

Kekic, Laza

Research Report

To what extent has FDI benefited the transition economies of Central and Eastern Europe?

Columbia FDI Perspectives, No. 236

Provided in Cooperation with:

Columbia Center on Sustainable Investment (CCSI) - A joint center of Columbia Law School and the Earth Institute, Columbia University

Suggested Citation: Kekic, Laza (2018) : To what extent has FDI benefited the transition economies of Central and Eastern Europe?, Columbia FDI Perspectives, No. 236, Columbia University, Columbia Center on Sustainable Investment (CCSI), New York, NY

This Version is available at:

<https://hdl.handle.net/10419/254070>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 236 October 8, 2018

Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)

Managing Editor: Marion A. Creach (marion.creach@sciencespo.fr)

To what extent has FDI benefited the transition economies of Central and Eastern Europe?*

by

Laza Kekic**

The theoretical case for a positive impact of FDI on economic growth seems strong, but the empirical evidence has been mixed. Despite the numerous alleged benefits of FDI to the host economy, empirical studies have failed to establish a significant, unconditional, positive impact of FDI inflows on the growth of GDP. Some studies identify a positive impact conditional on the existence of a minimum threshold of human capital, or of institutional and financial development. At the microeconomic level, the evidence on positive spillovers from FDI on domestic companies and industries has been sparse.

The transition economies of Central and Eastern Europe (CEE)¹ may be an exception in terms of FDI having a more unambiguously positive impact on growth. FDI has long been seen as a crucial factor in the transition to market economies. These economies started out in 1989 far away from the international technological frontier. Yet, unlike many developing countries, they had a relatively developed industrial structure, a highly educated workforce and proximity to rich Western European markets.

In a model prepared by the author for this *Perspective*, several variables explain over 90% of the inter-country variation in GDP in 2017 relative to output in 1989 for all 28 CEE transition economies.² An index of initial conditions at the start of the transition and an indicator of whether the country was affected by war in 1989-2017 explain some 50% of the variation in transition economies' growth in 1989-2017. Other control variables, all statistically significant, include income per head at the start of the transition, natural resource wealth, the ratio of external debt to GDP, an index of corruption (a measure of the quality of institutions), and an index of progress in economic reform. Debt flows had a significant negative impact, in line with the results for emerging markets in general. The results for FDI, measured by FDI stocks in 2016 per capita, show a positive impact on growth, but were only on the edge of statistical significance and not especially strong or robust. The estimated impact of FDI was much stronger for the 1989-2008 period alone, suggesting that the role of FDI in the post-crisis period after 2008 has been less favorable.

According to UNCTAD data,³ the inward FDI stock in CEE relative to GDP—a median value of 49% in 2016—was higher than the global (42%) and EU (47%) median values. In a recent blog, Thomas Piketty talked of the “colonisation” of CEE and called these countries “foreign-owned”.⁴ For several countries in the region he compared net outflows of profits and incomes from property with net transfers received from the EU and found that the outflows have been much higher. For example, on average in 2010-2016, annual net outflows of profits and incomes from property amounted to 4.2% of GDP in Slovakia, 4.7% in Poland, 7.2% in Hungary, and 7.6% in the Czech Republic. By comparison, over the same period, the annual net transfers from the EU amounted to 2.7% of GDP in Poland, 4% in Hungary, 1.9% in the Czech Republic, and 2.2% in Slovakia. It should be noted, however, that Piketty’s indicator includes all interest incomes, including the interest paid on external debt, and reinvested profits, and thus does not necessarily reflect FDI-related “outflows”.

Progress in convergence with income levels in the developed EU has been relatively modest, especially since the 2008 global crisis. The average ratio of GDP per head for the 16 CEE countries relative to the developed western EU 15 countries rose from 44.1% in 2008 to 48.6% in 2017. Importantly, for the population, personal income growth and living standards are more crucial than GDP growth.⁵ The rate of convergence of wages has been slower than the rate of convergence of GDP, and growth in consumption has generally lagged behind growth in GDP. The rewards from growth have gone disproportionately to the owners of capital—in these countries, that tends to mean foreigners.

Looking forward, the countries in the region will need to develop growth strategies that do not depend so overwhelmingly on FDI. Even if FDI is important, it is unlikely to lead to sustained convergence with developed economies. The priority tasks for policy-makers in the region will be to improve access to finance for domestic companies, further deregulation in select areas and increasing incentives for domestic innovation, as well as to encourage foreign investors to upgrade their operations.

*** The *Columbia FDI Perspectives* are a forum for public debate. The views expressed by the author(s) do not reflect the opinions of CCSI or Columbia University or our partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

****** Laza Kekic (kekiclaza@gmail.com) is an independent consultant. The author is grateful to Alexey Kuznetsov, Elina Pelto and Zbigniew Zimny for their helpful peer reviews.

¹ These 16 countries are the 11 EU members from the region (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and 5 western Balkan countries (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia).

² The model also includes 12 former Soviet Republics.

³ UNCTAD, *World Investment Report 2017* (Geneva: UNCTAD, 2017), [Annex table 07. FDI inward stock as a percentage of gross domestic product, 1990-2016](#).

⁴ Thomas Piketty, “2018, the year of Europe,” *Le Monde*, January 16, 2018.

⁵ [Simon Tilford, “All is not well in the Visegrad economies” *Centre for European Reform*, November 29, 2017.](#)

*The material in this Perspective may be reprinted if accompanied by the following acknowledgment: “Laza Kekic, ‘To what extent has FDI benefited the transition economies of Central and Eastern Europe?’, *Columbia FDI Perspectives*, No. 236, October 8, 2018. Reprinted with permission from the Columbia Center on Sustainable Investment (www.ccsi.columbia.edu).” A copy should kindly be sent to the Columbia Center on Sustainable Investment at ccsi@law.columbia.edu.*

For further information, including information regarding submission to the *Perspectives*, please contact:

Columbia Center on Sustainable Investment, Marion A. Creach, marion.creach@sciencespo.fr.

The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is a leading applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. Our mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools. For more information, visit us at <http://www.ccsi.columbia.edu>.

Most recent *Columbia FDI Perspectives*

- No. 235, Reji K. Joseph, “Investment facilitation: new dynamism at the WTO on investment,” September 24, 2018
- No. 234, Jan Knoerich, “Do developing countries benefit from outward FDI?,” September 10, 2018
- No. 233, Meg Kinnear, “Moving with the times: amending the ICSID rules,” August 27, 2018
- No. 232, Kavaljit Singh, “Investment facilitation: Another fad in the offing?,” August 13, 2018
- No. 231, Theodore H. Moran, “CFIUS reforms must be reformed,” July 30, 2018

All previous *FDI Perspectives* are available at <http://ccsi.columbia.edu/publications/columbia-fdi-perspectives/>.