Patterns of inward FDI in economies in transition

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Abstract

This article analyses the contribution of foreign direct investment to structural change in various groups of economies in transition: new European Union member countries (including Bulgaria and Romania), South-East Europe (excluding Bulgaria and Romania), and the Commonwealth of Independent States. It comes to the conclusion that foreign direct investment has had the deepest impact on structural change in new EU members, and the smallest (in fact negative) impact in the Russian Federation. This is related to differences in timing of investment flows (they started earlier in new EU members; other subregions caught up later on), as well as the sectoral composition of FDI. It also has to be noted that the FDI of new EU member countries, especially in automotive production and electronics proved to be more vulnerable to the crisis of 2008–2009 than FDI in other transition economies. It remains to be seen if these countries in turn will be able to benefit fast from the post-crisis recovery.

Key words: FDI, transition, structural change, crisis

JEL Classification: E23, F21, N64, P33

1. Introduction

Modernizing the economy through structural change has been a key prerequisite for Central and Eastern Europe's successful reintegration into the world economy after the fall of the Berlin Wall in 1989 (Landesmann, 2000,

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2003). To what degree foreign direct investment (FDI) can contribute to that restructuring has been a contested issue (UNCTAD, 2003). Immediately after transition had started – and independence had been gained, in many cases – liberalization in trade and capital flows became the first vehicles of reintegration with the world economy (EBRD, 1999). In most economies in transition, trade liberalization not only tended to be radical, but it was also accompanied by the elimination of the state monopoly on international trade. A major reorientation of trade, both in terms of partners and products, followed.

From the mid-1990s onwards, inward FDI has gained importance in the restructuring of an increasing number of Central and Eastern European countries (UNCTAD, 2003). Beyond its contribution to financial resources, investment, technology and providing access to markets, inward FDI in economies in transition has also played a role in the strengthening of the private sector and the emergence of market-economy behaviour, as well as the elimination of macroeconomic distortions inherited from earlier centrally planned systems (Kalotay, 2001). Industrial restructuring accelerated when privatization involving FDI was stepped up (Hunya, 2000). However, the process of restructuring started to take place unevenly (Hunya, 2001). A duality of performance in the manufacturing sector appeared in two respects: a dichotomy between modern, foreign-dominated industries on the one hand, and traditional industries with both domestic and foreign companies, on the other; and a duality of high and low FDI-penetration countries.

Almost two decades after the start of transition, and with the accession of 10 economies in transition to the European Union (EU), it is timely to take stock of what has happened to FDI flows to economies in transition in the longer run, and how it has contributed to structural change which was needed to successfully reintegrate into the world economy. For that purpose, this paper analyses the main patterns of FDI inflows to economies in transition over the period 1991–2006. This study does not cover in its discussion of structural changes in FDI the period of the crisis which originated in the United States in 2007, and became a global crisis in 2008. It nevertheless presents a case study of the automotive industry, which was forced to undergo major downsizing and restructuring in 2008–2009, before rebounding in 2010. The study also analyses FDI flows in their entirety since 1992 (the year since comprehensive data are available till 2009).

By economies in transition,[1] this study means both the new EU member countries which have been reclassified as part of the group of developed countries and the EU, and the countries of South-East Europe and the

[1] This study does not analyse FDI in those territories that have declared independence but have not been recognized by the majority of international community.

Commonwealth of Independent States (CIS).[2] This paper takes into consideration the divergences that exist between various economies in transition in terms of the quantity and structure of FDI. For that analytical purpose, countries in transition are grouped into four categories:

1. New EU members (that joined it in 2004[3] and 2007);
2. South-East Europe (except Bulgaria and Romania which became EU members in 2007);
3. the Russian Federation (a category of its own) and
4. the other members of the CIS.

Some of the structural analysis is further cut into three periods:

1. 1991–1995, or early transition, when most of the initial adjustment took place, with privatizations that often limited the participation of foreign investors;[4]
2. 1996–2000, or the period of major advances in terms international integration, and an opening to foreign participation in the future EU member countries and
3. 2001–2006/2007, or the period when EU enlargements were prepared and realized, and both privatization-related and greenfield FDI was moving increasingly into new locations.

FDI has been so important for the reintegration of economies in transition into the world economy because, unlike trade, FDI is not a one-off transaction. Productive capacities created through FDI remain in the host country for the long term. Moreover, transnational corporations (TNCs), the main agents of FDI, participate in almost two-thirds of world trade: one third through their sales to third parties, and one third through their intra-group transactions ($4.7 trillion in 2006, out of a total world trade of $14.1 trillion) (UNCTAD, 2007).

The discussion of this paper starts with an overview of total inward FDI from a quantitative point of view. The second section looks at the role of such FDI in financial accumulation (FDI to gross fixed capital formation). The third section analyses the patterns of cross-border mergers and acquisitions (M&As) from three perspectives: 1. their link with FDI through privatization; 2. their industry patterns; and 3. their geographical patterns. The fourth section looks briefly at the case of the automotive industry. Finally, section five concludes the discussion from a policy perspective. All data used in this paper are derived

[2] This study uses the term CIS to designate all countries of the former Soviet Union except the Baltic States. It is true that of the 12 countries in question, only 9 are full members of the CIS. Officially, Ukraine is only a “participant State”, Turkmenistan is only an “associate State, and on 17 August 2009 Georgia ceased to be a CIS member. However, the term “CIS” still is more appropriate to use than the looser term of “former Soviet Union”.

[3] With the exception of the non-transition economies of Cyprus and Malta.

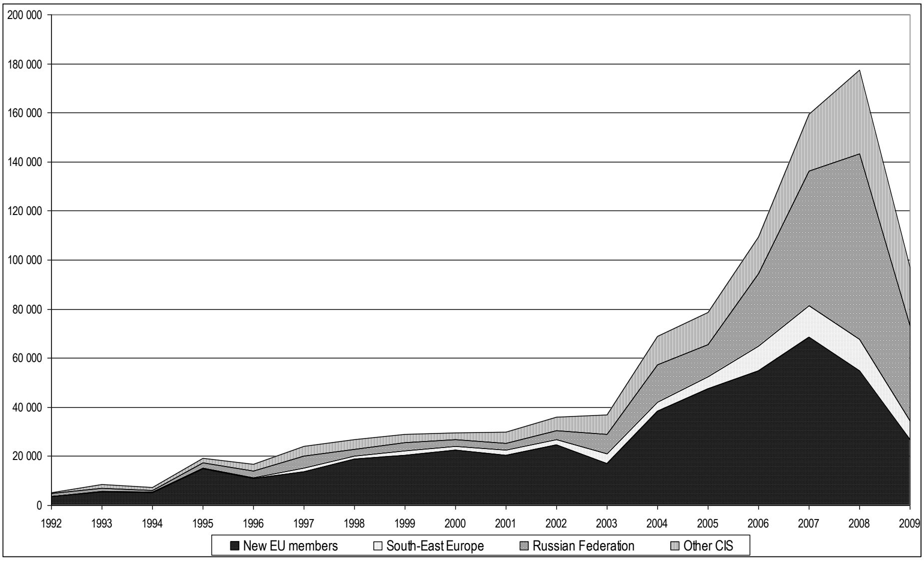
[4] With the exception of Hungary and Poland.

from UNCTAD's FDI/TNC and cross-border M&A databases, unless otherwise stated.

2. Growth and the spread of FDI inflows, 1992–2008, decline in 2009

Over the period 1992–2008 the FDI inflows of economies in transition had maintained a strong upward trend, with the exceptions of 1994 and 1996. Their growth followed a chronological sequence, spreading from the West (the future EU member countries) towards the South-East (South-East Europe) and the East (the CIS). In this process, the rise of the Russian Federation to a status of major global recipient (to FDI inflows of $75 billion in 2008 alone) has been probably the most spectacular phenomenon. Nevertheless, new EU members still accounted for almost half (49% of the group's cumulative total of close to $ 1 trillion over the period 1992–2009 (figure 1). They were followed by the Russian Federation (27%), other CIS (17%), and South-East Europe (only 7%). One of the reasons why the cumulative FDI inflows of South-East Europe were small is due to the fact that Bulgaria and Romania are now listed under the new EU members.

Figure 1. FDI inflows to economies in transition, by group, 1992–2009 (Millions of dollars)

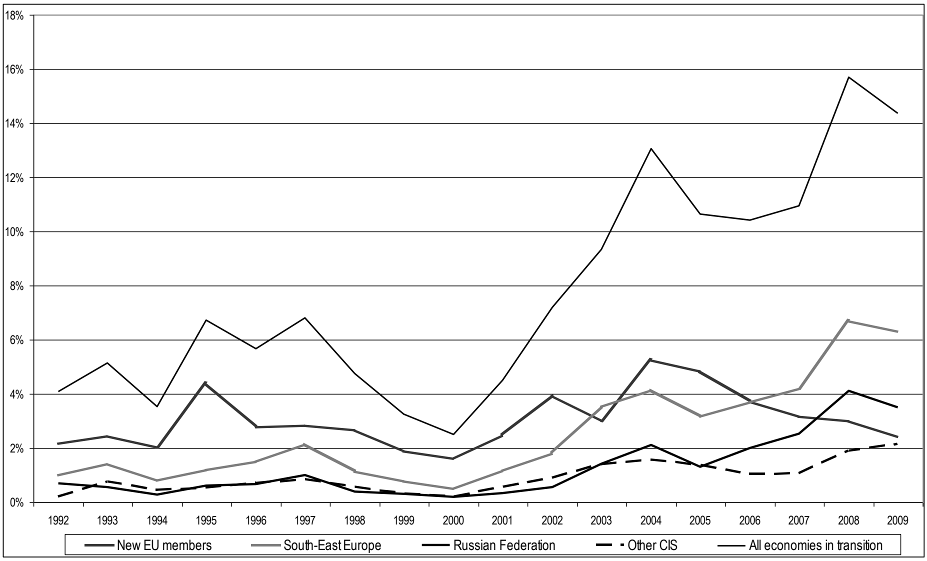


Source: UNCTAD, FDI/TNC database

Note: Data exclude FDI in special purpose vehicles (SPVs).

Thanks to the quick growth of FDI inflows, the share of economies in transition in global FDI was on an almost constant rise until 2008, with the exception of some years in the late 1990s. Over the period 1992–2008, as the FDI inflows of economies in transition grew faster than the inflows of other countries of the world, their share in the world total quadrupled, from 4% in 1992 to 16% in 2008 (figure 2). In 2009, they declined back to 14%. As for individual sub-groups, the share of new EU members has been on a decline since 2005, although from a high level, while the share of the Russian Federation increased sharply between 2006 and 2008 (figure 2). The relative decline of new EU members may be related to the two-way restructurings of productive capacities that lave led not just to new investments but also rationalizations (Hunya and Sass, 2005), while the rise of the Russian Federation is mostly linked to its GDP growth (for market-seeking investors) and the high prices of its natural resources (for resource-seeking FDI) (UNCTAD, 2007).

Figure 2. Share of economies in transition in global FDI inflows, 1992–2009 (Per cent)



Source: UNCTAD, FDI/TNC database

The spreading of FDI flows was related to differences in the phasing of transition in general, and FDI attraction in particular, in different economies in transition (Holland et al, 2000). The first surge of inflows in the 1990s for example was linked with the privatization efforts of the would-be EU member countries (with the exception of Bulgaria and Romania), while the second surge in inflows after 2000 was more related to the opening up of South-East Europe, and Bulgaria and Romania, to privatization-related FDI, and the increasing attractiveness of natural-resource-rich economies in the CIS (Kalotay and Hunya, 2000).

Despite the overall rise and spreading of FDI inflows in economies in transition, there remain issues related to the lumpiness and fluctuations of those flows. One of them is the lessons of the end of privatization after 1995 in various new EU member countries and a subsequent slowdown of FDI inflows: it is expected to be repeated in other countries undergoing similar large privatization processes in the current stage.

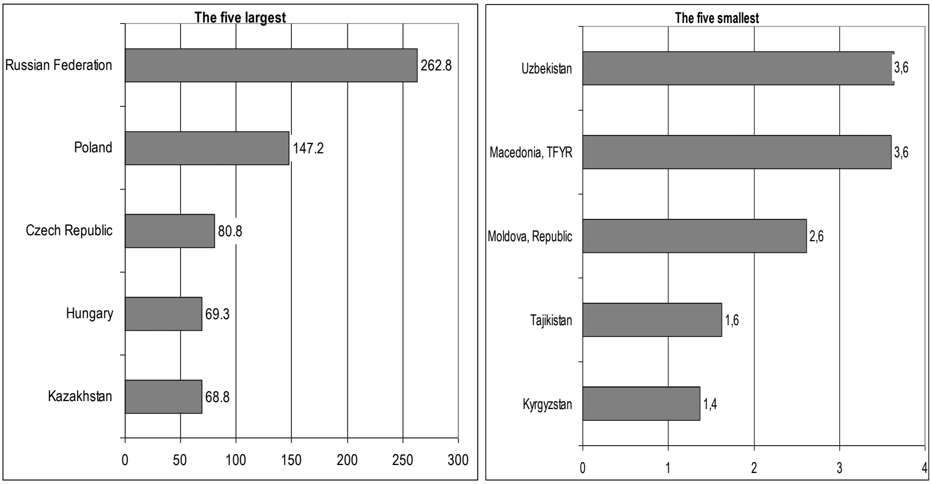
A second issue is the post-EU accession slump of FDI: it can affect other countries that will join the integration grouping in the future. Indeed, a new take off of FDI started in the accession countries after 2000 when the timetable for their membership was clarified. However, as mentioned above, it was followed by a second slowdown after 2004, as restructuring from manufacturing to services FDI took its toll (Kalotay, 2006). For countries that aspire to accede to the EU at a later stage, it is vital to know how strong the relationship between EU accession and fluctuations in inward FDI is. In the case of CIS countries for which future EU membership is not an option, it is important to know in general what can drive FDI in the post-privatization stage (beside natural resources).

The third issue is related to the somewhat unexpected rise of FDI to the Russian Federation and other CIS after the oil price hikes. If this rise is not fully warranted by improvements in the business environment, can we say that the whole rise is due to oil and other natural resource prices? Again, related to the rise of FDI to the Russian Federation and other CIS countries, is the question of increasing State ownership in certain industries. If the re-emergence of the State no longer hinders inward FDI, can we say that privatization is no longer needed to attract FDI?

A fourth issue is related to the crisis of 2008–2009. The crisis has affected FDI around the globe, but certain economies (e.g. Brazil and China) proved to be more resistant to the decline. In such economies, in fact, the decline was delayed to 2009, and on the hypothesis that 2010 is the first year of a modest recovery, the crisis may prove to be a one-year phenomenon only. This relative resistance was also characterizing the Russian Federation and other CIS countries. In turn, the crisis started earlier in the new EU member countries which were deeply integrated with Western Europe, a region feeling the effects of the crisis early on, and in South-East Europe.

The largest open issue is related to the unevenness of FDI and the marginalization of various countries in transition. There are indeed large differences in cumulative inflows (figure 3). Massive flows have been attracted in large economies, such as the Russian Federation and Poland ($263 billion and $147 billion in 1992–2009, respectively), and to some 'early bird' economies which have relied on FDI from an early stage of transformation (Kalotay, 2001) such as the Czech Republic and Hungary. In turn, tiny flows, less than $4 billion over 18 years characterize some small low-income economies such as Kyrgyzstan, Tajikistan, the Republic of Moldova and the Former Yugoslav Republic of Macedonia (figure 3).

Figure 3. The five largest and smallest cumulative FDI inflows in economies in transition, 1992–2009 (Billion dollars)



Source: UNCTAD, FDI/TNC database

3. FDI in financial accumulation

FDI has various development impacts on home countries. In economies in transition, given the resources intensity of transformation and structural change, its contribution to financial accumulation has been particularly important (Holland et al., 2000). This role of FDI in financial accumulation can be proxied by its ratio to gross fixed capital formation (GFCF).

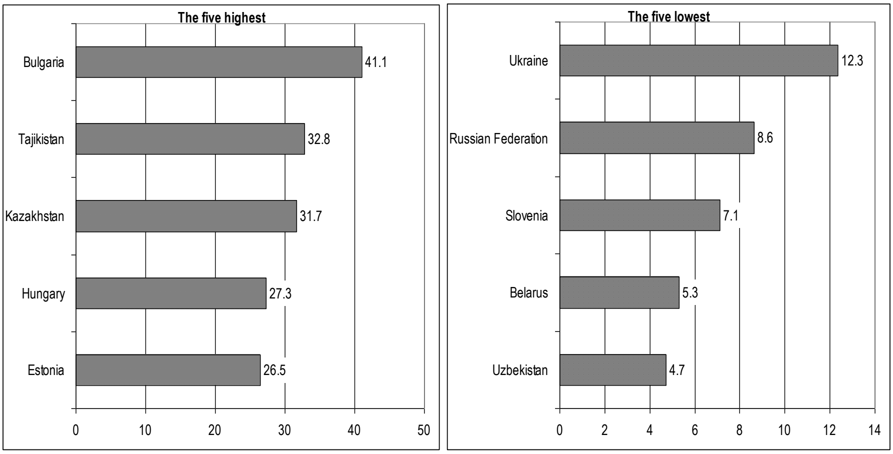
In the economies in transition, that ratio of FDI to GFCF has indeed tended to be higher than the world average, and has increased over time (figure 4). It has to be stressed here that due to fluctuations in data, three-year moving averages have been used in this measurement. On the world average, the ratio increased over the 1990s and reached a peak of 16% in 2000. Afterwards, it fell under 10% in 2002-2004 but exceeded 10% in 2005 and 2006. In economies in transition, the decline of the early 2000s was much less pronounced, and in some parts of the grouping, such as South-East Europe, it was not felt at all (figure 4).

Figure 4. FDI inflows to economies in transition, compared to GFCF, three-year averages, 1992–2008 (Per cent)

Source: UNCTAD, FDI/TNC database

One has to note also however that some countries have relied heavily on FDI in their capital accumulation, others have not (figure 5). Both groups are heterogeneous: the first one includes two ‘early birds’ in FDI attraction (Estonia and Hungary), a ‘late star’ in FDI attraction (Bulgaria) an oil economy (Kazakhstan), and a low-income country with very low GFCF (Tajikistan). The second group logically includes two large economies where even apparently large volumes of FDI flows are small compared to the size of the economy (the Russian Federation, which is the number one recipient of FDI inflows in absolute values, and Ukraine), the most developed (highest income) economy (Slovenia), and two countries with political problems in FDI attraction (Belarus and Uzbekistan) (figure 5). It has to be noted that this calculation excludes Bosnia and Herzegovina, Montenegro and Serbia, due to missing data for a large part of the period analysed.

Figure 5. The five highest and lowest ratios of inward FDI to GFCF, average of 1992–2009 (Percent)



Source: UNCTAD, FDI/TNC database
Note: Bosnia and Herzegovina, Montenegro and Serbia are excluded form the calculation due to a large number of missing data points.

One can conclude on GFCF that in general, FDI inflows have been important resources for transition but varied by country. The share was high in countries that based their development on FDI; in smaller countries well endowed with natural resources; and in low-income countries with very low GFCF. The share was low in countries that avoided inward FDI in their development strategy; some larger countries; the most developed country that could rely on domestic resources; and countries that had political problems. One has to ask therefore: if the speed of FDI penetration correlated with the speed of transition, which one was the cause and which one was the consequence? Can we say that, *ceteris paribus*, an economy in transition relies more on FDI than a non-transition economy?

4. Cross-border M&As: industry and geographical patterns

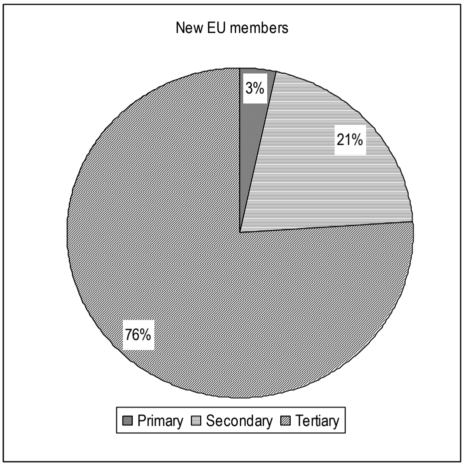
Of the various forms of international integration of national economies (trade, migration, financial flows, investment etc.), FDI is a particularly strong agent of structural change and upgrading (Ozawa, 1992; UNCTAD, 1999, 2002). Under the conditions of transition from centrally planned to market economy, when the domestic private sector is in a nascent stage, that role should be particularly strong (Kalotay, 2001).

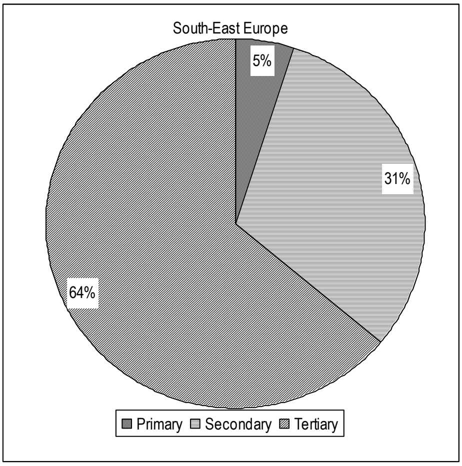
To test the hypothesis of FDI as agent of structural change in transition, the subsequent analysis will use the structure of cross-border M&As as proxy for the industry and geographical trends of inward FDI. This is done so because they move together with FDI globally. In addition, in economies in transition, FDI and M&As have been traditionally linked together via privatization, although unevenly: privatization was always a main source of FDI in early transition but in early transition FDI did not necessarily play a key role in privatization. A third reason is that data are more detailed for M&As than for FDI. For example, this is the way to measure structural patterns in the Russian Federation that does not report these trends for FDI and other foreign investment separately.[5]

As a negative consequence of using M&As, one has to mention that their statistics by default miss out greenfield investment, and that may be a problem for industries such as electronics manufacturing that are main targets of greenfield projects, and may be underestimated by M&A data. It also has to be stressed that FDI and cross-border M&A data are not directly comparable as they are collected by different methodologies.[6] As a consequence the difference between total FDI and cross-border M&As does not give us the value of greenfield projects.

Over the period of 1991–2006, one can observe different patterns in the sectoral and industry composition of cross-border M&As (figure 6):

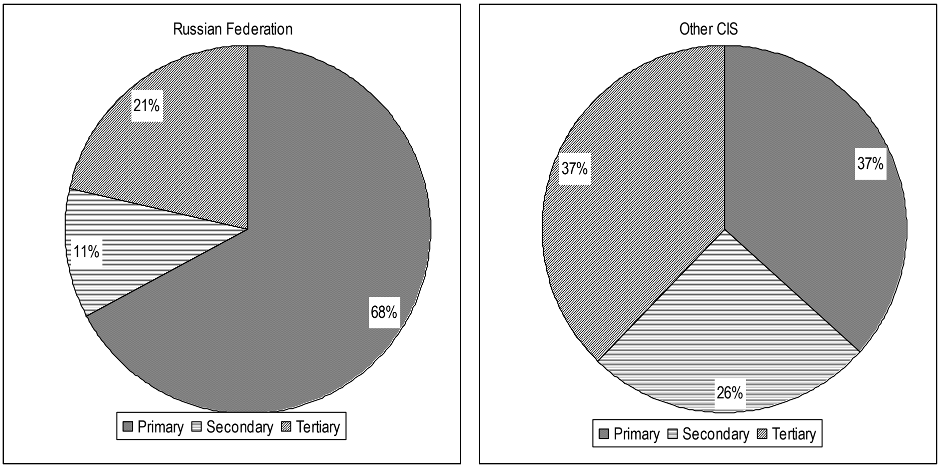
Figure 6. Sectoral composition of cross-border M&A sales in economies in transition, 1991–2006 (Per cent)





[5] In the Russian Federation, foreign portfolio investments tend to exceed FDI, and have special structural characteristics (high level of financial services, low level of extractive industries); for these reasons data on the industry composition of total foreign investment may be misleading for FDI analysis.

[6] FDI data register financial flows related to investment by TNCs on a net basis (net of divestment) and in the year when the projects are effectively paid. In turn, cross-border M&As are registered in the year when they are officially realized, and on a transaction basis, which makes it difficult to calculate the net flows.



Source: UNCTAD, Cross-border M&A database

1. Data on the cross-border M&A sales of new EU members confirm the previous observation (Stare, 2005) that they are service economies: they derived 76% of their revenues from services transactions in 1991–2006 (figure 6). If one cuts the data series into three periods (table 1): early 1990s (1991–1995), late 1990s (1996–2000), and the new millennium (2001–2006), one can observe that telecommunications and banking were leading industries in all periods (except for banking in the early 1990s); the share of business services was constantly increasing, to almost 10% in the early 2000s; the share of electricity, gas and water was fluctuating, following the trends in privatizations (in the early 1990s and in the 2000s); and motor vehicles were important in the early 1990s but their share declined due to a shift towards greenfield projects. This is the picture of a group that undergoes important shifts toward higher value added activities.

Table 1. Share of selected industries in total M&A sales of new EU members, 1991–2006

Industry	1991–1995	1996–2000	2001–2006
Mining and petroleum	0.5%	3.9%	3.2%
Food, beverages and tobacco	12.2%	6.6%	1.9%
Motor vehicles	19.9%	1.8%	0.5%
Electricity, gas and water	16.3%	3.8%	13.7%
Transport and telecom	21.3%	32.3%	26.2%
Finance	7.9%	28.0%	23.2%
Business services	0.0%	2.0%	9.5%

Source: UNCTAD, Cross-border M&A database

2. South-East Europe is somewhat similar to the new EU (figure 6): services still dominated, but manufacturing was more important. As for historical shifts (table 2), one can note a large but fluctuating share of telecommunications, except in the early 1990s when privatizations did not yet start; the relative importance of the food and beverages in the early 1990s and that of the chemicals industry in the early 2000s; and the rise of finance and banking in services since the mid 1990s. These are signs of some kind of modernization, although not as pronounced as in the new EU member countries.

Table 2. Share of selected industries in total M&A sales of South-East Europe, 1991–2006

Industry	1991–1995	1996–2000	2001–2006
Mining and petroleum	0.0%	0.1%	5.6%
Food, beverages and tobacco	23.5%	2.5%	6.0%
Chemicals	18.3%	1.7%	23.0%
Transport and telecom	0.4%	67.4%	24.3%
Finance	1.1%	18.7%	32.9%

Source: UNCTAD, Cross-border M&A database

3. A different world is that of cross-border M&A sales in the Russian Federation, dominated by the primary sector (68% over the full period) (figure 6). The share of mining and petroleum was rising spectacularly in the early 2000s, reaching 73% (table 3). In turn, the share of telecom was declining from a high level. In other industries, one sees mostly fluctuations in other industries. Food beverages and tobacco, and financial services, maintained their relative importance over different periods (table 3). This picture is that of a country that undergoes negative structural changes, with extractive industries gaining importance over time.

Table 3. Share of selected industries in total M&A sales of the Russian Federation, 1991–2006

Industry	1991–1995	1996–2000	2001–2006
Mining and petroleum	10.5%	7.5%	73.0%
Food, beverages and tobacco	0.0%	12.8%	5.9%
Coke and petroleum	0.0%	12.6%	0.8%
Metals	11.9%	1.2%	0.8%
Motor vehicles	0.0%	0.0%	0.3%
Transport and telecom	64.9%	50.4%	7.6%
Finance	7.3%	3.0%	5.4%

Source: UNCTAD, Cross-border M&A database

4. In the group of other CIS countries, no sector dominated cross-border M&A sales in 1991–2006 (figure 6). Moreover, there are few clear-cut trends (mostly

fluctuations) (table 4). Mining and petroleum were still very important in all periods (almost half of all transactions in 1996–2000 and almost one third in 2001–2006). Transport and telecom became important in 1996–2000, and the share of metals and finance rose sharply in the early 2000s. This is a picture of some limited structural change, with natural-resource-based activities still playing a major role.

Table 4. Share of selected industries in total M&A sales of other CIS, 1991–2006

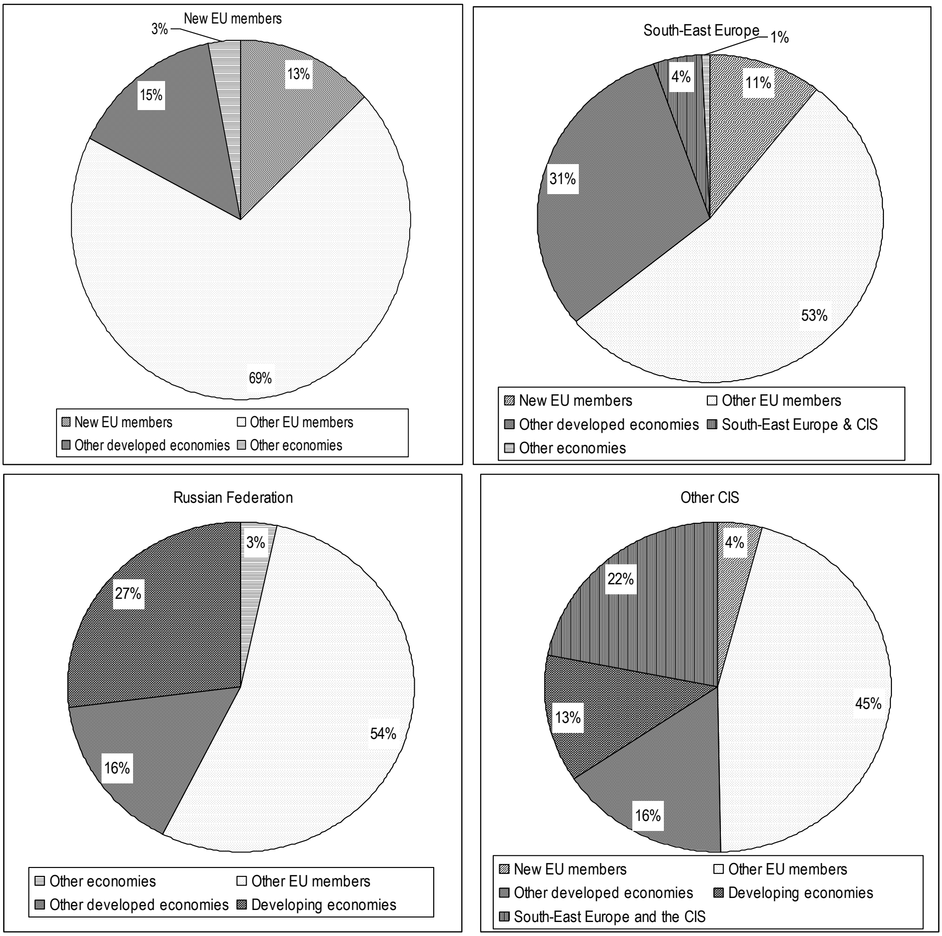
Industry	1991–1995	1996–2000	2001–2006
Mining and petroleum	1.4%	48.4%	33.2%
Food, beverages and tobacco	24.8%	0.5%	0.5%
Metals	0.0%	0.6%	29.9%
Electricity, gas and water	0.0%	7.8%	1.8%
Transport and telecom	0.0%	23.6%	15.5%
Finance	0.0%	0.5%	13.8%

Source: UNCTAD, Cross-border M&A database

On the countries of origin, and their historical shift, it is possible to observe a variety of situations in different groups of transition economies (figure 7). The only real common thread is the importance of “old” new EU members as sources of FDI for all of them, and the relatively stable, but clearly lower share of the United States:

- In the new EU, other EU members dominated largely (especially France, Austria and Germany), followed by other developed countries (United States). The share of some of the source countries was rising between periods, while that of others was declining. For example, the share of Germany and of the Netherlands declined significantly from their initially high levels. The share of the United States was relatively stable, while fluctuations (up and down) characterized the share of France. Of the rising sources, the United Kingdom and Poland are notable ones, as well as Austria, whose share was increasing very quickly. If the aim of this geographical exercise is to identify non-traditional sources of FDI, the case of Poland has to be mentioned. In addition, Austria can be considered as a border case between traditional and non-traditional sources of FDI.
- In South-East Europe, sources of cross-border M&A investment are more evenly spread; still “other EU” (Germany, Italy) and other developed countries (United States) dominate. Over time, the share of Germany and Italy rose and declined, while that of the United States declined and rose. In the new millennium, Norway, Hungary (two non-traditional sources), and France emerged as major investors.

Figure 7. Geographical composition of cross-border M&A sales in economies in transition, 1991–2006 (Per cent)



Source: UNCTAD, Cross-border M&A database

- In the Russian Federation, pre-2004 EU member countries are again the main source of cross-border M&A investment (especially the United Kingdom and Germany), but developing countries are second (especially China and India), and other developed countries third (United States). The most important historical changes were the rise of resource-seeking China, the decline and recovery of resource-seeking India, the rise and decline of the round-tripping hub Cyprus, and the rise and decline of the United Kingdom, related to the investment of BP into its BP-TNK joint venture in the late 1990s.
- In other CIS countries, the "old" EU was still important (especially the Netherlands, which alone represented 32% of the total), but economies in

transition (the Russian Federation and Kazakhstan) were on the second place. The Netherlands and the Russian Federation rose over time. For the latter, geographical and cultural proximity explains the success of investments. Natural resource seeking M&As from China and Japan grew, especially from the latter. Further research should establish why Kazakhstan is so prominent on the top list. To sum up, “other EU” dominate in all subregions, and new sources of cross-border M&As exist but play a more moderate role. These latter are often natural resource seeking; this is why they are particularly important sources of cross-border M&As in the Russian Federation, and partly in other CIS countries.

5. The case of the pre-crisis automotive industry

Of the industries brought in or strengthened by inward FDI, electronics and automotive are particularly important from the point of view of enhancing competitiveness and structural upgrading (UNCTAD, 2002; Szanyi, 2006), as well as technological progress (Pavlínek, 2002). They differ however in the sense that FDI in electronics enhances technological upgrading but a weaker contribution to local supplier links, while the reverse is true to the automotive industry. For economies in transition, as they need to strengthen their domestic enterprises parallel with their opening to international transactions, the automotive industry is one of the main channels of potential linkages with local suppliers, although often at the level of second-tier suppliers only in the initial phase of new projects (Ferenčíková and Fifeková, 2006). Additionally, the automotive industry has a strong clustering effect on the host economy (Radosevic and Rozeik, 2005).

In economies in transition, practically all projects were related to FDI, as national champions characterizing the development of Japan and the Republic of Korea in this domain are mostly missing.[7] At the early stages of transition, countries with capacities inherited from communist times, such as the Czech Republic and Poland, opted for the privatization of existing factories, while in countries where these capacities were lacking at the outset, greenfield projects dominated FDI in automotive from the outset (table 5). However, as time passed by, greenfield investment became the main form of FDI. It is important to note that in the longer run, differences between modes of entry (privatization versus greenfield projects) have mattered little, as privatization projects in most cases have in fact been ‘brownfield’ projects, in which the initial sales have been followed by new investments by the new owners (Meyer and Estrin, 2001). In both cases, foreign owners were quick in introducing improved management and organizational practices (Pavlínek, 2002). The main differences between the two

[7] There were attempts at the beginning of transition to keep national champions in the Russian Federation (Pavlínek, 2002). Later on, however, Russian firms too opted for joint venture production with Western partners).

modes of entry lie in the level of local value added after the entry of foreign investors, which tended to be high in privatized plants and low in greenfield projects, with a tendency of convergence at later stages. It is also notable that local embeddedness has depended much on the technological sophistication of the assembly factories: high-technology projects such as Audi (Hungary) have had much more limited local sourcing than lower-technology projects such as Suzuki (Hungary) (UNCTAD, 2002).

Table 5. Economies in transition are host to large car assembly projects: examples, 2007

Country	Location	Producer	Established	Form of entry
Czech Republic	Mlada Boleslav	Volkswagen/ Skoda	1991	Privatization
	Kolin	Toyota/PSA	2002	Greenfield
	Novosice	Hyundai	2006	Greenfield
Hungary	Esztergom	Suzuki	1991	Greenfield
	Györ	Audi	1992	Greenfield
Poland	Bielso Biala	Fiat	1991	Privatization
	Poznan	Volkswagen	1993	Greenfield
	Warsaw	Daewoo FSO	1996	Privatization
	Gliwice	General Motors/Opel	1998	Greenfield
Romania	Pitesti	Renault Dacia	1995	Privatization
Russian Federation	Togliatti	GM/AvtoVAZ joint venture	2002	Privatization
	Vzhevolovsk	Ford	2002	Greenfield
	Moscow	Renault	2005	Privatization
Slovakia	Bratislava	Volkswagen	1993	Privatization
	Trnava	PSA/Peugeot	2003	Greenfield
	Zilina	Hyundai/KIA	2004	Greenfield
Slovenia	Novo Mesto	Renault	1991	Privatization

Source: UNCTAD

FDI in automotive assembly accentuates or exacerbates the differentiation between countries, especially the haves: Czech Republic, Hungary, Poland, Russian Federation, Slovakia, Slovenia etc., and the have nots: large parts of the CIS (table 5). Future or ongoing large projects such as Mercedes' A car project in Hungary (IHT, 2008), or the series of new car projects in the Russian Federation in 2008 (UNCTAD, 2008a), still tend to target the same 'haves', further increasing the differences between the haves, where car assembly is growing fast as a result of successful projects (table 6), and the have nots, where production is still zero. In the former group, policy makers can afford choosing between future industrial development strategies based on quick technological upgrading with limited local content, or more limited technological progress combined with a faster increase of local linkages and local jobs. In both cases, they can measure their development gains. In the have not group, policy makers face tougher choices: they have to raise the question to what degree it is realistic to expect the automotive industry arrive to them, or they need to base their catching up with the rest of the region on other industries. In the former case, they have to increase efforts to attract such projects; in the latter case, however, economic policies should find other priority industries.

Table 6. Production of passenger cars in selected countries, 2005–2007 (Number of units)

Country	2005	2006	2007	Change 2007/2005 (%)
Czech Republic	596 774	848 799	925 778	55.1
Poland	540 100	632 300	695 000	28.7
Slovakia	218 349	295 391	571 071	161.5
Hungary	148 553	187 633	287 982	93.9
Romania	174 538	201 663	234 103	34.1
Slovenia	138 393	119 212	174 209	25.9

Source: European Automobile Manufacturers' Association

6. Remarks about the crisis

The crisis of 2008–2009 has highlighted one additional problem related to the champion industries of structural change (automotive and electronics in particular), namely their relative vulnerability to changes in global markets. For example, the crisis brought about a need for restructuring in the global car industry, and it has affected production sited in economies in transition, independently of their efficiency. It remains to be analysed in the future if these development are signs of a shift away of production in those economies, or they can regain or even strengthen their competitiveness in the post-crisis era. As will be highlighted at the end of this section, the possibility of regained, or even strengthened competitiveness, is not excluded. However, it is still too early to provide a definitive analysis of the impact of the crisis on economies in transition.

As far as the group of new EU members is concerned, this was the group of transition economies that had undergone the deepest integration with the world in its productive capacity, and logically was the most affected by the crisis. As the manufacturing export platforms of new EU member countries were all dominated by foreign affiliates, or they were the only players (as was the case in automotive), the degree of decline could be gauged from general output and export statistics. In February 2009, one of the deepest points of the crisis (table 7): Bulgaria, the Czech Republic, Estonia, Hungary and Latvia, Slovakia and Slovenia, all showed similar major declines in industrial output (over 20%), in exports (over 20%) and in the exports of the transport equipment industry (over 40%).

Table 7. Year-to-year changes in manufacturing output and exports, selected countries, February 2009, in percent points

Country	Change in manufacturing output	Change in manufacturing exports	Change in the exports of transport equipment
Bulgaria	-24.3	-39.2	-41.0[a]
Czech Republic	-23.4	-22.2	...
Estonia	-32.7	-26.0	-54.0
Hungary	-26.1	-30.4	-48.1
Latvia	-24.3	-29.3	...
Lithuania	-17.9	-21.8	-31.9
Poland	...	-24.8	-25.7
Romania	-14.5	-15.9	...
Slovakia	-28.2	-31.0	...
Slovenia	-24.1	-25.1	-42.3[b]

Source: Kalotay and Filippov, 2009
[a] Machinery and transport equipment.
[b] January 2009.

This decline is not necessarily the sign of the end of the car manufacturing industry in economies in transition. It has been shown that since then manufacturing output and exports have rebounded, and sometimes in a spectacular manner. An even more important question is the capacity of transition economies in attracting FDI projects in the post-crisis phase. As a case study to prove that a new round of investment in the automotive industry of the region is not excluded, it is possible the refer to Hungary, where one automotive project (that of Mercedes Benz) was announced during the crisis (2008), followed in 2010 by announcements by Audi and Opel on major extension plans on their existing capacities (Die Presse, 2010).

7. Some policy-oriented conclusions

It has to be emphasized again that FDI has been one of the main channels of reintegrating the economies in transition in the world economy. Since the beginning of transition, various countries of Central and Eastern Europe and the CIS have undergone important structural changes, linked with the entry of FDI. In the early phases of transition, these structural changes were linked with the adjustment of enterprises to the requirements of the new, market-based macroeconomic framework. It was followed by a phase of structural changes determined by the demand and supply factors of the newly established market economies and their integration into the international division of labour. Already in this phase, structural change proceeded unevenly, with future EU members advancing faster than other countries in transition (Szanyi, 2004).

The current stage of FDI and structural change is strongly influenced by the relationship of economies in transition with the EU. Those countries that have joined the EU have undergone a process of adjustment in the inward FDI to the requirements of the economic union (Kalotay, 2006, 2008). Potential candidate countries have followed that path, but at a slower speed. As for CIS members, the main structural changes in the current phase of FDI flows reflect their status of external suppliers of inputs, especially those of raw materials. This process was slowed down and disrupted by the crisis of 2008-2009; however with the gradual recovery of FDI from 2010 on, the process of spreading FDI can restart. In fact it is an open question which economies in transition will benefit more from the FDI recovery.

In economies in transition, FDI has been an agent for structural changes, but rather unevenly. It created strong structural change only in the new EU member countries. In other economies in transition, not just the volume of FDI was more modest, but also its structural impact was less clear. Structural change in FDI was less pronounced in South-East Europe and in some CIS countries, and FDI contributed to the conservation of dependence on extractive industries in the Russian Federation. On the basis of these findings, one has to ask, if policies to attract FDI and benefit from it have been sufficient and the right ones from the point of view of desirable structural changes in the recipient economies. The uneven record of FDI in structural change raises the question if there is a need for a stronger link between investment promotion and industrial policy.

The relationship between the quantity and the quality of FDI still needs to be better understood, especially in order to draw lessons for investment promotion, which for the moment is more articulate on quantity than on quality. Moreover, the fact that FDI and private ownership are no longer so clearly interrelated, and FDI can grow in parallel with more State ownership, raises the question of how policies to attract FDI have to be modified in face of the rise of State-owned FDI.

Finally, and probably most importantly, there is an important number of economies in transition that are marginalized in FDI flows. In those countries, the question of FDI flows and structural change is not yet on the agenda because the former are too limited to be expected to have any significant impact, positive or negative. The question is how these countries can overcome the three types of handicaps they are suffering from. Can they mitigate their geographical handicap through infrastructure development? Can they mitigate their market size handicap via specific economic development strategies? Can they mitigate their policy handicap through an improvement of FDI policies?

All these questions now have to be raised in the context of a potentially longer-term slowdown and financial crisis of the world economy (UNCTAD, 2008b). It is known from the experience of past financial crises that FDI is more resistant to the downturn than international portfolio flows and bank loans. They however affect the willingness and the capabilities of TNCs to invest abroad. It is also a question to what degree the contagion of crisis spreads to economies in transition as host countries of FDI. While some of them with relatively isolated economies can withstand the crisis well, smaller economies with deep integration into the world economy may be vulnerable to a prolonged downturn. And in the case of economies with a history of capital flight such as the Russian Federation (Bulatov, 1998), a lack of confidence may result to a resurrection of capital flight (New York Times, 2008), affecting mostly portfolio investments, but potentially spreading to FDI too. Under such a scenario of slowdown in FDI, the potential for structural change carried out through that channel can also suffer.

The FDI downturn has created a major policy challenge for governments worldwide and economies in transition in particular. The crisis has further highlighted the need for policies aimed at upgrading production capacities to higher value-added activities, especially in the form of investment in knowledge and innovation, and support to R&D function of foreign affiliates. This makes the need for strong and proactive FDI policies even more evident.

The above questions on FDI and structural change in economies in transition require further analysis, including more quantitative and econometric studies. These future studies could shed also further light on additional country-by-country and period-by-period difference that this summary study could not highlight.

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