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Foreign Direct Investment in Central, East and Southeast Europe 2008-2009: FDI in the CEECs under the Impact of the Global Crisis: Sharp Declines

The Vienna Institute for International Economic Studies (wiiw) presents an analysis of foreign direct investment (FDI) in 20 Central, East and Southeast European countries based on the latest update of its database.

At present, the FDI-led growth strategy of the new EU member states (NMS) and the Southeast European (SEE) countries is in a critical state. Excessive foreign exposure has resulted in high vulnerability, particularly of the smaller countries, and facilitated the transfer of the financial crisis. After years of continuous growth, *FDI inflows to the NMS declined by 9%* and to the SEE countries by 22% in 2008 (Table 1). This was compensated by an FDI boom in the European CIS (+17%) although mainly in the form of round-tripping Russian capital.

The performance of the NMS was uneven: Romania and Slovenia registered significant increases in FDI inflow last year, while Poland, Bulgaria and the Baltic states were hit by declines. Some of these changes were the result of normal fluctuations due to individual large investment projects. In the Czech Republic, Hungary and Slovakia FDI inflows remained at the previous year's level and investments continued to flow also into export-oriented projects, in industries that suffered major declines of production in early 2009.

The Western Balkan countries (with the exception of Albania) *experienced major setbacks of FDI in 2008*. The main reason for the meagre inflow is that most of the economies in the region are narrowly based and the FDI here is market seeking. Investors rarely set up export-oriented projects, therefore the Western Balkan countries have not succeeded yet in becoming integral parts of international production networks like the NMS.

Based on global trends and the results in the first quarter of 2009 we *expect the FDI inflow to shrink to at least half* of last year's level. Despite that considerable decline, the amount of FDI to flow into the NMS may reach EUR 20 billion, which is similar to the amount these countries received at the beginning of the 2000s. FDI will remain more resilient than other forms of financial inflows and its structure is undergoing some temporary changes. Foreign investors have reported the delay of larger FDI projects but they go on with smaller efficiency-improving investments and have started to restructure their production and sales networks. *It is possible that more production will shift from Western Europe to low-cost NMS*, and that some subsidiaries will be closed also in the CEEC region. New investment opportunities also appear in the NMS, due to a growing number of EU-financed projects. In the Western Balkan countries more FDI is expected in the energy sector which is short of power generating capacity.

CEECs have not only benefited from the inflow of foreign capital in recent years, but they have also paid a high price for it. *FDI has become a source of income outflow and contributed to the external financial problems in some countries*:

- FDI financed a declining share of the current account deficit in 2008, thus other, more volatile sources of financing had to be tapped (Table 2). Only in the Czech Republic was the FDI inflow higher than the current account deficit; Bulgaria, Romania and Slovakia financed more than half of their current account deficits by FDI, other countries significantly less.
- The soaring income of foreign investors comprised an increasing part of the current account deficit, more than half of it in all five Central European NMS (Table 2). Investors' income in proportion to the FDI stock increased to as much as 18% in Hungary and 14% in the Czech Republic.
- An increasing part of the FDI-related income was repatriated from the NMS (Table 3). In 2008 the average rate of repatriation reached 70%, the highest in the region's history. Slovenia, Slovakia, Bulgaria and Hungary were above the average, the Czech Republic and the Baltic countries significantly below.
- The amount of FDI inflow financed only half of the repatriated income from Hungary and also less than 100% in Slovakia in 2008 (Table 3) while income repatriation and FDI inflow were of almost equal amounts in the Czech Republic. In the remaining countries FDI inflows still exceeded repatriated income, mostly in those countries where the FDI is of more recent origin.

In the ideal case, foreign investors establish export capacities, thus *the negative income balance can be compensated by a foreign trade surplus*. This is partly the case in the Czech Republic and Hungary, but all countries will need further export-generating investments and have to stimulate investors to re-invest their incomes. Such investments may not come during the present crisis due to the general fall of economic performance. Current account deficits are definitely shrinking, thus FDI will again play a bigger role in balancing the current account.

(Tables 1-3 overleaf)

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Table 1

Overview of FDI in Central, East and Southeast Europe

	FDI inflow, EUR million				Per capita inflow, EUR	Per capita stock, EUR
	2005	**2006**	**2007**	**2008**	**2008**	**2008**
Czech Republic	9374	4355	7634	7329	703	7844
Hungary	6172	6024	4429	4406	439	6254
Poland excl. SPEs	7112	12711	15352	10970	288	3005
Slovakia	1952	3741	2382	2323	430	5700
Slovenia	473	513	1050	1239	607	5100
NMS-5	**25082**	**27344**	**30848**	**26266**	**398**	**4600**
Bulgaria	3152	6158	8488	6163	809	4293
Romania	5213	9061	7250	9084	422	2402
Estonia	2302	1432	1962	1366	1019	8690
Latvia	568	1326	1648	916	404	3566
Lithuania	826	1448	1473	1073	320	2722
NMS-10	**37143**	**45152**	**49151**	**44868**	**439**	**4100**
Albania	213	259	481	682	215	935
Bosnia and Herzegovina	493	572	1546	690	179	1400
Croatia	1468	2765	3667	2930	661	4930
Macedonia	77	345	506	413	201	1600
Montenegro	393	644	1008	832	1325	4864
Serbia	1265	3516	2272	1879	256	1586
Southeast Europe	**3909**	**8101**	**9480**	**7425**	**346**	**2200**
Belarus	245	282	1304	1467	151	492
Moldova	153	200	360	484	136	509
Russia	10336	23675	40237	47982	338	2500
Ukraine	6263	4467	7220	7307	158	719
European CIS	**16997**	**28624**	**49121**	**57240**	**284**	**2000**
Total region	***58049***	***83494***	***110271***	***109533***	***337***	***2700***

Note: SPEs – Special Purpose Entities; 2008 preliminary data.

Source: wiiw Database on FDI incorporating national bank statistics.

Table 2

FDI and current account position

	FDI income deficit in % of the current account deficit				FDI net in % of the current account deficit			
	2005	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**
Czech Republic	369	231	252	229	696	109	161	131
Hungary	63	71	94	74	66	42	26	37
Poland	245	134	93	59	184	116	90	44
Slovakia	67	67	103	71	56	83	62	52
Slovenia	63	71	94	74	-9	-23	-18	12
Bulgaria	27	32	28	25	119	129	114	66
Romania	35	33	26	28	76	85	42	54
Estonia	50	40	44	62	157	25	29	48
Latvia	29	21	19	14	29	33	30	27
Lithuania	38	26	25	18	37	48	25	27

Source: wiiw Annual Database incorporating national bank statistics.

Table 3

Repatriation of FDI-related income

	Share of repatriated income in FDI income (outflow), %							FDI inflow in % of repatriated FDI income
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2008**
Czech Republic	37.8	48.4	51.8	51.1	57.8	54.5	57.7	107
Hungary	43.0	43.7	49.6	59.6	80.6	79.3	71.2	54
Poland	262.9	104.1	35.3	63.3	56.5	51.0	63.5	143
Slovakia	.	20.3	36.1	68.1	64.9	78.3	81.8	90
Slovenia	33.4	26.3	27.5	34.9	65.1	94.6	97.8	173
Bulgaria	62.8	55.0	27.4	44.9	35.0	49.1	77.2	364
Romania	.	28.1	30.4	50.5	19.4	69.9	66.2	293
Estonia	85.8	29.1	29.3	32.5	15.8	16.0	17.2	361
Latvia	71.5	54.3	42.9	45.4	13.9	21.3	17.5	239
Lithuania	42.3	45.3	37.2	57.3	11.0	13.3	8.8	553
Croatia	57.5	33.9	52.7	33.0	33.7	56.0	62.2	4726
Russia	77.8	43.6	48.2	52.0	57.5	45.9	48.4	1502
Ukraine	98.2	86.2	96.5	98.6	96.5	98.6	.	.

Source: wiiw Database on FDI incorporating national bank statistics.