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THE CHANGING POSITION OF EUROPEAN TRANSITION ECONOMIES IN CONTEMPORARY FOREIGN DIRECT INVESTMENTS FLOWS[1]

Foreign direct investments flows have been significantly influenced by the world crisis since 2008 and some changing patterns have emerged. Given the significance of FDI inflows in all European transition economies it is necessary to analyze the position of these countries in the changing trends. Not all European transition countries were equally successful in attracting FDI. The aim of the paper is to show the differences in the scope and dynamics of FDI between transition countries in Central Europe, on the one hand and the Balkan countries, on the other hand.

Key words: *foreign direct investment, transition economies*

1. Introduction. Inclusion of the country into the global economy flows on the principles of comparative and competitive advantage leads to an increase in economic prosperity of the country, as evidenced by numerous empirical studies at the end of the last and the beginning of this century, which proved a positive relationship between the degree of openness of the economy and its long-term economic growth and which is particularly clearly shown in the group of small economies. Therefore it is no surprise that one of the main pillars of the model of transition imposed on former socialist European economies (most of which are small economies) was the liberalization of trade and capital flows. Quick opening to the world, especially to the developed West, in terms of significant differences in development and technological equipment, implied the necessity of rapid structural reforms, a significant increase in the rate of investment, technological leap, as well as the inclusion of transition economies in global distribution flows and production chains. Given the low level of domestic savings, insufficient for dynamic economic growth, the inflow of foreign capital was a necessary condition for a successful transition, and if one bears in mind all the other, listed above, transition «necessities», it is clear that among all types of the inflow of foreign capital, foreign direct investment can be singled out as the most preferred.

When it comes to the method of FDI entry in this group of countries, privatization is central (brownfield investment), with an emphasized dominance of

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this type of investment in the early stages of transition. The utilization of a monopoly position in the domestic market and conquering the market was often a motive for this type of investment. In economies which have completed the process of privatization, there is a need to create investment environments that will be attractive for Greenfield as well, i.e. non-privatized foreign investment. Such investments are economically desirable and export-oriented, and their main motivation is to use the benefits of cheap and skilled labor force, on the one hand, and trade privileges in the EU market which these countries achieve on their road to full membership in the EU, on the other hand (Bevan, Saul, 2004; Christie, 2003).

UNCTAD data on the inflows and stock of foreign direct investment in the world will be used in proving the hypothesis.

The rest of the paper consists of two sections and a conclusion. In the next section the basic characteristics of world FDI flows with reference to the position of transition countries will be discussed. Subsequently, the dynamics of FDI inflows in European transition countries will be analyzed.

2. FDI flows in the contemporary world economy and position of transition economies

One of the main characteristics of globalization, increasing openness and interdependence of national economies, is well reflected in global trends in foreign direct investment (FDI). In the period observed between 1992 and 2012 the total volume (stock) of FDI in the world has increased by about ten times, from 2.4 to 22.8 billion dollars (Figure 1, right panel). A constant and significant increase in the volume of FDI was interrupted only in 2008, with the onset of the global economic crisis, when there was a reduction in the volume of FDI in the world for around 15% compared to 2007, and already in 2009 the total volume of FDI in the world was greater than in the pre-crisis period. Observing by groups of countries, the global economic crisis has hit developing countries the least (reduction in the volume of FDI in 2008 as compared to 2007 of only 5 % and reaching pre-crisis level in 2009), and group of countries in transition – TE the most (36% of reduction in the volume of FDI in 2008 compared to 2007, and reaching pre-crisis level in 2010). In the case of developed countries the decrease was around 15 % and the pre-crisis level was reached in 2010.

The share of certain groups of countries in total world FDI stock (*Figure 2*, right panel) was relatively constant until 2004, when from 73 % to 78 % of global FDI inflow was made in the group of developed economies, from 22 % to 27 % in the developing countries, while the transition economies (TE) accounted for a modest 0.5 % to 1.5 % of the global inflow. After 2004 there comes to significant structural changes in the total FDI stock. Developing countries increased their share reaching 34 % in 2012, while the share of developed countries was constantly reduced to the extent of 62% in 2012. The share of transition economies increased in this period, and in 2012 it amounted to 4%. Interestingly, the global economic crisis has not affected this trend of FDI redistribution in the world, which started in 2004, therefore it was only more pronounced (see more in Hunya, 2011).

In contrast to the constant FDI stock growth in the world, with the exception in 2008, the FDI inflow per year was subject to significant fluctuations that accompany the movement of world economic cycle (*Figure 1*, left panel). In the observed period of the last twenty years, the total world FDI inflow had periods of growth from 1992 until the outbreak of the economic crisis in Asian and Latin American developing countries (at the end of the last decade of the twentieth century) and the crisis in the U.S. and developed economies at the beginning of XXI century, caused by the burst of the bubble in the sector of IT industry, when a decline in global FDI inflow was recorded, followed by a regrowth of annual FDI inflow, which lasted until the outbreak of the global economic crisis in 2008. The developed economies, which were the first affected by the crisis, were the first to feel the decline in FDI inflows, while the decline in FDI inflow in developing countries and countries in transition was achieved in 2009. Short-term recovery of direct investment movement was accomplished in 2010 and 2011, and in 2012 a relapse was recorded, following the pattern of the global economic crisis with «double-dip» (Hunya, 2012). As the decline was greater in developed countries than in developing countries, from 2011, for the first time in history, the FDI inflow was higher in developing countries than in developed countries. Despite these episodes of decline in the global FDI movement, the volume of annual inflow of direct investments in the observed twenty-year period increased by about eight times at the level of the world economy (five times in developed economies, thirteen times in developing countries, and even around fifty times in transition economies, which is the result of a very low base in 1992).

The share of certain groups of countries in the annual FDI inflow has significantly changed in the course of the observed period (*Figure 2*, left panel). Until the outbreak of the crisis in Asian and Latin American economies in the second half of the last decade of the twentieth century, developing countries have increased their share at the expense of developed countries. With the outbreak of the crisis, there was a significant diversion of FDI flows towards developed economies, whose share reaches a maximum of 81% in 2000, while the share of developing countries drops to only 18%. After 2000, there comes to an increase of the share of developing countries, and a decrease in the share of developed countries, and this trend continues after the outbreak of the global economic crisis, which resulted in a greater share of developing countries in FDI inflows than developed economies in 2012, for the first time in the recent history of the world economy. The share of developing countries in FDI inflow in 2012 was 52 %, as opposed to 41 % in developed countries. This drastic diversion of FDI flows, in only two years, is a consequence of the smaller impact of the global economic crisis on developing countries, especially countries of the BRICS group, and anemic recovery from recession in the group of developed economies. The share of countries in transition in global FDI inflow in 2012 was 7%, which was significantly higher compared with the end of the century, but it is interesting to note that the flow of FDI in the transition countries in the period from the outbreak of the global economic crisis is correlated with investment flows in developed economies, i.e. that the crisis has affected the decrease in the share of this group of countries in global trends, as opposed to developing countries where there was an increase in the share in this period.

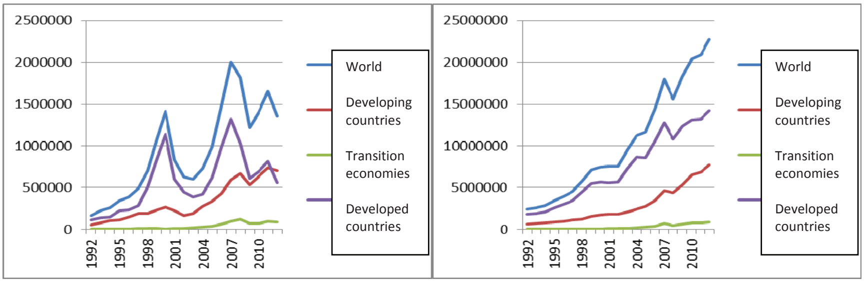

Figure 1. **Inflow and Stock of FDI (in millions of dollars)**

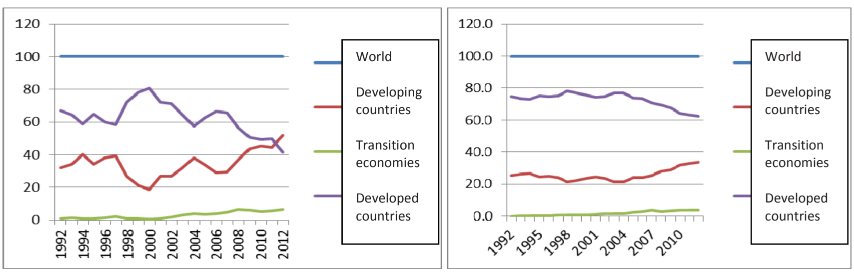

Figure 2: **Inflow and Stock of FDI (share in the world economy)**

Although countries in transition are a destination for a very small part of the total FDI in the world, we can get a more complete picture of the position of these countries, bearing in mind the differences in economic size of the observed groups of countries, reviewing two important parameters: the inflow and stock of FDI in relation to population and in relation to gross domestic product (GDP). Despite the fact that transition economies accounted for only 4 %, and developing countries for 34% of the total global FDI stock, the volume of FDI in relation to the population (*Figure 3*, right panel) is twice as large in TE ($ 2800 versus $ 1350 per capita). The world average is $ 3250, and in the group of developed economies it is $ 13750 pc.

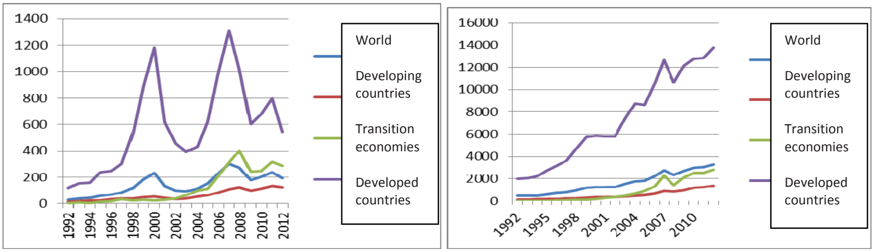

Figure 3: **Inflows and Stock of FDI per capita (in dollars)**

The position of the transition countries is even better if we observe the share of FDI in GDP (*Figure 4*). Although FDI accounts for less than 0.5% of GDP in transition countries in the early 1990s (below the world average, but the average in developed and developing countries), since 2002 countries in transition have been emerging into the top of the list according to this indicator, with 2.4% of GDP. In the record year of FDI inflow in the world (2007), the world average was 3.6% of GDP, and in transition countries even 5.2 % of GDP (which is the largest share of FDI in GDP in the whole observed period among all the analyzed groups of countries). Although the global crisis has led to a drop in GDP in all the analyzed groups of countries, and in the world as a whole, the decline in FDI flows was even greater, and from 2008 there comes to a pronounced downward trend in the share of FDI in GDP, which was briefly interrupted in 2010, so that it would continue in 2011. Therefore the world average in the 2012 amounted to 1.9% of GDP, 1.3% for developed countries, 2.8% for developing countries, while the transition economies are still on top with an average of 3.2% of GDP. These tendencies in the FDI inflow (in relation to GDP), where countries with the lowest starting base had the largest inflow, have led to the convergence of the share of FDI stock in GDP among all the analyzed groups of countries (Figure 4, right panel), so that the stock of FDI in 2012 is about 30-33 % of GDP in all the observed groups of countries.

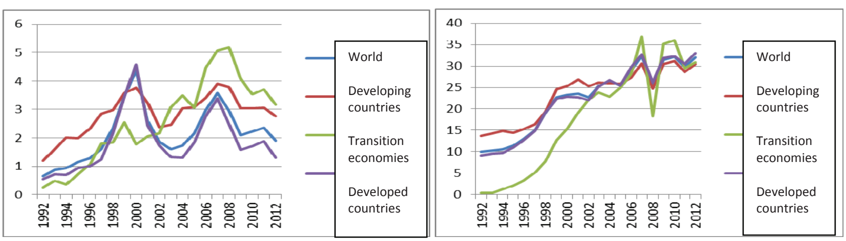

Figure 4: **Inflows and Stock of FDI (% of GDP)**

If, in addition to FDI inflows, we observe their outflow (*Figure 5*), the developed countries were in the whole observed period a net exporter of FDI, while the developing countries and countries in transition were net recipients of FDI. When we take into account the size of the economy, transition economies, in the first decade of the XXI century, surpassed developing countries in net FDI inflow, but the outbreak of the global economic crisis influenced the decline in FDI inflows in transition countries to a great extent, and since 2009 developing countries have had a higher share of net FDI inflow in GDP than transition economies.

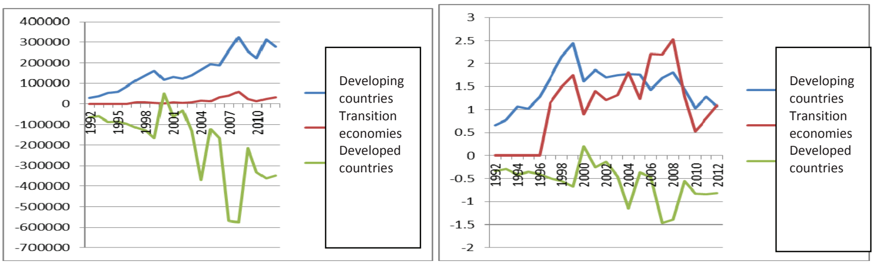

Figure 5: **Net FDI Inflow (in millions of dollars and as % of GDP)**

3. FDI inflow in European transition economies

Differences between European countries in transition in terms of the beginning time of the transition process, the rapidity of its implementation, success on the road to EU membership, political stability, and the existence of conflicts caused the different patterns of FDI inflow (Brada, Kutan, Yigit, 2006; Kalotay, 2010). Region of Central Europe, which was first launched in transition in conditions of relative political stability, was the first to attract foreign investors since the beginning of the last decade of the twentieth century. A group of Baltic countries (Lithuania, Latvia, and Estonia) soon joined the Central European countries, as an attractive destination for FDI, and in the second half of the 1990s FDI arrives in Romania and Bulgaria in significant extent. The Western Balkan countries, burdened by war conflicts and the creation of nation-states, are late with the beginning of transition, thus an increased FDI inflow into the country practically began at the end of the twentieth century (*Figure 6*). At the beginning of the XXI century there was a significant increase in FDI in all transition countries, and a kind of investment boom lasted until the outbreak of the global economic crisis in 2008. The maximum FDI inflow, as observed for all countries together, and by region (Central Europe, Baltic region, Eastern Balkans – Romania and Bulgaria, and Western Balkans), was recorded in 2007 and 2008 before the outbreak of the crisis. FDI inflow in five countries of Central Europe (Poland, Czech Republic, Slovakia, Hungary, and

Slovenia) reached a maximum in 2007, and amounted to about 33 billion dollars. In the same year the maximum FDI inflow was recorded in the Baltic countries (about 7 billion dollars). While in these countries in 2008 was already happening substantial decline in investments under the influence of the outbreak of the global crisis, the Balkan countries just then recorded the maximum FDI inflow (about 24 billion dollars in Romania and Bulgaria, and about 13 billion dollars in the Western Balkans). Therefore, the Balkans felt the crisis with a one-year delay in terms of FDI inflows, in relation to Central Europe.

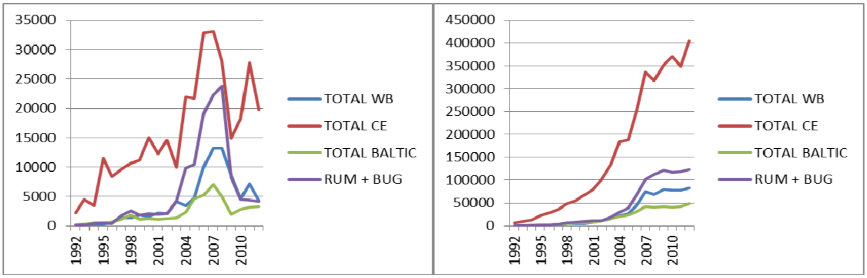

Figure 6: **The Inflow and Stock of FDI in European Transition Countries (in millions of dollars)**

In the entire observed period, foreign investors were the most interested in the region of Central Europe, and this region recorded the highest FDI in each year respectively (*Figure 6*, left panel), which has not changed even with the global economic crisis. The highest percentage drop in FDI was recorded in Romania and Bulgaria, so the inflow of FDI in these countries in 2012 was at the level of the Western Balkans inflow (about 4 billion), despite nearly twice as higher FDI inflow in 2007. In the same year, the countries of Central Europe have attracted about $ 20 billion of FDI, and Baltic countries slightly over 3 billion dollars. In all the observed groups of transition countries, the initial shock of the crisis was followed by a brief recovery inflow of foreign investment (the exception of recovery are Romania and Bulgaria), but then came a new drop (the exception of the second drop in FDI inflow are the Baltic countries).

The global economic crisis has dramatically decreased the inflow of foreign capital in transition countries. The total FDI inflow in all observed transition countries along with about $ 75 billion in 2007 declined to about $ 34 billion 2009, which represents more than halved FDI inflow. The extent of the decline in FDI inflow during the economic crisis is evidenced by the fact that FDI globally decreased in the same period by 39 % and in the group of developed countries by only 10 %. In its scope, the decline in FDI inflow in transition countries observed during the crisis is equal in its size to the decline in investment in developed countries (about 55%).

This confirms the above conclusion that the pattern of FDI inflow in transition countries follows the pattern of FDI inflows in developed countries rather than in developing countries!

The differences in the attractiveness of the observed transition regions affected the significant differences in the level of total accrued FDI (*Figure 6*, right panel). In 2012, the countries of Central Europe had by far the highest cumulative investment (over $ 400 billion), while Romania and Bulgaria were at a significantly lower level (about $ 130 billion), the Baltic countries (about $ 90 billion), while the countries of the Western Balkans tailed with about $ 50 billion.

The fact that global economic crisis has significantly reduced the FDI inflow in European transition countries than in the other groups of countries is evidenced by data on the participation of the countries in total world FDI (*Figure 7*, right panel).

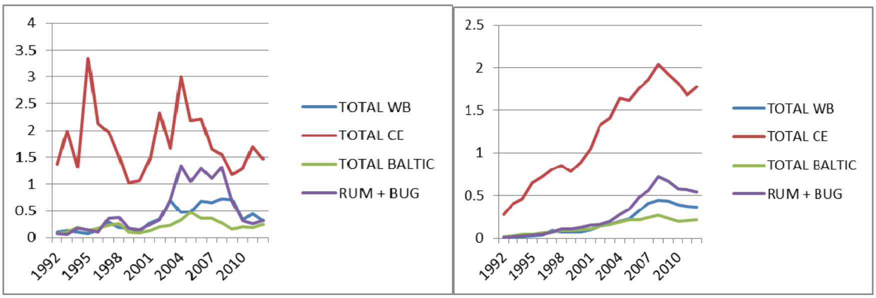

Figure 7: **Inflows and Stock of FDI (share in the world economy) in European Transition Countries**

The share of observed European transition countries in total FDI stock in the world has been constantly growing since the beginning of the transition to the global economic crisis (with negligible 0.3% in 1992 and 3.5% in 2008, when the maximum share in global FDI was recorded). After the outbreak of the crisis, there comes to a decline in the share of transition countries in total world FDI stock (to 2.8% in 2011). A slight recovery was recorded in the 2012, when the share of the observed transition countries rose to 2.9 %, but only due to the region of Central Europe, which is the only one of the observed region which recorded the regrowth of share in the global distribution of FDI. The share in world FDI stock in the region of Central Europe in 2012 is 1.77 %, Romania and Bulgaria have a share of 0.54 %, followed by the WB countries with the share of about 0.36 %, while the Baltic countries are with the share of 0.21 %. As a whole, the European transition countries were, during the crisis, facing the decline in the share of cumulated world FDI by about one fifth. For comparison, a group of developing countries in the same period (from 2008 to 2011) increased its share by about one-fifth, while the share of developed countries dropped by about the same percentage. Once again, it was confirmed that the pattern of FDI inflow in transition countries matched the pattern of FDI inflows in developed countries far better than in developing countries.

Taking into account the size of the European transition economies, we get a better picture of the attractiveness of certain groups of countries as an investment destination. If we put the inflow and stock of FDI in relation to the population (*Figure 8*), we see that the FDI cumulative per capita in 2012 is at the same level in the region of Central Europe and the Baltic region (about $ 8400 per capita), which is significantly higher than in Bulgaria and Romania (together average about $ 5000 per capita), while the Western Balkans leg behind with about $ 4000 per capita. If we take achieved GDP as denominator (*Figure 9*), the picture changes significantly: Romania and Bulgaria protrude to the top with cumulated FDI of around 70% of GDP in 2012, followed by the Western Balkans with about 63% of share of cumulative FDI in GDP, and the last are the Central European and Baltic countries with about 56%.

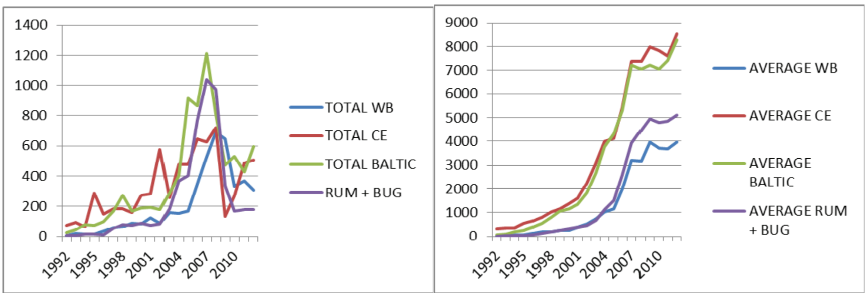

Figure 8: **Inflow and Stock of FDI Per Capita in European Transition Countries (in dollars)**

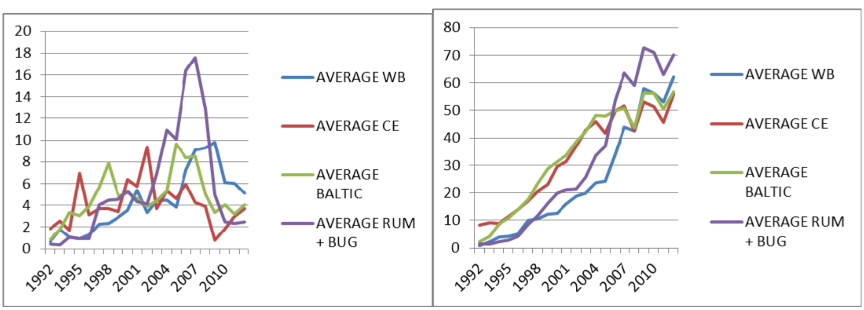

Figure 9: **Inflow and Stock of FDI (%GDP) in European Transition Countries**

4. Conclusion

Foreign direct investment, due to not only the inflow of the missing capital, but also technology transfer and the inclusion of countries in the global production and distribution flows, is considered one of the most popular form of foreign capital inflow. This is particularly true in terms of a relatively sudden and rapid transition from socialist to capitalist economy, which was implemented or is still being implemented in the countries of Central and South-eastern Europe. Changing the approach to FDI and the desire to attract more foreign investors caused the increase in FDI inflows in transition countries. After a modest share in global FDI inflow during the last decade of the twentieth century, when the transition countries participated in the global FDI cumulative with less than 1 %, the first decade of the XXI century has brought a significant increase in the share of these countries in world FDI flows, and their share at the end of 2012 amounted to a modest, but given the number of inhabitants and the size of the economy, for this group of countries significant 4%. This increase takes place at the same time as developing countries increase their share in world FDI, while the attractiveness of developed countries decreases.

Despite the fact that transition economies participate with only 4 %, and developing countries with 34% of the total global FDI stock, FDI volume relative to the population is twice as high in transition countries ($ 2800 versus $ 1350 per capita in 2012). The position of the transition countries is even better if we observe the ratio of FDI to GDP. In the record year for FDI inflow in the world (2007), the world average was 3.6% of GDP, and in transition countries even 5.2 % of GDP. All the data confirm the initial hypothesis that the attractiveness of European transition countries, as an investment destination for foreign investors, increases. However, this conclusion is valid only for the period up to the beginning of the global economic crisis.

The global economic crisis affected the reduction of FDI volume in the world as expected, but it also influenced the structural changes in the patterns of FDI inflows among groups of countries. The crisis affected FDI inflows in developing countries the least, and the group of countries in transition the most. The total FDI inflow in all observed European transition countries was about $ 75 billion in the record 2007 and declined to about $ 34 billion in 2009. The extent of the decline was evidenced by the fact that FDI globally decreased in the same period by 39 % and in the group of developed countries by only 10 %. In its scope, the decline in FDI inflow in transition countries, observed during the crisis, is equal in its volume to the decline in investment in developed countries (about 55 %). It can be concluded that after the outbreak of the global economic crisis pattern of FDI inflow in transition countries follows the pattern of FDI inflow in developed countries rather than in developing countries. This calls into question the confirmation of the initial hypothesis about the growing share of European transition countries in world FDI flows.

Differences between European countries in transition in terms of the beginning time of the transition process, the rapidity of its implementation, success on the road to EU membership, political stability, and the existence of conflicts caused the different patterns of FDI inflows. The differences in the attractiveness of the observed transition regions are reflected in the level of total accrued FDI. In 2012, by far the highest cumulative investment is in the Central Europe, while Romania and Bulgaria, the Baltic countries, and the Western Balkans are at a significantly lower level.

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Станісіч Н.

Стан європейських країн з перехідною економікою в сучасних умовах залучення прямих іноземних інвестицій

Світова економічна криза 2008 року значно вплинула на потоки прямих іноземних інвестицій, чим і були спричинені деякі зміни в їх структурі. Враховуючи значимість потоків прямих іноземних інвестицій в усіх європейських країнах з перехідною економікою необхідно проаналізувати стан цих країн в умовах мінливості тенденцій. Не всі європейські країни з перехідною економікою були однаково успішними у залученні прямих іноземних інвестицій. Мета цієї статті – показати відмінності в масштабах і динаміці прямих іноземних інвестицій між країнами з перехідною економікою в Центральній Європі, з одного боку, і балканських країн – з іншого.

Ключові слова: *прямі іноземні інвестиції, країни з перехідною економікою.*

Станисич Н.

Состояние европейских стран с переходной экономикой в современных условиях привлечения прямых иностранных инвестиций.

Мировой экономический кризис 2008 года значительно повлиял на потоки прямых иностранных инвестиций, чем и были вызваны некоторые изменения в их структуре. Учитывая значимость потоков прямых иностранных инвестиций во всех европейских странах с переходной экономикой, необходимо проанализировать состояние этих стран в условиях изменчивости тенденций. Не все европейские страны с переходной экономикой были одинаково успешными в привлечении прямых иностранных инвестиций. Целью этой статьи является показать различия в масштабах и динамике прямых иностранных инвестиций между странами с переходной экономикой в Центральной Европе, с одной стороны, и балканских стран – с другой.

Ключевые слова: *прямые иностранные инвестиции, страны с переходной экономикой.*

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