDI inward stock was reported in Estonia. The next three places were taken by: Czechia, Slovakia and Hungary. Poland was at the bottom of the ranking, ahead only of Romania,
- As far as FDI inward stock per sq. km is concerned, the Czech Republic left other countries far behind. The next two places were taken by Slovakia and Hungary which also significantly overtook other countries.

The relationship of economic wealth and FDI expressed by the similarity of per capita GDP and per capita FDI demonstrated further deep differentiation between the countries analyzed. Four economies, these are Bulgaria, Hungary, Czechia and Estonia showed themselves as positive outliers (having higher than average FDIpc Stock related to GDPpc). Negative outliers (Romania, Poland, Latvia, Lithuania and Croatia) attracted less FDI than their development level would allow.

Poland's FDI inward stock per capita was significantly too low as related to its size in terms of the GDP per capita indicator. Unfortunately, from this viewpoint, all the countries of the Visegrad Group, to which Poland is often and willingly compared, left Poland far behind.

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