

# FDI IN THE EEC-10: A COMPARATIVE ANALYSIS<sup>19</sup>

**Simona Moagar-Poladian\***  
**Iulia Monica Oehler-Şincai\*\***

## **Abstract**

The present paper examines the evolution of FDI flows generated and received by ten new member states of the EU (NMS minus Cyprus and Malta, EEC-10) during the period 2000-2011, with the aim to identify their dynamics, composition and performance. Taking into consideration the EEC-10' high dependence on the Internal Market and the weaknesses of the national companies, the authors demonstrate that the strengthening of the national firms and the diversification of the trade and investment flows are crucial for the future development of each EEC-10. In the same context, the authors point to the fact that a strong impetus to the EEC-10 near-term development could also come from the absorption of European cohesion and structural funds.

**Keywords:** *EEC-10, FDI, Internal Market, FDI/GDP index, FDI/external debt index, FDI contribution index, FDI performance index, FDI regulatory restrictiveness index*

*JEL classification: E22, E32, E44, F21, F62, G01, G11, G15*

## **Introduction**

The group of EEC-10 continues to hold reduced shares in the total EU trade in goods and services. During the last decade, their contribution to these flows increased only marginally. More than that, the EEC-10 is more dependent on the Internal Market than the EU-15 and, besides, the dependence degree augmented in the case of import of goods and trade in services, as compared to the situation of the EU-15, which diversified their export destinations and import sources (Eurostat, 2012a).

On the FDI side, the trend is similar. The bulk of FDI inflows in EEC-10 originates in the EU (WIIW, 2011). It is worth mentioning also that no transnational corporation (TNC) from the EEC-10 is present either in the hierarchy of the world's top 100 non-financial TNC or in the hierarchy of the top 100 TNC from developing and transitions economies (UNCTAD, 2012, Annex Tables).

In the context of the global financial and economic crisis and the debt crisis in the Euro Zone, this should be an alarm signal for the decision factors in these countries. That is why we ask at this moment a difficult question: Which should be the EEC-10 development drivers for the future, in addition to the FDI?

In the present research paper we are trying to demonstrate that among the determinants of the EEC-10' economic growth, besides the FDI it could be also included: the acceleration of the absorption of the structural and cohesion funds (with a view to the financial framework 2014-2020 and having in mind the lessons learned from the period 2007-2013), the

---

<sup>19</sup> The paper was presented at the 22<sup>nd</sup> International RESER conference, 20-22 September 2012, Bucharest, Academy of Economic Studies.

\* Ph.D., Senior research in the Institute for World Economy of the Romanian Academy, Bucharest, Romania, e-mail: smpoladian@yahoo.com.

\*\* Ph.D., Senior research in the Institute for World Economy of the Romanian Academy, Bucharest, Romania, e-mail: oehler.sincai@gmail.com.

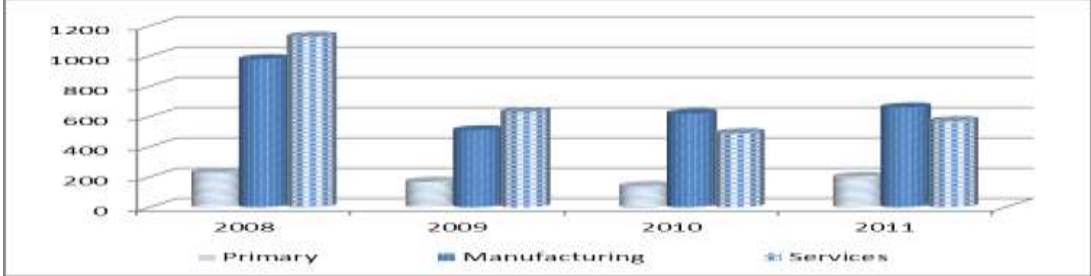
strengthening of the TNCs from EEC-10 home countries, which should become active players on the international stage, the development of a skilled and motivated labour and of a good infrastructure, the diversification of trade and investment flows.

**1. Overview of FDI flows: recent trends at international and national levels**  
**1.1. Recent trends of the global FDI flows**

In the last two decades, it has been recorded a substantial increase of world GDP, international trade flows and FDI stock worldwide. The FDI stock augmented by almost 10 times, from US\$ 2018 billion to US\$ 20438 billion, according to the latest UNCTAD World Investment Report (WIR 2012). In the same period, the world GDP rose by 3.4 times, from US\$ 20206 billion in 1990 to US\$ 69660 billion in 2011. A significant increase in absolute terms has been registered in exports of goods and non-factor services from US\$ 4382 billion in 1990 to US\$ 22095 billion in 2011, meaning a 5 times increase over the stated period of time. The highest increase, of over 18 times, had been noticed in incomes generated by the inward FDI in 2011 in comparison to 1990, reflecting the gradual growth of FDI efficiency worldwide. At the same time, the FDI stock ratio in world GDP has soared from only 10 per cent in 1990 to circa 30 per cent in 2011.

The FDI in services sector amounted to US\$ 570 billion from the total investment worldwide in 2011, after a massive downturn during the global financial crisis. A gradual decrease of FDI projects value in services over the 2008-2011 has changed the sectoral distribution of FDI. It is worth mentioning that the FDI in manufacturing surpassed the value of the FDI in services sector from 2010 onward (Figure 1).

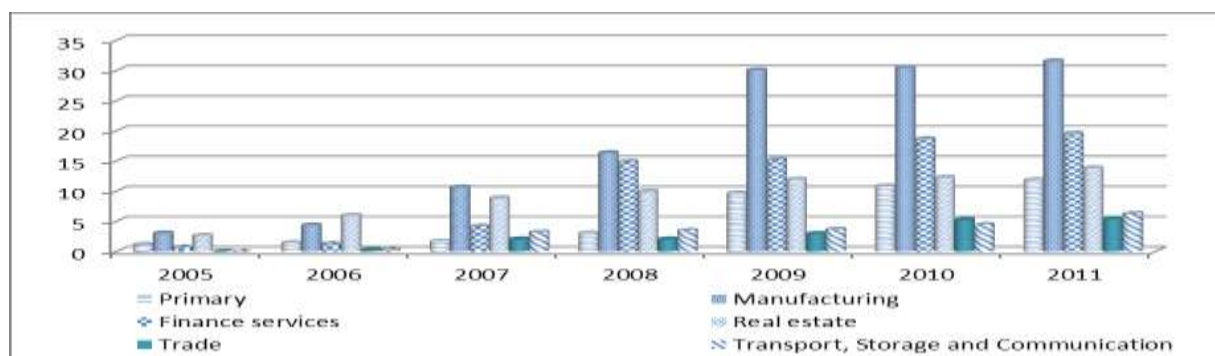
**Figure 1: Sectoral distribution of FDI projects during 2008-2011, US\$ Billion**



Source: UNCTAD database (WIR 2012); [www.fdimarkeys.com](http://www.fdimarkeys.com).

An increasing significance of indirect FDI flows has become visible starting from 2005. According to UNCTAD (WIR 2012), FDI by Sovereign Wealth Funds (SWFs) has gained gradually an important role in the last years. Their total volume has soared by almost 11 times to US\$ 125 billion in 2011. It is worth pointing out that EU attracted circa 42% of this amount. Services sector accounted for 65% of the total FDI by SWFs in 2011, while the manufacturing industry only a quarter. The highest growth rate of FDI by SWFs has been found in Transport, Storage and Communication, Financial services, and Trade. The specific behaviour of these SWFs is finding the most profitable branches in a country (Figure 2).

**Figure 2: FDI by SWFs, breakdown by branches, 2005-2011, US\$ Billion**



Source: UNCTAD database (2012).

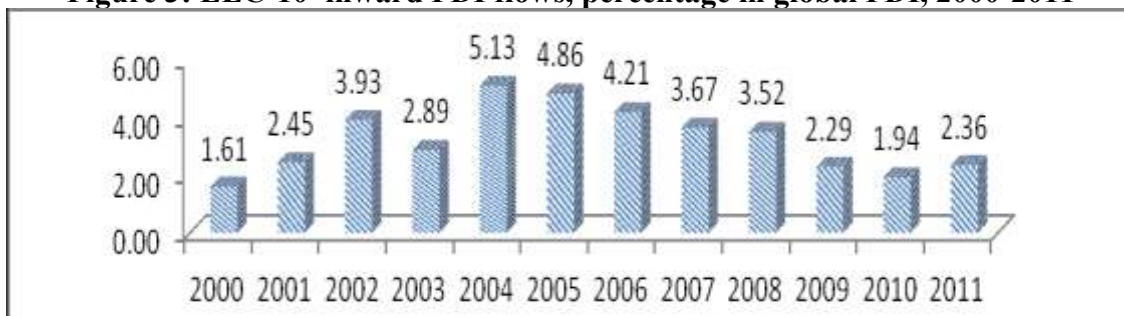
Returning to the investment projects worldwide, these were significantly driven by cross-border M&As that rose 52 per cent in 2011 to US\$ 526 billion. In the same time, the value of greenfield investment projects has been maintained almost steady at US\$ 904 billion in 2011 (UNCTAD 2012). The EU had a share of 28% in the global inward FDI flows, 33% in the total value of M&As worldwide and 36% in the world FDI stock in 2011. Anyway, the percentage of the EEC-10 in the FDI attracted by the EU was under 10%.

### 1.2. FDI in EEC-10: a brief comparative analysis

Relations between EEC-10 and EU have been strengthening gradually in parallel with to privatization and integration processes. International investors, mainly from EU saw the Eastern openness and fall of the communist regime as an opportunity for obtaining market advantages in these countries. The gradual increase of the EEC-10' FDI has been possible through the opening of these markets to investors from all over the world, after almost five communist decades. These were attractive and relatively near markets for investors from Western Europe. The integration process of the EEC-10 into the Internal European Market accelerated after signing the Association Agreements, which offered an opportunity for investing in these countries. Besides their large markets, the EEC-10 offered access to a relatively skilled and cheap workforce, and also to a good quality agricultural land and to natural resources at a relatively low price.

As a direct consequence, inward FDIs in the EEC-10 have been expanding gradually as a share in the world total, from the modest share of 1.6% in 2000 to 5% in 2005-2006. As the EEC-10 and the main FDI home countries were hardly affected by the international financial and economic crisis in 2008-2009, the percentage of EEC-10' inward FDI in the world total decreased to 1.94% in 2010 – the lowest level in a decade, as indicated by Figure 3. The modest share of this group of countries in the world FDI inflows illustrates the lower attraction capabilities in comparison with other countries. In fact, when we analyze the FDI flows, we should always keep in mind the balance between what these countries have been offering and which are the main motivations of the TNC to invest abroad: resources (natural or cheap and/or highly qualified labour force), market dimensions, effectiveness and strategic assets (OECD, 2002, pp. 39-41). Anyway, even if the basic motivations are the same, the investors' strategies are not identical and they depend on the policy and priorities of each TNC.

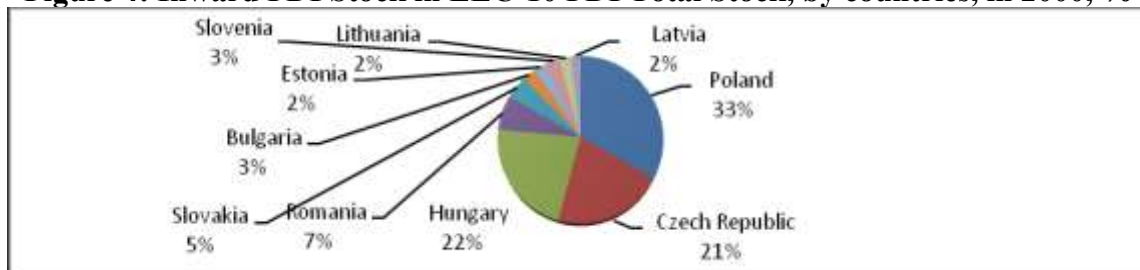
**Figure 3: EEC-10' inward FDI flows, percentage in global FDI, 2000-2011**



Source: Own calculations, based on UNCTAD data (2012).

Still, a comparison between 2000/2011 shows a gradual increase of inward FDI stocks for EEC-10 as a group, from US\$ 103.1 billion to US\$ 634.4 billion, reflecting a substantial growth, of more than six times.

**Figure 4: Inward FDI Stock in EEC-10 FDI Total Stock, by countries, in 2000, %**

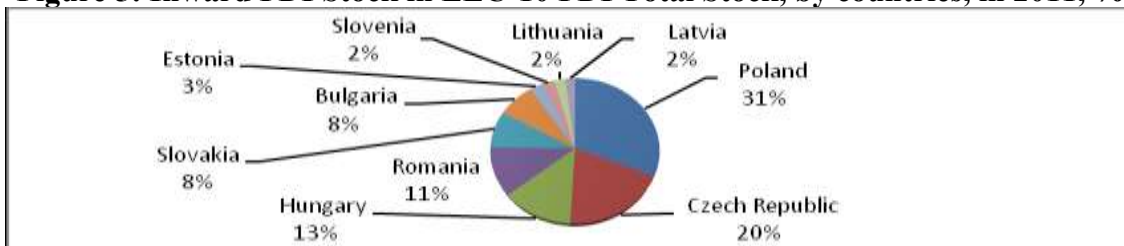


Source: Own calculations, based on UNCTAD data (2012).

At the same time, a comparison between the main beneficiaries of inward FDI (at level of stock) among the EEC-10, in 2011 as compared to 2000 reveals: Poland ranking the first, a change of positions between Hungary and the Czech Republic, in favour of the latter and Romania, Slovakia and Bulgaria ranking the fourth, fifth and sixth respectively (Figures 4 and 5).

Although the same countries remained in the top six positions (with changes of places between Hungary and the Czech Republic), it is worth mentioning that Hungary has registered a marked decreasing of its share in the EEC-10 total inward FDI stock in 2011 compared to 2000, from 22% to only 13%. On the opposite side there is Bulgaria who has gained from only 3% to 8% in total EEC-10' FDI stock.

**Figure 5: Inward FDI Stock in EEC-10 FDI Total Stock, by countries, in 2011, %**



Source: Own calculations, based on UNCTAD data (2012).

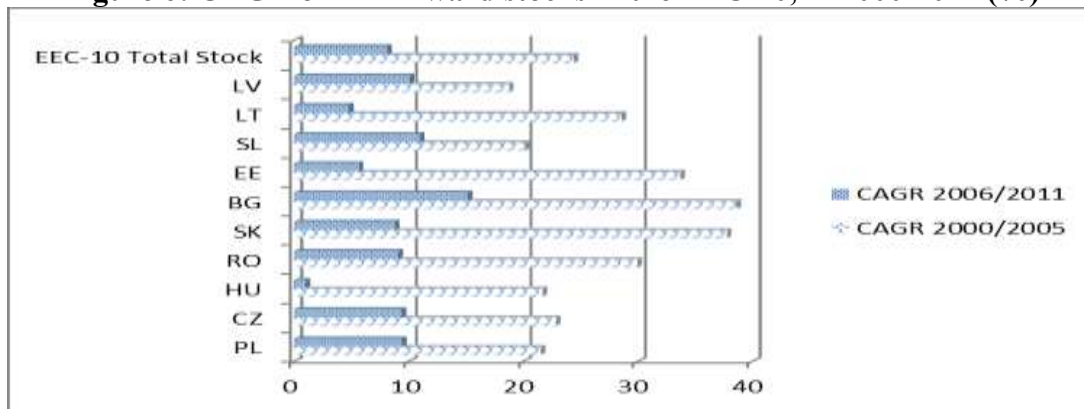
### 1.2.1. Some FDI indicators

Taking into consideration the FDI contribution index,<sup>20</sup> it appears that the strongest development impact of FDI on the host economy is recorded by Hungary, followed by Belgium (2), the Czech Republic (3), Romania (4), Poland (6) and Estonia (8) (UNCTAD, 2012, p. 197).

A significant increase of annual contribution to GDP growth due to FDI inflows has been registered by services, especially financial intermediation and banking and also by services connected to manufacturing industry. The FDI inflows to each EEC-10 have contributed to export increasing and also to the improvement of the trade balance.

As regards the FDI yearly growth rate in terms of inflows in the EEC-10, one can distinguish a marked differentiation among the period 2000-2005 and 2006-2011. Figure 6 highlights the main trends in EEC-10' FDI inflows in terms of growth rates. For example, the average annual growth (CAGR) of EEC-10' FDI inflows was considerably higher in the first years of 2000-2011, with Slovakia and Bulgaria being the leaders in the process of catching-up with Poland, Czech Republic and Hungary. The average annual growth of EEC-10' FDI inflows decreased markedly in the 2006-2011 for each member country as well as at the level of the EEC-10 group. The main cause is the spread of the world financial and economic crisis, associated to a substantial decrease of world FDI.

**Figure 6: CAGR of FDI inward stocks in the EEC-10, in 2000-2011 (%)**



Source: Own calculations, based on UNCTAD data (2012).

Albeit the above mentioned advantages generated by investing in EEC-10, the domestic demand gap between EEC-10 and EU-15 remains at a high level. Nevertheless, the percentage of EEC-10 in EU-27 total demand has increased, even if only marginally: from almost 5% in 2000 to circa 8% in 2011 (Figure 7).

<sup>20</sup> “The UNCTAD FDI Contribution Index ranks economies on the basis of the significance of FDI and foreign affiliates in their economy, in terms of value added, employment, wages, tax receipts, exports, research and development (R&D) expenditures, and capital formation (e.g. the share of employment in foreign affiliates in total formal employment in each country, and so forth). These variables are among the most important indicators of the economic impact of FDI” (UNCTAD, 2012, pp. xv-xvi and p. 31).

**Figure 7: Domestic demand evolution in 2000-2011 (comparison between EEC-10 and EU-15 as a percentage of total EU-27 total demand)**

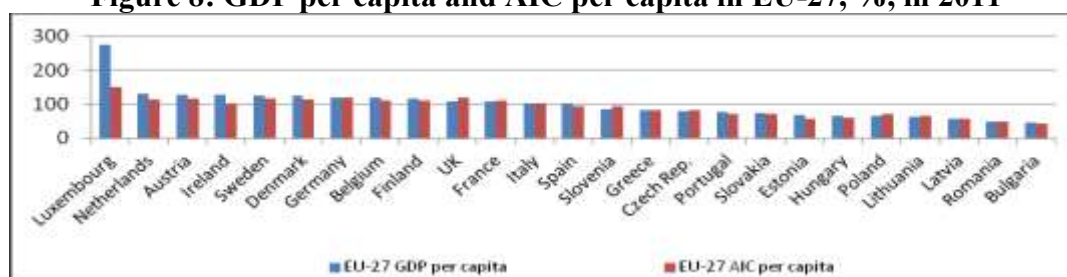


Source: own calculations on the base of Eurostat database (2012a).

In spite of high intra-trade integration (illustrated by the high export intensity of 70-85%) the standards of living gap between EEC-10 and EU-15 remains relatively unchanged. Based on first preliminary estimates for 2011, Gross Domestic Product (GDP) per capita expressed in Purchasing Power Standards (PPS) varied from 45% to 274% of the EU-27 average across the Member States (Eurostat, 2012b). At the EEC-10 level there have been retained almost the same differences over the time. On the top positions there were Slovenia and the Czech Republic i.e. between 15% and 25% lower than the EU-27 average, and Slovakia was around 25% below. Estonia, Hungary, Poland and Lithuania were between 30% and 40% lower than the average. Latvia was around 40% below average, Romania around 50% and Bulgaria 55% lower than the average.

According to Eurostat database<sup>21</sup> while GDP per capita is often used as an indicator of countries' level of welfare, an alternative welfare indicator, better adapted to reflect the situation of households, is Actual Individual Consumption (AIC) per capita. In 2011, AIC per capita ranged between 44% of the EU average in Bulgaria to 150% in Luxembourg (Figure 8).

**Figure 8: GDP per capita and AIC per capita in EU-27, %, in 2011**



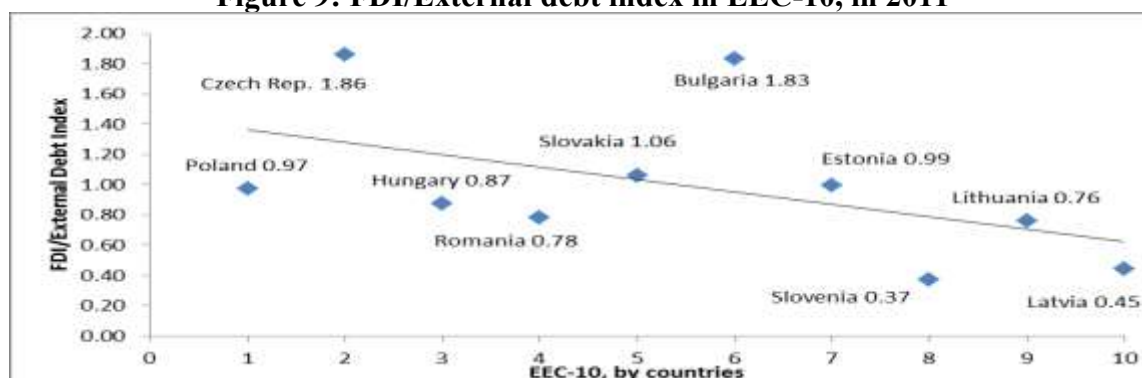
Source: Eurostat (2012b).

The FDI inflow in each EEC-10 country divided by the national external debt suggests an inverse correlation, underlining a positive FDI contribution to reducing the external debt. The tendency line illustrates the indirect correlation between the FDI inflow and the external debt. Larger FDI inflows contribute to the lowering of the external debt (Figure 9). A more significant impact of the FDI on lowering the external debt or maintaining this debt at a low level can be remarked for countries like Czech Republic, Bulgaria and Slovakia.

<sup>21</sup> Individual Consumption (AIC) consists of goods and services consumed by individuals, irrespective of whether these goods and services are purchased and paid for by households, by government, or by non-profit organisations (Eurostat definitions).



**Figure 9: FDI/External debt index in EEC-10, in 2011**



Source: own calculation, based on UNCTAD database (2012).

Going further with our analysis, we conclude that the index of FDI efficiency, measured as the ratio of inward FDI stock to the GDP of these countries, reveals a general increasing trend during 2004-2011 (0.48% in 2011 as compared to 0.43% in 2004), suggesting a relatively more intense relationship between the internal development and the FDI, as can be seen in the Table 1. At the same time, a comparison between the index of FDI efficiency worldwide and the index of FDI efficiency at the level of EEC-10 reveals a higher dependence in EEC-10. Bulgaria, Estonia and Hungary have recorded an outstanding GDP dependency on inward of FDI during 2004-2011. Conversely, at the other extreme, there are Slovenia, Lithuania and Poland (Table 1). Although Poland is the first destination of FDI at the level of EEC-10, it ranks the sixth in terms of FDI inward stock / GDP. This apparent paradox is due to its GDP, the largest among the GDP values of the analysed countries.

**Table 1: FDI Inward Stock as a percentage of GDP, 2004-2011**

YEAR	2004	2005	2006	2007	2008	2009	2010	2011
Poland	0.35	0.35	0.39	0.45	0.34	0.36	0.47	0.38
Czech Rep.	0.52	0.50	0.57	0.66	0.57	0.61	0.67	0.59
Hungary	0.64	0.58	0.69	0.78	0.60	0.72	0.74	0.61
Romania	0.29	0.33	0.42	0.44	0.34	0.40	0.46	0.40
Slovakia	0.57	0.52	0.64	0.63	0.60	0.62	0.58	0.54
Bulgaria	0.41	0.51	0.76	0.98	0.92	1.05	1.01	0.93
Estonia	0.87	0.86	0.82	0.85	0.73	0.86	0.88	0.78
Slovenia	0.23	0.21	0.24	0.32	0.30	0.32	0.30	0.31
Lithuania	0.29	0.34	0.39	0.42	0.30	0.36	0.38	0.34
Latvia	0.34	0.32	0.41	0.45	0.38	0.44	0.44	0.46
<b>Total EEC-10' Inward Stock of FDI</b>	<b>0.43</b>	<b>0.42</b>	<b>0.49</b>	<b>0.55</b>	<b>0.45</b>	<b>0.49</b>	<b>0.56</b>	<b>0.48</b>

Source: own calculation based on Eurostat (2012a), UNCTAD database (2012).

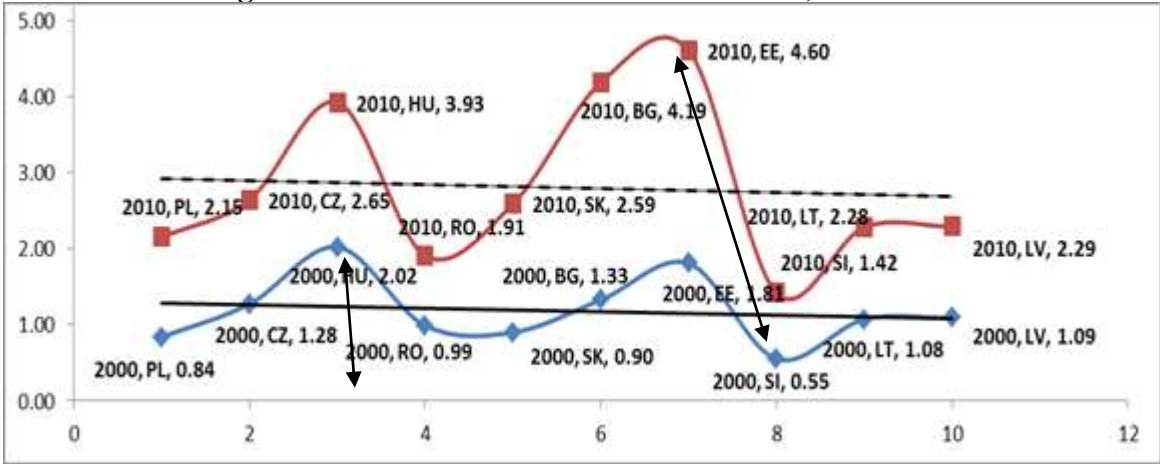
Before proceeding to a deeper analysis, we bring to the forefront a very suggestive indicator: Inward FDI stock ratio in gross fixed capital formation (GFCF)<sup>22</sup>, taking into

<sup>22</sup> GFCF is an indicator used for the first time by Simon Kuznetz in 1930s. Two decades later this concept became an internationally measure for the investment share in national GDP. Theoretically, GFCF excludes land and financial transactions and also the value of inventories.

consideration FDI inflows that have become gradually a very important asset for a country's sustaining growth especially for developing and emerging groups. These countries have become in the same time more vulnerable in a case of financial turmoil due to the fact that financial intermediation services and real estate transactions mainly registered the highest growth rates among all the categories of services in the last decade. That is why we consider important to see the real impact of inward FDI to create capital assets in the host country as a long term development contributor.

By calculating the inward FDI stock ratio in GFCF in each analysed country we obtain a remarkable connexion. The difference between local maxima and local minima had increased in 2010 as compared to 2000 (3.18 in contrast to 0.47). On the top are positioned Estonia (4.60), Bulgaria (4.19) and Hungary (3.93) and on the other side, there are Slovenia (1.42), Romania (1.91) and Poland (2.15) with the lowest FDI stock contribution to the GFCF. Nevertheless a higher ratio reflects a stronger dependence of the foreign resources and also a substantial contribution in national development of capital accumulation (Figure 10). The motivation of lower ratios for countries that attracted the bulk of EEC-10' FDI, namely Poland and Czech Republic consists in an early economic openness to foreign investors than the other countries from the group and also the larger dimension of internal development capacity. But what is remarkable is the maintaining of the same order in the EEC-10 group in 2010 as in 2000. This share reflects only partially what it's happening in these countries. Purchases of second-hand assets like planes, industrial equipment and road vehicles represent a higher share in the total investment in comparison to the EU-15. *The investment quality is not taken into consideration here and we notice its increasing importance.*

**Figure 10: Inward FDI stock ratio in GFCF, in 2000 and 2010**



Source: own calculation on the base of UNCTAD and OECD database (2012).

**1.3. Comments on the EEC-10' inward and outward FDI**

**1.3.1. EEC-10 capacity to attract FDI**

As already suggested in the previous chapter, the attractiveness of an economy for FDI is given by several factors, such as:

- Market attractiveness by the size of the market (GDP by PPP); spending power (GDP per capita by PPP); real GDP growth rate;
- Availability of low-cost labour and skills by unit labour cost, size of manufacturing workforce;



- Presence of natural resources by exploitation of resources (value of fuels and ores exports); agricultural potential (arable land);
- Enabling infrastructure by transport infrastructure (road density) (UNCTAD, 2012, p. 30).

Several of the above mentioned determinants are present in the EEC-10 countries as well. In the last years of '90s after signing the Association Agreements the EU-15 FDI outflows to the EEC-10 countries were primarily oriented to manufacturing due to the advantages like good skilled workforce and the low wages in the majority of these countries. Each of the EEC-10 governments put in practice national strategies to attract affiliates of the TNC to locate in economy and to contribute to the general GDP growth.

At the motivations mentioned before should be added the restrictions present in the host countries, which could impede the FDI. These are reflected by the *FDI Regulatory Restrictiveness index (FDI RR index)* (OECD 2012). This index measures statutory restrictions on foreign direct investment in 55 countries, including all OECD and G20 countries, and covers 22 sectors in accordance to definition. The following categories are taken into consideration as scored measures for FDI RR index:

- (i) Foreign equity restrictions,
- (ii) Screening and prior approval requirements,
- (iii) Rules for key personnel,
- (iv) Other restrictions on the operation of foreign enterprises.

If the score for any measure in any sector is 1 this means the measure fully restricts foreign investment in the respective sector and if the score is 0 there are no regulatory restrictions to FDI in the sector.

The scores for all four above mentioned types of measures for each sector are obtained by summing up with the condition that the result is limited at a value of 1. By comparing the FDI index for each country to the average of all 55 countries for which the FDI index is calculated, we notice that only one EEC-10 country, namely Poland, is above the average (0.108 as compared to 0.105). This means a permissive FDI environment in all the EEC-10 countries, minus Poland. This conducts us to the following questions: if Poland implies restrictions or certain rules to the FDI, why does this country attract the bulk of the FDI in the EEC-10 countries? Why is this country the first in the hierarchy of the EEC-10 countries in terms of GDP (in US\$, in current prices)? Why its GDP has been continuing to grow while the other EU countries were affected by recession? We consider that the policies oriented towards the maximization of the FDI contribution to the economic development of a country are even more important than the policies focused on attracting FDI.

**Figure 11: EEC-10' FDI RR index, 2012**



Note: Among the EEC-10, Bulgaria and Slovakia weren't on the sample of the 55 countries for which the FDI index is calculated.

Source: OECD FDI Regulatory Restrictiveness Index ([www.oecd.org/investmeny/index](http://www.oecd.org/investmeny/index)).

According to the WIIW database, at the level of 2010, Poland, Czech Republic, Hungary and Romania were the main beneficiaries of the FDI stock in EEC-10. Together,

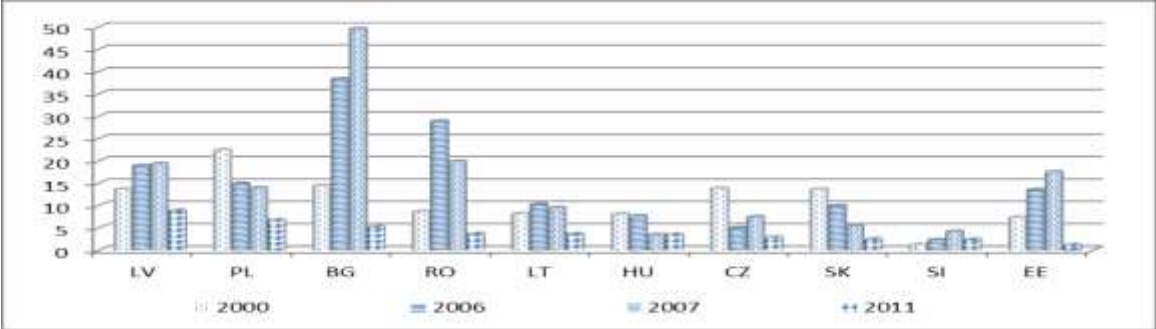
they attracted around 3/4 of the total FDI stock in EEC-10. Nevertheless, the differences between these countries were notable. These can be emphasized by examples such as the FDI stock accumulated in Romania, which represented only one third of the FDI stock in Poland but it was six times higher than that attracted by Latvia. The bulk of the FDI stock at the level of EEC-10 originated in the EU-15 (circa 85% of the total value). According to the UNCTAD database the percentage of inward FDI stock in Poland, Czech Republic, Hungary and Romania together accounted for the lion's share of the EEC-10 group (75.5 per cent) in 2011 too. The rest of the EEC-10, namely Slovakia, Slovenia, Bulgaria, and the three Baltic states accounted for only 24.5 per cent of the total FDI stock inflows in 2011.

The importance of the foreign enterprises in the host economies induced many debates and analyses at the international level. In 2008, Dunning and Lundan defined an index as an average of four indicators:

- FDI inflows as a percentage of GFCF (average for three years);
- FDI inward stock as a percentage of GDP;
- The value added of foreign affiliates as a percentage of GDP;
- Employment of foreign affiliates.

The contribution of FDI flows to EEC-10 trade is positive over the past decade. A calculation of the FDI inflows to EEC-10 total trade ratio reveals the increasing role of FDI in total trade volume. However, it is worth mentioning a sharp decrease of this ratio after the 2008-2009' global financial turmoil, due to the drastic decrease in the inward FDI. The most visible decrease could be seen in Bulgaria and Romania, both countries acceding in the EU in 2007 (Figure 12).

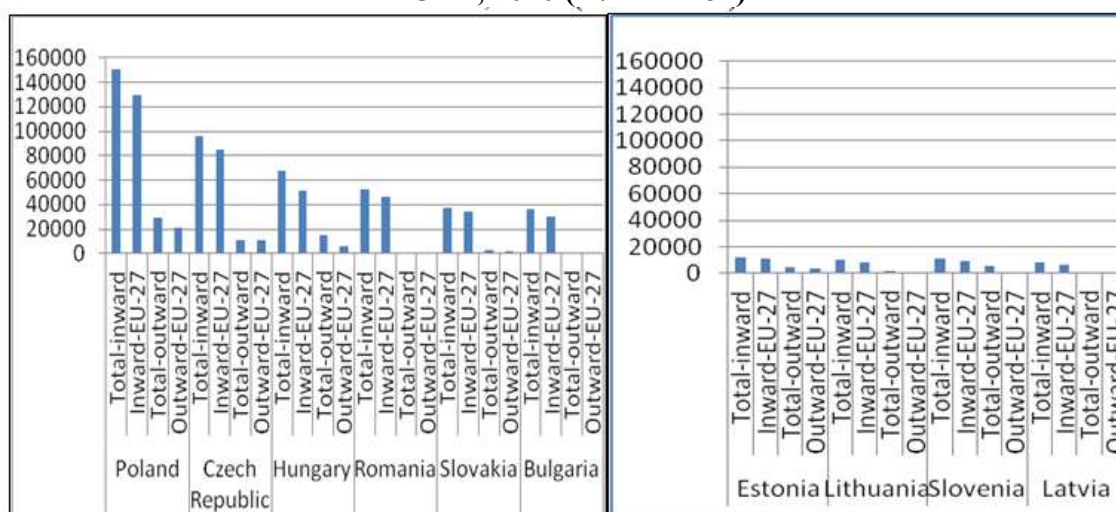
**Figure 12: EEC-10 inward FDI in the total trade (%)**



Source: own calculation on the base of UNCTAD (2012).

As many companies scaled back or suspended their expansion plans due to the global financial crisis, FDI inflows in Poland and Bulgaria declined considerably in 2008, but in the Czech Republic and Hungary they did not change significantly, despite increasing macroeconomic problems in both countries. For many years the automotive industry has been the key driver of strong FDI inflows to the new EU member countries, but the decline in Euro area car sales that began in the last quarter of 2008 has revealed the region's vulnerability on account of its heavy reliance on the industry (UNCTAD, 2009).

**Figure 13: FDI inward and outward stocks in the EEC-10, total and in relationship to EU-27, 2010 (Eur Million)**



Source: WIIW (2011).

The examination of the data referring to the structure of the FDI stock in the EEC-10 by sectors at the level of 2010 (Table 2) highlights the following conclusions:

- Manufacturing represented the most attractive sector in the Czech Republic, Lithuania, Poland, Romania and Slovakia.
- The sector of real estate, renting and business activities was the main destination of the FDI in Bulgaria, Estonia, Hungary and Latvia, while in the case of Slovenia the sector of financial intermediation attracted the bulk of the FDI stock in this country.
- Financial intermediation represented the second most attractive sector for foreign investors in other seven of the analysed countries (including Romania).
- Another sector with high shares in the total FDI stock attracted by the NMS-10 was represented by wholesale, retail trade, repair of motor vehicles. These two last evidences should be directly correlated to the increasing consumption in the EEC-10.
- FDI stock in transport, storage and communication surpassed 10% of the total FDI stock in Bulgaria and Lithuania, while FDI in electricity, gas and water supply was close to 13% in Slovakia.

**Table 2: FDI Inward Stock by activities, according to NACE Rev. 1, 2010 or the most recent year available (in % of total stock received by each country)**

	Bulgaria	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia
Agriculture, hunting and forestry +Fishing <sup>1</sup>	0.4	0.2	0.6	0.4	2.6	0.9	0.5	1.0	0.2	0.1
Mining and quarrying	0.8	2.6	0.5	0.3	0.6	0.5	0.2	4.0	1.1	0.1
Manufacturing	16.8	32.0	14.4	24.8	12.6	28.1	31.8	31.5	34.5	26.9
Electricity, gas and water supply	4.7	8.0	3.8	5.5	3.8	8.7	4.1	5.5	13.3	3.0
Construction	7.6	1.4	1.5	0.8	1.9	1.5	2.5	3.7	1.2	0.8

	Bulgaria	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia
Wholesale, retail trade, repair of motor vehicles etc.	13.3	9.9	11.2	12.7	12.0	13.4	15.9	12.2	11.0	13.1
Hotels and restaurants	1.8	0.5	0.6	0.4	0.7	0.7	0.4	0.4	0.2	0.2
Transport, storage and communication	12.7	5.2	5.4	7.4	7.3	12.4	5.8	6.8	4.4	3.4
Financial intermediation	17.7	20.4	30.1	9.5	23.5	12.4	18.6	20.5	20.9	40.4
Real estate, renting and business activities	22.1	16.2	30.5	30.8	25.0	18.7	17.6	13.7	12.3	11.5
L-Q <sup>2</sup>	0.6	1.3	1.0	0.0	1.3	0.0	0.5	0.7	0.8	0.4
Private purchases & sales of real estate	0.0	2.2	0.0	2.2	0.0	1.9	2.1	0.0	0.0	0.0
Other not elsewhere classified activities	1.4	0.0	0.4	5.2	8.6	0.8	0.1	0.0	0.0	0.2

<sup>1</sup> Percentages corresponding to *B Fishing* are 0.0 or close to 0.0 for each of the ten countries presented in this table.

<sup>2</sup> L Public administration, defence, compulsory social security, M Education, N Health and social work, O Other community, social and personal services, P Private Household with employed persons, Q Extra-territorial organizations and bodies.

*Note: Data for Bulgaria, Hungary, Latvia, Lithuania as of 2010, the Czech Republic, Estonia, Poland and Slovakia as of 2009, Romania as of 2008 and Slovenia 2007.*

Source: WIIW Database (2011).

### 1.3.2. Comments on the EEC-10' outward FDI

Poland, Hungary and the Czech Republic generated together in 2010 almost 77% of the total FDI stock originating from the group of EEC-10. It is worth mentioning that the outward FDI stock generated by the EEC-10 represented only 15% of the corresponding inward FDI stock in 2010. Romania, on a par with Bulgaria, lagged well behind the three leading countries (each with 1.6% of the total FDI stock generated by the group of EEC-10 versus 40.5%, 20.7% and 15.5% respectively) and they were surpassed by Slovenia (7.6% of the total), Estonia (6%), Slovakia (3.5%) and Lithuania (2.2%).

According to the literature (Helpman, Melitz and Yeaple, 2004, p. 301), least productive firms serve only the domestic market, relatively more productive firms export and the most productive companies engage in FDI. The analysis of labour productivity (GDP per person engaged) based on data of the International Labour Organization (Key Indicators of the Labour Market) emphasizes that most of the EEC-10 increased mostly their productivity in the last two decades, as compared to the EU-15. Anyway, in terms of GDP per person engaged in 2010 (constant 1990 US\$ at PPP) as well as GDP per hour worked (constant 1990 US\$ at PPP), Romania is the last in the hierarchy of the EU countries and also in EEC-10 as can be seen in Table 3.

**Table 3: GDP per person engaged and GDP per hour worked in EU-27, in 2010**

Country	GDP per person engaged (constant 1990 US\$ at PPP)	GDP per hour worked (constant 1990 US\$ at PPP)
Estonia	44,568.00	24.34
Slovenia	36,752.00	21.86
Slovakia	32,911.00	19.43
Latvia	28,665.00	14.71
Lithuania	26,870.00	14.42
Poland	25,873.00	12.52

Country	GDP per person engaged (constant 1990 US\$ at PPP)	GDP per hour worked (constant 1990 US\$ at PPP)
Czech Rep.	24,941.00	13.21
Hungary	21,473.00	10.91
Bulgaria	18,141.00	10.93
Romania	11,019.00	5.88

Source: International Labour Organization, Key Indicators of the Labour Market, available online at: <http://kilm.ilo.org/kilmnet/>.

As to the hierarchy of the Forbes Global 2000 (the best 2,000 companies taking into consideration a composite ranking from four metrics: sales, profits, assets and market value), among the EEC-10, there are present only TNC from *Poland* (PGE Polska Grupa – utilities, PKO Bank Polski, PKN Orlen – oil and gas operations, KGHM Polska Miedz – mining, Grupa PZU – property and casualty insurance, Pgnig Group – oil and gas and JSW Group – diversified metals and mining), *Hungary* (MOL – oil and gas operations and OTP Bank), *the Czech Republic* (one, which surpasses all the other TNC from the EEC-10 in terms of the composite index: CEZ – utilities). Anyway, there are strong TNC in other EEC-10 countries, although not so highly competitive (e.g. Slovenian companies: Gorenje Group, Krka dd, Adria Airways dd and Petrol dd). UNCTAD (2001 and 2003) presented detailed analyses of the EEC-10' TNC. Nonetheless, these were overshadowed by the ascension of the TNC from emerging economies such as Brazil, Russia, India and China (BRIC) and they remained a “second-tier” research topic.

As a conclusion, some TNC of the EEC-10 are able to compete on the international stage, anyway, they lag far behind their competitors from the developed and some emerging economies, such the BRIC countries.

#### 1.4. Inward FDI: the case of Romania

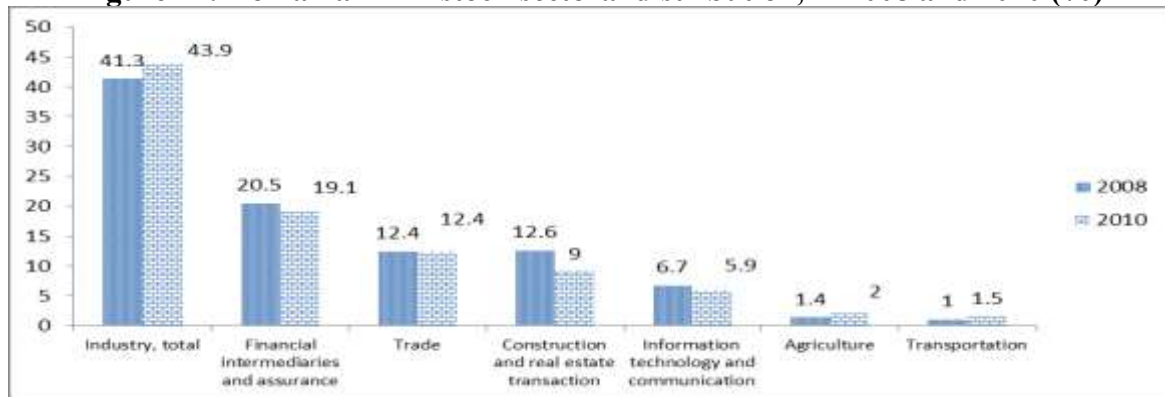
According to statistics of the National Bank of Romania<sup>23</sup>, the growth rate of FDI inflows in our country was 7.8% at the end of 2010, as compared to the end of 2008. The analysis of the FDI structure reflects that over 40% of the FDI stock is oriented to industry and especially manufacturing industry.

The bulk of FDI stock is oriented to manufacturing industry with 32% from total FDI stock at the end of 2010 (31.3% at the end of 2008). A breakdown of FDI stocks illustrates the most attractive branches is *metallurgical production* (6.9%), followed by *Food, drink & tobacco* (4.6%), *Mineral oil refining, Chemicals, Rubber & plastics* (4.3%), *Railroad and transport equipment* (4%), *cement, glass and ceramics* (3.6%). Among other branches, *financial intermediation and assurance* recorded a share of 20.5% followed by *construction and residential transactions* (12.6%), *trade* (12.4%) and *information technology and communication* (6.7%). According to the data released by the National Bank of Romania, the stock of FDI shared by branches has remained relatively unchanged with one exception: *construction and residential transactions* registered a decrease to 9% at the end of 2010. In absolute values the decrease is more suggestive, from Euro 6.2 billion to Euro 4.7 billion. The FDI stock in *Information technology and Communication* registered a small decrease from 6.7% to 5.9% but it remains relative constant in absolute volume (Figure 14).

<sup>23</sup> Foreign Direct Investment in Romania to 31 December 2008 and Foreign Direct Investment in Romania to 31 December 2010, National Bank of Romania, Statistical Direction.



**Figure 14: Romanian FDI stock sectoral distribution, in 2008 and 2010 (%)**

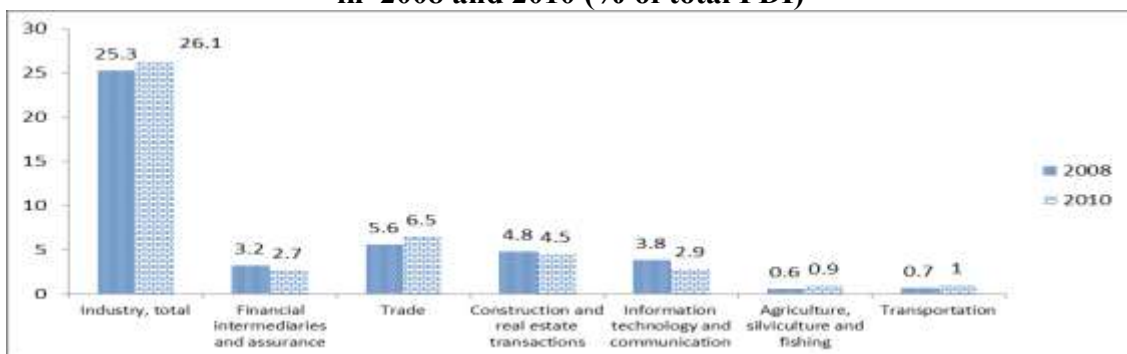


Source: own calculation based on statistics released by National Bank of Romania (2011).

For a better understanding of Romania's FDI evolution it is important to mention the level of tangible and intangible assets in its total FDI. In accordance to statistical data released, the percentage of tangible and intangible assets in total Romanian stocks is highly represented with a total of 46.2% at the end of 2010. This means a high level of foreign investment stability, especially in manufacturing industry branches (18.2% from total FDI in 2011). Among different manufacturing branches a high percentage of tangible and intangible assets is performed in electrical production, gas and water supply (4% in 2010 from 2.9% in 2008).

A small percentage of FDI and tangible and intangible assets respectively in total FDI has been registered in traditional branches such as Textiles, Clothing, Leather, Footwear and Furniture manufacturing. The share of tangible and intangible assets for services as a whole is very low, especially at end of 2010 as it can be seen in Figure 15.

**Figure 15: Tangible and intangible assets by main branches in Romania, in 2008 and 2010 (% of total FDI)**



Source: own calculation based on statistics released by National Bank of Romania (2011).

By types of FDI in Romania, the structure at the end of 2010 was as follows:

- Greenfield FDI represented 1.1% from the total FDI (1.2% in 2008);
- M&A also represented a low percentage of 2.3%, meaning a noteworthy sinking from 32% at the end of 2008.
- The increasing capital accumulation (from 66.8 per cent in 2008 to 96.6 per cent in 2010).

In spite of the significant increasing of capital accumulation share in the total FDI if is compared the absolute value we remark that it grew only marginally: Euro 3.5 billion in 2008 and Euro 3.9 billion in 2010. The foreign investors prefer to develop their investments instead to the other two types of FDI. This is a general pattern for EEC-10 in the last 2 years due to international financial crisis and the modest pace of economic development.

For a better image of the Romanian Inward FDI it is worth to mention that in the 2003-2005 Romania held the 26<sup>th</sup> position in a world hierarchy made by UNCTAD on the base of *FDI Performance Index*. According to UNCTAD definition, this index is calculated as the ratio of a country's share in global FDI flows to its share in global GDP (WIR 2002, p. 23). In 2010 Romania's ranking in the world hierarchy decreased sharply to 47 from a number of 141 total countries. The most part of FDI income is provided by net capital investment.

As to FDI contribution to Romanian exports it is remarkable their predominance in the trade balance. It is illustrative the fact that the branches with the highest FDI contribution have also the greatest participation to Romanian exports. As a matter of fact, foreign firms generate new export possibilities from the host country since imported inputs and parts may be incorporated to final production exported.

Still the percentage of manufacturing to Romanian exports decreased markedly in 2010 to 61.2% from 83.4% in 2008 due to international financial crisis. In the same time, the contribution of foreign - controlled enterprises to Romanian manufacturing imports diminished from 83% in 2008 to 44.2% in 2010.

### **1.5. European structural and cohesion funds: development drivers for future?**

Another appropriate development measure for EEC-10 could be the increasing of the European funds rate absorption in the coming years. From the total EU budget the group of the NMS has a part of 18.3% for convergence, sustainable growth, rural development, fishing and other development objectives. Poland ranked the first as regards the European structural and cohesion funds both in 2010 and 2011, in absolute volume. In relative terms, Romania has a low rate of absorption of only 7.4 per cent from the total amount. This is more striking if we take into consideration that our country is the second largest EEC-10 in terms of population.

Romania like other EEC countries with low rate of funds absorption could learn from Poland who managed to attract all the projected funds of Euro 68 billion over the period 2007-2012. In the context of financial crisis this amount could cover the most part of the national investment plans. At the national level Poland managed to approve Euro 100 billion investments oriented primarily in finishing 600 km of highways, modernising railway infrastructure, implementing education and innovation programmes and developing IT companies. Nevertheless we must recognise that Poland had more than two and a half years in advance, from May 2004 to December 2006. In this period Poland like the other EEC that became EU members in 2004 benefited of supplementary financing.

In order to increase the European absorption rate in Romania we highlight that both quantitative and qualitative aspects are important. At the quantitative level we should have the goal to assimilate as much as we can from these funds and at the qualitative level it is vital to select carefully the projects that could be a solid base for a durable and sustainable development. We consider that changing the way of thinking, the mentality, is essential because it is imperative to attract resources for spurring the local investment. But first of all, the political actors should set the priorities and stimulate those projects that are oriented toward infrastructure, competition, labour skills improvements and human resources.

The first direction might be the improvement of European funds absorption degree in primary and manufacturing sectors. These two sectors lag well behind the EU-15 in terms of technological state of the art. The second one is encouraging the services sector to become more competitive. Another priority should be the SMEs, increasing their capacity to compete

at national and even international level. Last but not least, Romania should have its own influential TNCs, like Poland, Czech Republic, Hungary and even Slovenia.

Romanian ranks the second in the EEC-10 in terms of population and in spite of that, with several exceptions, our country does not have any local and regional business representations in Brussels. This makes difficult the understanding of European procedures and statutory stipulations and hinders the improvement of the EU funds absorption rate and the lobby activity. Thus we see why the dialogue between the Romanian companies and Brussels, which is responsible for business development, has not been flexible and appropriate for the national needs.

In the case of agricultural projects and SMEs, local authorities should consider that the potential beneficiaries don't have the skills to conceive and monitor a project. That is the reason why, at the services-sector level there is a substantial need for consulting firms that could contribute to the improvement of the absorption rate of the European funds. Romania still has an insufficient number of skilled project auditors. The Romanian government should encourage the selection of skilled auditors, from Romania and from EU, specialised in EU projects.

In order to find solutions for all these problems and so as to develop the infrastructure, increase the utilisation of local resources, modernize current capacities, the Romanian government should have in view the development of human resources and the integration of all these elements in national strategies and, the most important of all, the implementation of these strategies, which could lead gradually to development of national firms and increase of their contribution to GDP.

*As a conclusion, with a view to the financial framework 2014-2020 and having in mind the lessons learned from the period 2007-2013, the acceleration of the process of absorption of the structural and cohesion funds should be a national priority.*

### **Conclusions**

The reverberations of the world financial and economic crisis, the Euro Zone debt crisis, the slowdown in economic activity at global level and the double-dip recession in many developed countries, associated with the political uncertainties in different regions of the globe represent a real challenge for the EEC-10. These countries are strongly interconnected with the EU as a whole and dependent on the European FDI and trade flows, as well as on the structural and cohesion funds. More than that, in the context of globalisation and ascension of emerging economies like BRIC, the harsh competition on the international stage urges the EEC-10 economies to restructure and become more competitive. Taking into consideration all these elements, our paper is trying to find several answers at the question: *Which should be the EEC-10 development drivers for the future?*

Resorting to indexes such as FDI/GDP index, FDI/external debt index, FDI contribution index, FDI performance index, FDI regulatory restrictiveness index and comparisons among the EEC-10 member states, our paper concludes that Poland remains the most attractive host country for FDI at the level of NMS. In this context, our investigation emphasizes that those policies oriented towards the maximization of the FDI contribution to the economic development of a country are even more significant than policies focused on attracting FDI. In spite of the evidence that Poland implies restrictions or certain rules to the FDI, it manages to attract the bulk of the FDI in the EEC-10 countries. Poland is the NMS ranking first in the hierarchy of the EEC-10 countries in terms of GDP (in US\$, in current prices). It was also the only EU country which did not fall into recession during the global downturn. Besides, among the EEC-10 countries, Poland is the NMS with the strongest TNC. Its multinationals, together with those from the Czech Republic, Hungary and, to a lesser extent, those from Slovenia are able to compete on the international stage. Although these

TNC lag far behind their competitors from the developed and some emerging economies, such as the BRIC countries, Romania can learn from their experience and resort to encouraging its own companies to “go out”.

Due to international financial turmoil EEC-10 lost a great part of the FDI inflows that could have been one of the most substantial engines for growth in the 2008-2010 period. The TNCs’ behaviour of redrawing demonstrates that EEC should build a set of development drivers that could work even in times of world economic crisis. EEC should use their geographical position between European partners on one side and Russia and China on the other side. In the same time they should focus on agricultural potential development and also to control better their resource driven branches.

Romania like other EEC faces multiple other challenges, including those from the process of absorption of European structural and cohesion funds. Primary statistical sources indicate that Romania, Hungary, Slovenia and Bulgaria are below average performers, in contrast with Latvia and Lithuania, which are top performers and Estonia, Slovakia, Czech Republic and Poland, which are above average performers. In our paper, we tried to outline some solutions for a better EU funds absorption based on a comparison between Romania and other EEC, considering the acceleration of the structural funds absorption as a development driver on the short and medium term. Our paper demonstrates that, on the long term, Romania and the other EEC need strong national firms’ involvement, skilled and motivated labour, good infrastructure, diversified trade and investment flows which are crucial for their future development.

#### References

- Dunning, J. H., Lundan, S. M. (2008). *Multinational Enterprises and the Global Economy*, Second Edition, Edward Elgar Publishing Limited, United Kingdom
- Faes-Cannito, F., Gambini, G. and Istatkov, R. (2012). *Intra EU Share of EU-27 Trade in Goods, Services and FDI Remains More than 50% in 2010*, Eurostat, Statistics in Focus, 3/2012
- Forbes (2012), *Global 2000 Leading Companies*, available online at: <http://www.forbes.com/global2000/>
- Helpman, E., Melitz, M. J., Yeaple, S. R. (2004). *Export versus FDI with Heterogenous Firms*, American Economic Review, 94(1): 300-316
- Kalotay, K. (2005). *The Late Riser TNC: Outward FDI from Central and Eastern Europe*. WIDER EUROPE, Kari Liuhto and Zsuzsanna Vincze, eds., pp. 199-223, Esa Print Oy, Lahti and Tampere, Finland, 2005. Available at SSRN: <http://ssrn.com/abstract=977975>
- Kuzel, M. (2004). *The World’s Largest Transnational Corporations and Their Affiliates in Poland*, Paper presented at the 12th Annual International Conference “Business and Economic Development in Central and Eastern Europe”, Brno, 10-11 September 2004
- Zaman, G., Cristea, A. (2011). *EU Structural Funds Absorption in Romania: Obstacles and Issues*, Romanian Journal of Economics, 2011, vol. 32, issue 1(41), pages 60-77, available on-line at: <http://www.revecon.ro/articles/2011-1/2011-1-4.pdf>
- DG Trade (2012). *Bilateral Relations Statistics* – database accessed in February 2012, available online at: <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/statistics/>
- European Commission (2010). *Communication from the Commission to the Council and the European Parliament, Trade, Growth and World Affairs – Trade Policy as a Core Component of the EU’s 2020 Strategy*, Brussels, COM(2010) 612
- European Commission (2006). *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, Global Europe. Competing in the World – A Contribution to the EU’s Growth and Jobs Strategy*, COM(2006) 567, Brussels, 4.10.2006
- Eurostat (2012a). *Databases on trade in goods, services, FDI, national accounts*, accessed in February 2012, available online at: [http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search\\_database](http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database)
- Eurostat (2012b). *GDP per capita in the Member States ranged from 45% to 274% of the EU27 average in 2011, First estimates for 2011*, Newsrelease, 97/2012, 20.06.2012
- International Labour Organization (2012). *Key Indicators of the Labour Market*, available online at: <http://kilm.ilo.org/kilmnet/>

- International Monetary Fund (IMF) (2012). *World Economic Outlook Database*, accessed in August 2012, available online at: <http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx>
- National Bank of Romania (2011). *Foreign Direct Investment in Romania as of 31 December 2008 and Foreign Direct Investment in Romania to 31 December 2010*, National Bank of Romania, Statistical Direction.
- OECD (2012). *FDI Regulatory Restrictiveness Index*, available online at: [www.oecd.org/investment/index](http://www.oecd.org/investment/index)
- OECD (2002). *FDI for Development, Maximizing Profits, Minimising Costs*, Paris
- UNCTAD (2012). *World Investment Report 2012, Towards a New Generation of Investment Policies*, New York and Geneva
- UNCTAD (2009). *World Investment Report 2012, Transnational Corporations, Agricultural Production and Development*, New York and Geneva
- UNCTAD (2003). *World Investment Directory*, Volume III, Central and Eastern Europe, New York and Geneva
- UNCTAD (2002). *World Investment Report 2002, Transnational Corporations and Export Competitiveness*, New York and Geneva
- UNCTAD (2001). *World Investment Report 2001, Promoting Linkages*, New York and Geneva.
- WIIW (2011), *FDI Database*, accessed in June 2012
- WTO (2011). *International Trade Statistics*, Geneva

### **Aknowledgements**

*This article benefited of financial support through the project “Post-Doctoral Studies in Economics: programme of continuous training for the elite researchers – SPODE”, financial agreement no. POSDRU/89/1.5/S/61755, project financed through the European Social Fund of the Sectoral Operational Programme Human Resources Development 2007-2013.*