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Foreign Direct Investment in Central, East and Southeast Europe: A short-lived FDI recovery

Foreign direct investment (FDI) continues to be of great importance for Central, East and Southeast European (CESEE) countries. Foreign investors whose subsidiaries were the main producers of exports played an important role in the economic recovery of 2011, which was based largely on external demand. Overall FDI inflows grew by 26%; the strongest growth was observed in the SEE countries (64%); in the NMS FDI grew by 26% and in the CIS by 18%. FDI inflows were still lower than in 2008 in all countries however. For 2012 experts from the Vienna Institute for International Economic Studies (wiiw) expect a renewed decline in FDI inflows. These are the main results of the recent analysis of foreign direct investment in 22 CESEE countries by the wiiw, based on the latest update of its FDI database.

In 2011 CESEE economies experienced a short-lived recovery that was largely export-based, with domestic engines of growth remaining weak and fiscal consolidation proving to be a drag on the economies. Hence the role of foreign investors whose subsidiaries generate a major portion of exports was enhanced. FDI inflows grew in almost all CESEE countries; the strongest growth was observed in SEE countries (64%) following a year of extremely low inflows. The growth of FDI in the NMS was 26% and in the CIS 18%. Despite these increases the total value of the inflows – almost EUR 96 billion – was still well below the peak years 2006-2008. Large countries like Russia, Turkey and Kazakhstan received the major part of the recent FDI boom, though Hungary, Serbia and Slovakia also significantly improved their positions. FDI inflows declined in only five countries including the Czech Republic, Estonia and Romania, though they remained important receivers of FDI.

Financial flows not necessarily related to physical investments have become a major form of FDI. They often include round-tripping of domestic capital and other tax optimizing flows. As an extreme example, about two thirds of Russian FDI inflows and outflows are to and from Cyprus and other tax havens. The share of the manufacturing sector in FDI is declining while the financial sector and other business services are increasing their shares. Much FDI in business services takes place through holding companies often based in the Netherlands making this country the most significant investor in the region. Disregarding these Dutch-based holding companies, Austria which is usually the second or third largest investor in the new EU members and Southeast Europe by official statistics would advance to first or second position after Germany.

As usual, a small number of large CESEE countries – Russia, Poland and Romania – attracted the highest number of new greenfield projects and also the largest amount of investment commitment, though Russia is by no means as dominant as FDI flows would suggest. In terms of the number of projects per inhabitant, the Czech Republic, Hungary and Slovakia were the main beneficiaries, all countries with important export oriented projects in industry and services. In 2011, the number of projects declined somewhat compared to 2010, especially in Russia and the Ukraine but also in the

Czech Republic and Slovakia. In South-East Europe both Serbia and Croatia attracted significantly more projects than in earlier years. According to all indicators, Serbia has joined the group of most popular FDI locations.

Profits of foreign investors recovered in most CESSEs in 2011. The rate of profit once again climbed above 10% of FDI stocks in the Czech Republic, Estonia and Russia, and to around 8% in Hungary, Lithuania, Poland and Slovakia. Meagre profits were recorded in Bulgaria, Romania, Slovenia and several SEE countries. These countries were hard hit by the crisis, have relatively little FDI in manufacturing and rather young foreign investment enterprises. A lower share of profits was repatriated from most of the NMS and SEE than in the previous year. It seems that deleveraging was postponed until 2012.

Several governments modified their FDI policies in response to the crisis, with resulting repercussions on the domestic economies and outflows of FDI-related income: some countries reacted with economic nationalism, others by improving their incentive systems even further.

As a result of the expected economic deceleration throughout Europe, wiiw experts expect a renewed decline in FDI inflows in 2012. On average, FDI flows are forecast to be 3% lower than in 2011. Expectations are supported by plummeting first quarter FDI flows and greenfield projects. Increases will be confined mainly to Russia where high oil prices may feed further offshore investments. Estonia, Croatia and Serbia may also see increased FDI inflows.

wiiw Database on Foreign Direct Investment in Central, East and Southeast Europe, 2012

Short-lived recovery

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Table 1

**Overview of FDI inflow in Central, East and Southeast Europe (EUR million)
and per capita inflow and stock (EUR)**

	2006	2007	2008	2009	2010	2011	wiiw forecast 2012	Per capita inflow 2011	Per capita stock 2011
Bulgaria	6222	9052	6728	2437	1209	1341	1200	182	5018
Czech Republic	4355	7634	4415	2110	4637	3890	3500	369	9175
Estonia	1432	1985	1182	1323	1162	130	1000	98	9527
Hungary	5454	2852	4191	1517	1728	2999	1700	301	6558
Latvia	1326	1698	863	68	286	1114	500	539	4550
Lithuania	1448	1473	1341	47	568	875	1000	286	3364
Poland	12711	15902	9736	7940	6674	9500	9000	248	3712
Romania	9061	7250	9496	3489	2220	1920	1500	101	2858
Slovakia	3741	2618	3200	-4	397	1542	1000	283	7339
Slovenia	513	1106	1330	-470	274	791	900	386	5710
New Member States-10	46264	51570	42481	18457	19155	24101	21300	243	4837
Albania	259	481	665	717	793	742	700	230	933
Bosnia and Herzegovina	442	1329	684	181	174	313	100	81	1301
Croatia	2765	3651	4219	2415	295	1048	1500	238	5422
Macedonia	345	506	400	145	159	304	200	147	1699
Montenegro	496	683	656	1099	574	401	500	647	7241
Serbia	3392	2513	2018	1410	1003	1949	2000	268	2435
Turkey	16075	16086	13261	6030	6818	11425	10000	156	1482
Southeast Europe	23774	25249	21902	11997	9816	16182	15000	171	1755
Belarus	280	1311	1539	1326	1048	2775	2000	293	1060
Moldova	206	396	483	104	149	197	200	55	691
Kazakhstan	5002	8123	9732	9497	8109	9274	9000	560	4344
Russia	23675	40237	51177	26254	32802	37974	40000	266	2807
Ukraine	4467	7220	7457	3453	4893	5177	5000	113	1097
Selected CIS	33629	57287	70388	40633	47001	55397	56200	254	2456
Total region	103667	134107	134771	71087	75973	95680	92500	232	2869

Remark: Hungary and Poland excluding SPEs.

Source: wiiw database relying on national balance of payments statistics, wiiw forecast and own calculations.