Chapter Seven

Foreign Direct Investment, Transition and Dependency in Central and South East European Countries

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Introduction

Eleven Central and South-Eastern European Countries (CSEEC)[1] – three Baltic States, six Central European countries previously in USSR orbit, two successor states of the former Yugoslavia – became new member states (NMS) of the European Union during three waves of membership (2004, 2007, 2013). Five of them have already joined the Eurozone,[2] the rest are expected to join in the near future. The countries of the Western Balkans,[3] for their part, are on the waiting list, most of them having submitted their request to open negotiations for their future membership of the European Union.

The NMS joined the EU after having suffered three successive shocks. These were a systemic shock with the collapse of communism, an economic shock with the adoption of macroeconomic and structural adjustment measures to face the new market environment, and finally an institutional shock in order to meet the strict and restrictive conditions for becoming a member of the European Union: the ability to withstand competition from other Member States and respect for the 'acquis communautaire.'

[1] Estonia, Hungary, Poland, Czech Republic, Slovakia, Slovenia (in 2004), Bulgaria, Romania (in 2007), Croatia (in 2013). Mention should be made of the presence of a 'stowaway,' the former GDR, which was quickly integrated, at a very high cost, into the Federal Republic after the fall of the wall.

[2] Estonia, Latvia, Lithuania, Slovakia, Slovenia.

[3] Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, Serbia.

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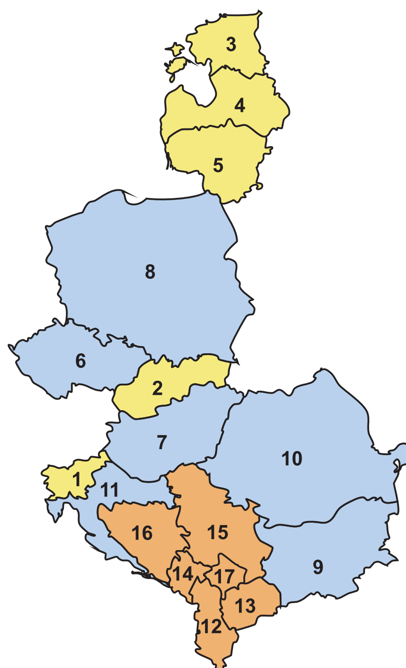
The transformation process, which is short in time, was particularly difficult, violent, especially at the very beginning. Most of these economies have resorted to shock therapy – 'The Washington Consensus' – under pressures of the European Union, major international institutions (IMF, World Bank and EBRD) and the large multinational firms that are there, implanted. Multinational corporations, the 'surprise guests,' via foreign direct investment (FDI), have played, with the European structural and cohesion funds, a determining role in the transformation of these economies, their lasting attachment to the European Union. The transformation of these economies represented a particularly difficult challenge for these formerly 'dependent socialist,' mostly Soviet type economies of the for the most part, self-managed and open economies (former Yugoslavia) or self-sufficient economies (Albania). When it comes to the transformation and redistribution of property, CSEECS leaders have oscillated between fairness and efficiency with a slider that has often shifted over political majorities. The liberal majorities favoured policies accelerating the movement of privatization. The socialist (ex-communist) majorities sought to curb them in order to continue to exercise control over the assets from a clientelist rather than a social perspective. Systemic constraints (EU membership), the rapid and growing arrival of FDI have accelerated adjustments, the reorientation of trade, and increased their competitiveness.

FDI has greatly contributed to integrating these economies through their massive investments in manufacturing, financial, distribution and infrastructure sectors. Several countries in the region, notably the four countries of the Visegrad group (Czech Republic, Hungary, Poland, and Slovakia) quickly became the hinterlands of Germany and the large Western neighbouring countries.

The transformation policies applied have left no space for alternative forms of control and management of public firms. With the exception of a few monopolies (in energy and telecommunications) which have not been affected, most large firms with growth potential have been absorbed by foreign buyers, some dismembered or even liquidated. These FDI flows have fostered a close industrial network with the EU-15,[4] which can be measured by the specialization as well as the value-added content of exports from the countries of the region, particularly to the

[4] Now EU-14, with the departure of the United Kingdom.

Area/Contry	(1)	(2)	(3)
Euro Area NMS			
1 Slovenia	2.1	29 933	82.4
2 Slovakia	5.4	29 224	89.4
3 Estonia	1.3	28 095	77.3
4 Latvia	2.0	23 095	65.3
5 Lithuania	2.9	27 904	76.8
Non-Euro Area NMS			
6 Czech Republic	10.6	31 353	86.3
7 Hungary	9.8	25 654	70.6
8 Poland	38.4	26 051	71.7
9 Bulgaria	7.1	17 794	49.0
10 Romania	19.7	21 608	59.5
11 Croatia	4.2	21 547	59.3
Western Balkans			
12 Albania	2.9	11 359	31.3
13 North Macedonia	2.1	13 055	35.9
14 Montenegro	0.6	15 725	43.3
15 Serbia	7.1	13 723	37.8
16 B&H	3.5	11 327	31.2
17 Kosovo	1.8	9 332	25.7



NOTES Column headings are as follows: (1) population (million), (2) real GDP per capita (PPP, USD, 2016), (3) real GDP per capita, percentage of EU-28 (2016).

FIGURE 7.1 Market Size of CSEEC

EU-15 (Jirasavetakul & Rahman, 2018). The study of the recent development of capitalism in the region has fuelled many theoretical debates concerning its varieties, the degree of dependence of these new formations around the typology of liberal market economies, coordinated market economies (Ban, 2013; Delteil, 2018). King (2007) introduced a distinction between liberal post-communist dependent capitalism applied in almost all of the countries of Central Europe and patrimonial capitalism (which may derive from then towards prebendalism) implemented in Russia, Ukraine and Central Asia with, which is new, development attempts in Hungary (Magyar, 2016; Scheiring 2018).

The capitalism introduced in the region is, in our eyes, liberal through

the form of privatization, governance, institutions, it is also an imported capitalism (Szélenyi 2015). In these countries, capitalist traditions never really existed. Where they existed (Bohemia), they were eradicated by the communist power when it was established in the region. These economies have thus become hierarchically dependent market economies considering the weight of the multinational firms operating there. Today, according to Nolke and Vliegenhart (2009), they form an institutional hybrid (dependent market economy) whose specific comparative advantage is not based on radical or incremental innovations but rather on the construction of assembly platforms for semi-standardized industrial goods (Ban, 2013).

Through their presence, multinational firms play a major role in terms of control, organization, skills and links with the markets (King, 2007). We can measure the dependence of the economies of central and south-eastern Europe quantitatively by recalling a few indicators such as the level, amount, content and sectoral destination of FDI, control of the main manufacturing and financial firms, and the net investments to GDP ratio. To these, we may add the direction and content of trade, the differences between levels of research and development expenditure with the country of origin of investors, migratory movements of skilled labour, and finally the degree of resulting hierarchy in the relations between parent firms, order givers, and domestic, order receiving, firms.

Towards the Market and the EU: Structural and Institutional Changes

What type of capitalism should have been introduced as a result of these political changes? Ivan Szelényi (2015), following King (2007), distinguishes three modes of development of capitalism that appeared during the years of 1980s and 1990s among the post-socialist economies of Europe and Asia: imported capitalism (Eastern Europe), capitalism from above (Russia, Central Asia), capitalism from below (China). In Russia, the introduction of capitalism took place from above via the constitution of a patrimonial-type capitalism via redistribution within a small elite (the oligarchs).

The patrimonial type of capitalism is characterized by the appropriation of goods and their possible redistribution (prebendalism) by an authority (a person, an institution). This form of redistribution characterized Russian privatizations through which the beneficiaries, the

oligarchs, (the *red barons*[5]) seized opportunities to appropriate assets often at a low price. In China, the reform and opening up of the socialist system carried out in the 1980s led to a mixed system with, on the one hand, state sector firms remaining in the hands of the central government and, on the other, the massive entry of private operators via the lowering of entry barriers. The whole is indirectly regulated by monetary and budgetary instruments as well as by various interventions of the centre (credit policy, various industrial policies, distribution of subsidies). This type of capitalism remains subject to the political power which can push for the development of a dynamic private sector, then puncture it, constrain it (access to finance and to markets), or even dismember and destroy certain firms that it has itself helped to emerge. In Eastern Europe, the imported model was that of Western capitalism, especially its liberal variant. Its establishment also met the hopes of the populations of the region, who saw in it the pledge of a prosperous future, moving them definitively away from the shortage socialist model.

The transformation that has taken place in the economies of the region has been articulated around four axes (Richet 1992):

- Macroeconomic stabilization in order to curb inflation and control public and external deficits;
- Creation and development of new market institutions hitherto non-existent or limited (financial and banking system, competition law and protection of property);
- Reintegration into the world economy (openness, exchange system and currency convertibility);
- Privatization and restructuring of companies and the entry of new domestic and foreign companies.

We can guess the importance of the structural reforms to be accomplished by these economies whose specializations and industrial organization were deeply marked by the imprint of Soviet-type industrialization. There was also the question of the managerial elites available capable of managing companies in this 'capitalism without capitalists' (Eyal et al., 1998), following the sale, the distribution of assets by different means, employees of companies, citizens, national and foreign buyers (companies, investment funds) often difficult to assess.

[5] In reference to the American robber barons, the great figures of capitalism who, in the 19th century, made their fortunes by robbing the state.

TABLE 7.1 Varieties of Capitalism in in CESECS, Russia and China

Country/ Region	Mode of introduction	Type of capitalism	Main features	Role of foreign capital
CSEEC	From the outside	Liberal	'Illiberal' for some (Poland, Hungary): obstacles to justice, infringement of press freedom; multi-party kleptocracies (Western Balkans)	Determinant in the shaping of capitalism, in restructuring, control and governance of companies, in the orientation of exchanges, in the specialization of firms
Russia, Central Asia	From above	Political capitalism Patrimonial evolving towards prebendalism (Putinian redistribution) A rent economy that is struggling to emancipate itself from Dutch disease (weight of the energy sector)	Illiberal, 'managed democracy'; Multi-party kleptocracies	Weak, controlled, discontinuity, upset entries
China	From below	Political and hybrid capitalism:* cohabitation of state, private, foreign (100%), joint (JV), private companies. Half-market, half-administered regulation	Illiberal, totalitarian. Western-style democracy has never been the order of the day Anti-occidentalism Claims. Perenniality of the Party-State on the economy, society	Determining in the development of several sectors, technological catch-up; controlled (forced transfer of technology, participation in R&D efforts); privileged state sector firms (access to financing)

NOTES * On the definition of political capitalism, cf. Branko Milanovic (2019): 'Communism is a social system which allowed backward and colonized societies to abolish feudalism, to regain economic and political independence and to build an indigenous capitalism,' that is to say the combination of a 'social and national revolution' in Third World countries. Adapted and developed from Ivan Szélenyi (2015).

We have thus moved from an administered economic system (central fixing of prices and quantities, inputs and recipients of the output) to a market economy system made up of private firms now operating in an open competitive environment. But, in the process, the economy has avoided what has been the strength of capitalism over time during its historical trajectory: entrepreneurial capitalism, managerial then institutional capitalism and now financialized capitalism. A more open system, the Yugoslav model was also constrained by its republican fragmentation and by the control exercised by the national communist parties.

The deprivations practiced in the CSEEC favoured either a particular mode or simultaneously resorted to several modes. The choice of one method of privatization over another was not neutral: it aimed, in one case, to constitute 'popular capitalism' (Czech Republic) by returning to the population what had been nationalized in the name of people in the old socialist system. It also sought to perpetuate industrial flagships, even if it meant selling them to foreign buyers in return for commitments concerning the maintenance of employment, the association of local management with the management of privatized firms. The participation of foreign firms, largely from the European Union, has strongly contributed to reshaping the industrial landscape of the region. This has been done by creating regional value chains, developing sectors that were hitherto non-existent, developing ex-nihilo the banking and financial sectors in return for a strong dependence in terms of the share of FDI in the GDP and control of assets, especially financial assets.

Foreign Direct Investment: An Instrument of Specialization and Dependence

FDI in the region has largely come from the European economies (EU-15) at more than 70%, more particularly from the closest countries (Germany, Austria) and the most important ones (Germany, France, Great Britain). The absorption capacities of these economies have not diminished over time even if some countries have become formally more reluctant to welcome FDI (Poland, Hungary). The role of FDI is seen there as an instrument that helps to perpetuate the status of semi-peripheral development of the region (Gal & Schmidt, 2017).

On the other hand, in the Western Balkans, FDI represents a windfall to allow the adjustment of economies still too marked by their previous

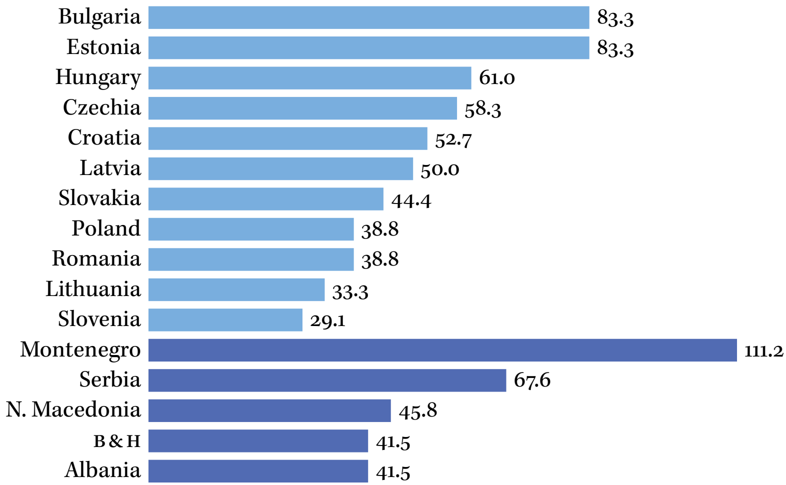


FIGURE 7.2 FDI Stock in New Member States of the EU and Western Balkans (adapted from Jirasavetakul & Rahman, 2018)

specializations, by narrow markets, by still high levels of risk (Estrin & Uvalic, 2014) even if the volumes are still relatively low compared to the NMS due to the fragmentation and narrow markets. FDI outside the EU-15 in the region comes from two sources, North America, notably through US branches in Europe and Asia (Japan, South Korea).

In turn, Asian firms, mainly from China, are investing in the region to develop services, telecommunications, basic industries, energy (nuclear, thermal). Chinese firms are investing in the automobile construction sector: assembly in Bulgaria (no follow-up since the bankruptcy of the joint venture), construction of electric batteries (Serbia, Croatia). This strategy can be seen as the start of building value chains in the region that can later serve as a starting point to reach more mature EU markets. Chinese firms are more in search of service provision (construction of highways, ports, refurbishment of nuclear power plants, construction of thermal power plants). As for acquisitions, they target firms in declining sectors such as chemicals iron and steel industries, in Hungary and in Serbia, which have never been brought up to standard. Green field investments, generally creating jobs, are almost non-existent. The creation of Chinese banks in Hungary and Serbia should facilitate the assembly and financing of projects within the framework of the new Silk Roads, projects which do not announce the lasting presence of Chinese companies (Richet & Vercueil, 2019; Richet 2019).

The attractiveness of the region to FDI is based on factors of proximity, demand, qualification of the workforce.

- The skilled workforce was quickly absorbed in Western settlements, particularly in the automotive sector, one of the main industries to have relocated massively in the region.
- The low cost of labour has been an additional factor of attractiveness, explaining the high concentration of FDI in the manufacturing sector where wages are still a quarter of the wages paid to employees of parent companies.
- The weakness, even the absence, of sectors essential to the functioning of a developed market economy (banking and finance, services, office property, etc.) and to the supply of the population (mass distribution) has attracted direct investments in large proportions.
- An integration effect in the European market explains the growing flow and the rise in the stock of FDI in recent years.

The share of the stock of FDI in relation to GDP, the contribution of FDI to productive investment, employment and exports show the importance of FDI in the recovery of economic activity and the specialization of firms in the region. The latest entrants (Bulgaria, Romania and Croatia) have benefited from this integration effect. These investments have had and continue to have a positive impact on growth in the region, which, to its benefit, differs from the growth rates recorded in the EU-15.

The massive arrival of foreign firms was a blessing in at the start of the transition: forced to sell assets, sometimes at discounted prices, the CSEEC governments benefited from the contribution of capital, managerial skills, access to western markets. The rapid, continuous and growing entry of FDI, despite frustrating factors such as rising labour costs and competition from countries with lower labour costs, in Asia, has not been denied in recent decades.

The presence of foreign capital raises, in the countries of the region, a sensitive question about the ownership and control of firms. The classic model of division of tasks within the multinational firm still prevails, despite the network effect, the autonomy of the different units in the regional strategy of firms. The strategic and financial decision-making centres, the bulk of research and development remain at the headquar-

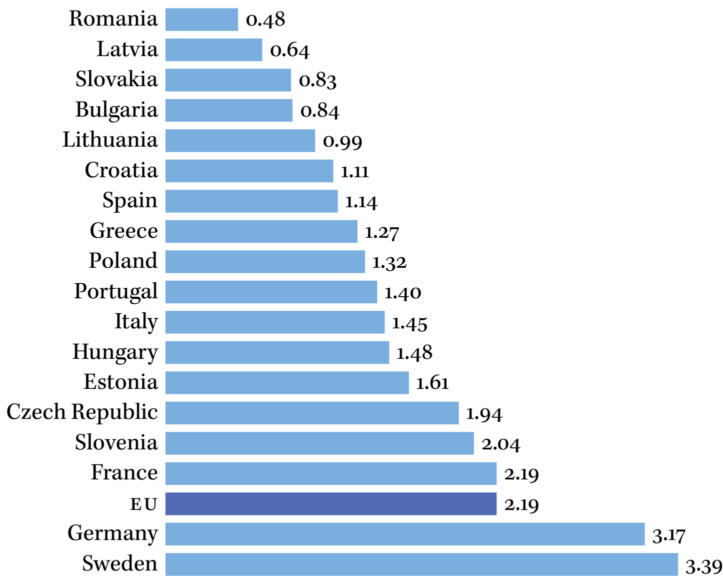


FIGURE 7.3 R&D Intensity in the EU (2019; based on data from Eurostat, https://ec.europa.eu/eurostat)

ters of companies in the West, which reflects the level of dependence of firms in recipient countries and the limits – even the impossibility – of a 'national accumulation' in the countries of the region.

The automotive industry sector illustrates the importance of FDI in the region, the development of new specializations and its linkage to the rest of Europe. The Czech Republic, Slovakia, Hungary, Romania, Poland received significant investment from the EU as well as Japan and South Korea. Through acquisitions and virgin investments, the auto companies have developed highly integrated value chains by specializing recipient countries to produce types of automobiles, components, engines to supply parent factories (final assemblies) or others located in the region (Richet, 2007).

Renault Dacia's success in Romania, on the other hand, shows how Renault's regional strategy (which also produces automobiles in Slovenia, Turkey and Russia) around the development of a low-cost model has been able to develop a regional hub very active. The research and development in charge of this model has been relocated from France to Romania, the factory exports not only automobiles to the region, to the EU-15, but also components (engines, electrical equipment, tires)

through Europe, Russia, Morocco where the Tangiers sister plant is highly dependent on Romania for components (Richet et al., 2015).

Despite these positive factors, we can measure the importance of dependence if we consider the weight of FDI in these economies, the net investment position of countries (the presence of firms in the main sectors of the economy such as banking and manufacturing industry). The fact remains that governments and local investors cannot control the decisions and choices of MNCs, as shown by the dominant share occupied by multinational firms in host countries. Governments, on the other hand, find it more difficult to continue playing on tax advantages. The most competitive firms in the region have thus become subsidiaries of large international groups. This integration does not prevent the emergence of highly competitive domestic firms in niches that supply different markets.

Certain companies with majority or full domestic capital integrate firms from their sector in the region. This is the case of, for example, MOL, a Hungarian firm in the energy sector that has made acquisitions in Slovakia and Croatia. This is also the case for branches of Western firms located in these countries which in turn are spreading throughout the region and beyond from their central and eastern European locations. Finally, the Franco-Romanian Dacia plant, both a producer of automobiles and components, as we have mentioned, is today at the centre of an international network of partnerships involving firms, subsidiaries and subcontractors (Asia, Russia, Turkey and Morocco). It is at the same time a strength and a weakness: the blackmail to relocation is never far away when the pressure to increase wages is emerging in the company. Morocco, with much lower wage costs and a strong integration policy can attract parts of the Romanian production.

Both the volumes invested, the proximity dimension and the availability of resources, on the one hand, and the institutional constraints and the instruments of integration on the other, have contributed to reshaping the East European economic area, a process that is currently underway with the Western Balkans. The source of profits for the firms that invest there, the countries of the region have acquired a strong specialization measured in added value terms which places them above the emerging economies of South and even of some countries of Southern Europe previously integrated to the EU (Portugal). The specialization affects the manufacturing sector (labour); it also concerns dynamic service industries. The latter, in the post-crisis period of 2008

account for more than a third of GDP growth in the region due to the strong demand for close external services from European firms.

The economies of the CSEEC, in the space of three decades, have been able to transform their productive systems, to integrate themselves into the international (primarily European) division of labour by developing a certain number of comparative advantages linked to proximity, to the industrial heritage, the quality of the training system, the differentials in labour costs. The mode of privatization and the massive entry of Western, mainly Western European firms did the rest, allowing these economies to adjust quickly. Institutional and structural reforms, with the arrival of FDI, have helped anchor these economies to EU economies. They have created a dependency effect while helping to develop strong specializations in several sectors. It is reflected in particular by the significant share of exports in GDP in terms of added value, reflecting both the effect of relocations and of catching up. The effects of integration and the presence of foreign capital are still being felt as the countries of the region are consistently recording high growth rates.

Several threats exist on the industrial future of these economies: the impact of the international financial crisis and its negative effects on employment, which may accelerate strategies to relocate activities in countries of origin severely affected by unemployment, labour reserve limits and declining demography (coupled with hostile policies against immigration). The more capital-intensive investments (robotics) to counteract this shortage could affect the pursuit of growth if foreign investors repatriate the capital-intensive investments home. In addition, the flow of skilled labour emigration to Western Europe (Hungary, Slovakia, and Slovenia, among others) can quickly dry up future growth reserves. The other threat is to see more labour-intensive foreign investments in the region leaving the host country and heading towards lower cost economies in neighbouring countries (Russia, Ukraine) or in Asia with larger markets. Further south, in the Western Balkans, the factors of attractiveness to FDI exist, but they are still weak, markets remain small, the qualified workforce emigrates, the political instability is still important and the dynamics of domestic demand still weak.

Conclusion

The configuration of the countries of the region has been profoundly modified by institutional and economic transformations and the ar-

rival of foreign capital. The CSEEC, in a few decades, have undergone a transformation which has made them pass from administered, non-capitalist economies, to market economies within the framework of a globalized economy where the centres of accumulation are fluctuating, where network firms predominate, where value chains are more and more complex and mobile. Finally, a theoretical question arises: how to articulate the concept of dependent capitalism and the domination of the world by the oligopoly of large industrial and financial groups? The role of FDI from the heart of Europe to its periphery has been mentioned throughout this contribution. However, the importance of these investments should be compared to the international investments made by the major European countries in other ways. European firms are internationalizing more, and for a long time outside the EU, in China, in the United States.

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