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Foreign investment in eastern and southern Europe after 2008

Still a lever of growth?

Edited by Béla Galgóczi, Jan Drahokoupil and Magdalena Bernaciak

“The golden era of foreign direct investment is over; new growth engines are needed”

This book maps recent trends in foreign direct investment (FDI) flows to Central-Eastern European and South European countries. The evidence suggests that from 2008 onwards, in most countries, FDI flows to both these regions have suffered a substantial setback. While FDI in business services continues to expand, foreign-investment sectors in general seem to have lost their growth-engine function and the catching up of new EU members to the EU15 has slowed down. At the same time, economic growth has become sluggish and the catching up of new EU members with the EU15 has slowed down.

Key findings

- Data presented in this publication show that FDI was one of the driving forces of the pre-crisis economic boom in the eastern and southern European Union. In response to the new macroeconomic environment and financing conditions after 2008, FDI flows suffered a sharp decline. The partial recovery of cross-border investment in 2011 and 2012 was followed by an even deeper slump in 2013. FDI is not a growth engine anymore and this is not a mere cyclical phenomenon. We have identified structural weaknesses in the role FDI played in catching up economies.
- While the general impact of FDI on regional development was positive, it also cemented or even sharpened regional disparities as a result of regions' asymmetrical integration into world markets. Regional distribution of FDI over time showed no major shift in the locational preferences of foreign investors when pre- and post-crisis periods are compared; indeed, the territorial concentration of foreign companies and their revenues became more pronounced.
- The impact of competitiveness-enhancing measures on private investment and more particularly FDI is inconclusive. While structural reforms during the adjustment period may have contributed to improvement in the balance of trade in goods and services and – except in Greece – export shares in GDP also grew, the anticipated positive effect on growth and investment did not materialise in any of the countries examined.
- Moreover, FDI appears to have only limited long-term developmental effects. Specifically, spill-over effects of foreign affiliates to the domestic economy are scarce; upgrading of value added content by foreign affiliates is at best selective and uneven; and the specialisation of central and eastern European economies in international value chains remains largely linked to the comparative advantage of low labour costs. Targeted policy interventions to attract and upgrade FDI in terms of quality or to broaden its regional dimension seem to have had only limited effect. According to the findings of this book, the period of high growth fuelled by foreign investment in both the southern and eastern periphery of the EU has come to an end. In their efforts to continue convergence, middle-income economies on the southern and eastern periphery of the EU might thus need to seek other growth engines.

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Key data

Figure 1 Convergence in GDP/capita at current PPP (EUR), 1995-2013, EU15=100.0

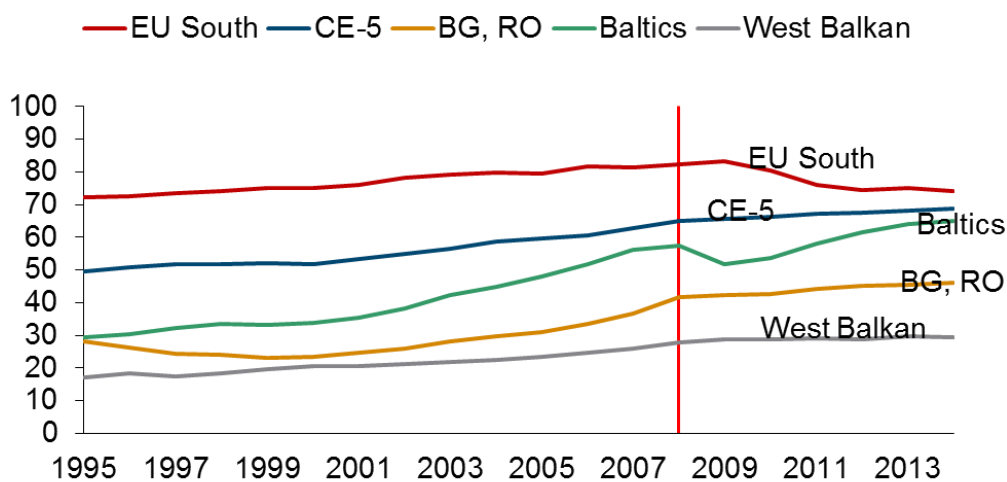


Figure 2 Foreign Direct Investment inflows in Eastern Europe and in V4 (CZ; HU, PL, SK): a downward trend since 2008

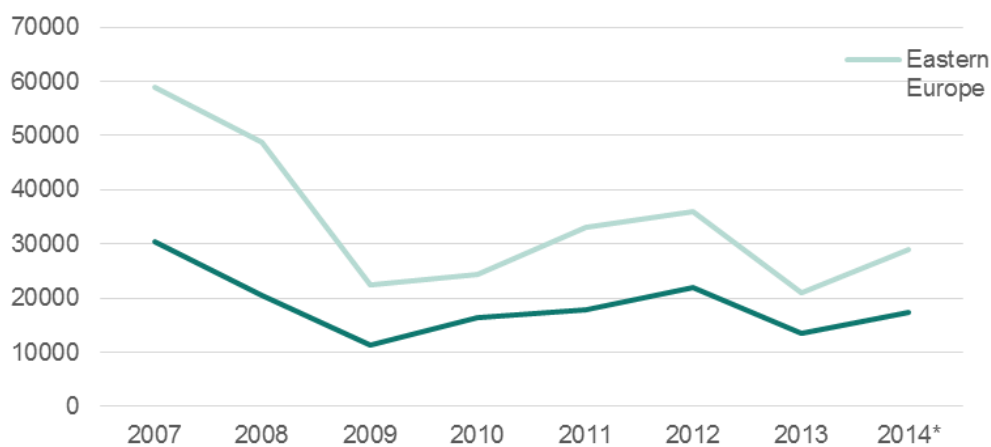
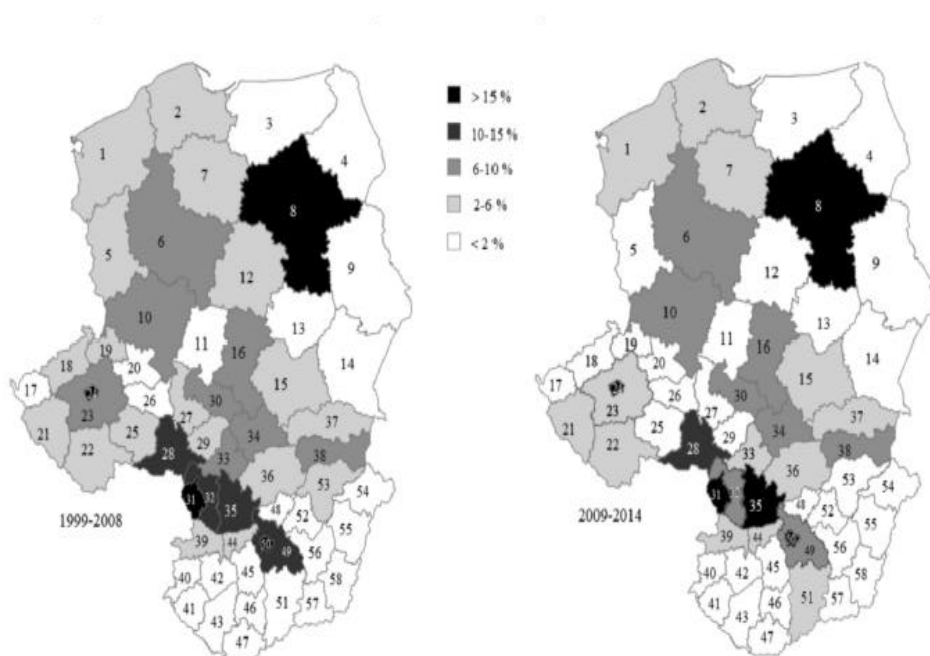


Figure 3 Regional Structure of FDI unchanged



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