FDI patterns in Hungary

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Introduction

- Foreign trade and FDI: catalysts promoting economic growth and integration of transition countries with the world economy
- The transition from central planning to market economy in the CEE countries has been resulted in large inflows of FDI and expansion of international trade.
- FDI is essential in augmenting domestic capital stock and in technology transfer which contribute to the long-run growth of an economy.
- The opening-up of transition countries and their trade integration with the European Union (EU) has brought about large increases in trade between the two groups of countries and the substantive trade creation has gone hand in hand with vast increases in FDI flows.

Inward FDI within the Visegrad region

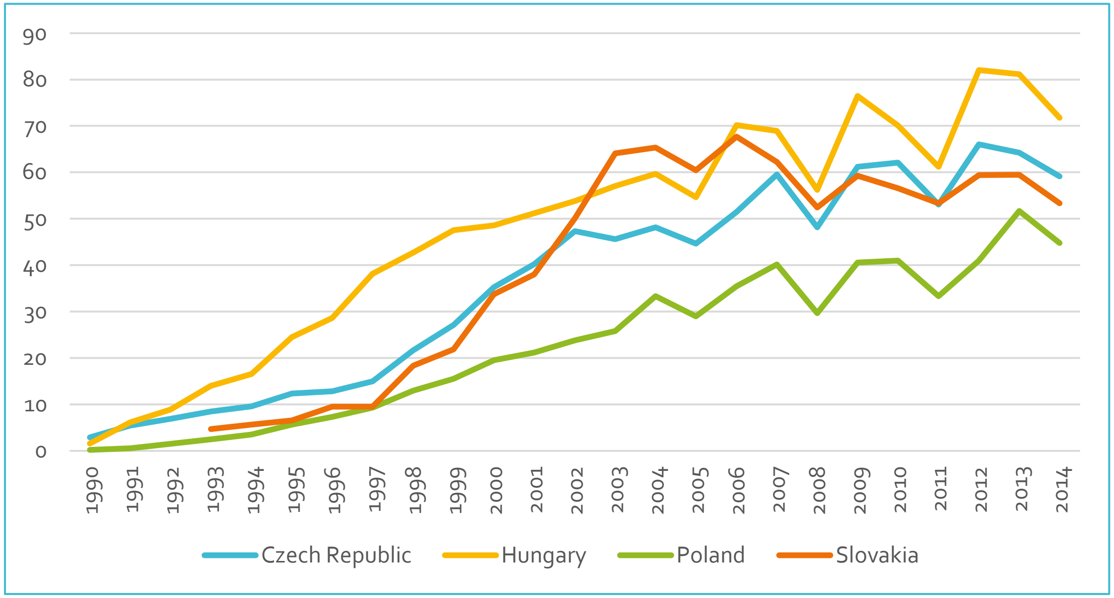
- Relatively new phenomenon (up to 1989 FDI was negligible)
- Cautious investment strategy, influenced by stable political and legal circumstances (serious efforts)
- Front runners in the transition process = leaders in FDI attraction (the Czech Republic, Estonia, Hungary, Poland and Slovenia)
- Moderate share of V4 (CEE) within total investments
- Wide array of literature implying a positive influence of FDI on the V4 countries' economies (a few contradictory ones)
- Strong reliance on FDI in central and eastern Europe appeared to represent a risk factor during the downturn in 2008 and 2009 (doubts about the sustainability of these countries' export-based and FDI-driven growth model)

Patterns of FDI in the V4 region

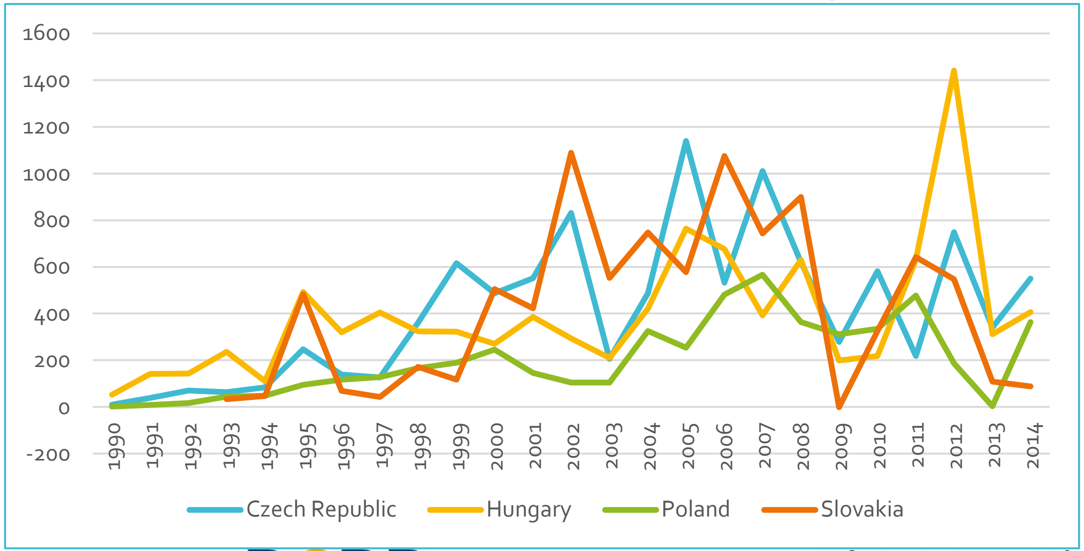
- Attractive region for FDI (1. privatization, 2. market access, relatively low wages, 3. skilled workers)
- Openness to trade is significantly linked to FDI inflows
- FDI in V4 economies dropped significantly after the financial crisis, but quick recovery
- Visegrad countries are competition states, which means that they became structurally dependent on foreign capital, which controls access to technology, know-how and distribution networks (Drahokoupil, 2007)
- Vulnerability to crisis: economies' significant reliance on external financing
- Domestic investments?
- Increasing share of OFDI (Hungary – leading foreign investor among MNS of the EU)

Patterns of FDI in the V4 region

Inward FDI stock as Percentage of Gross Domestic Product



Inward FDI flow (USD at current prices and current exchange rates per capita)



Source of data: UNCTAD

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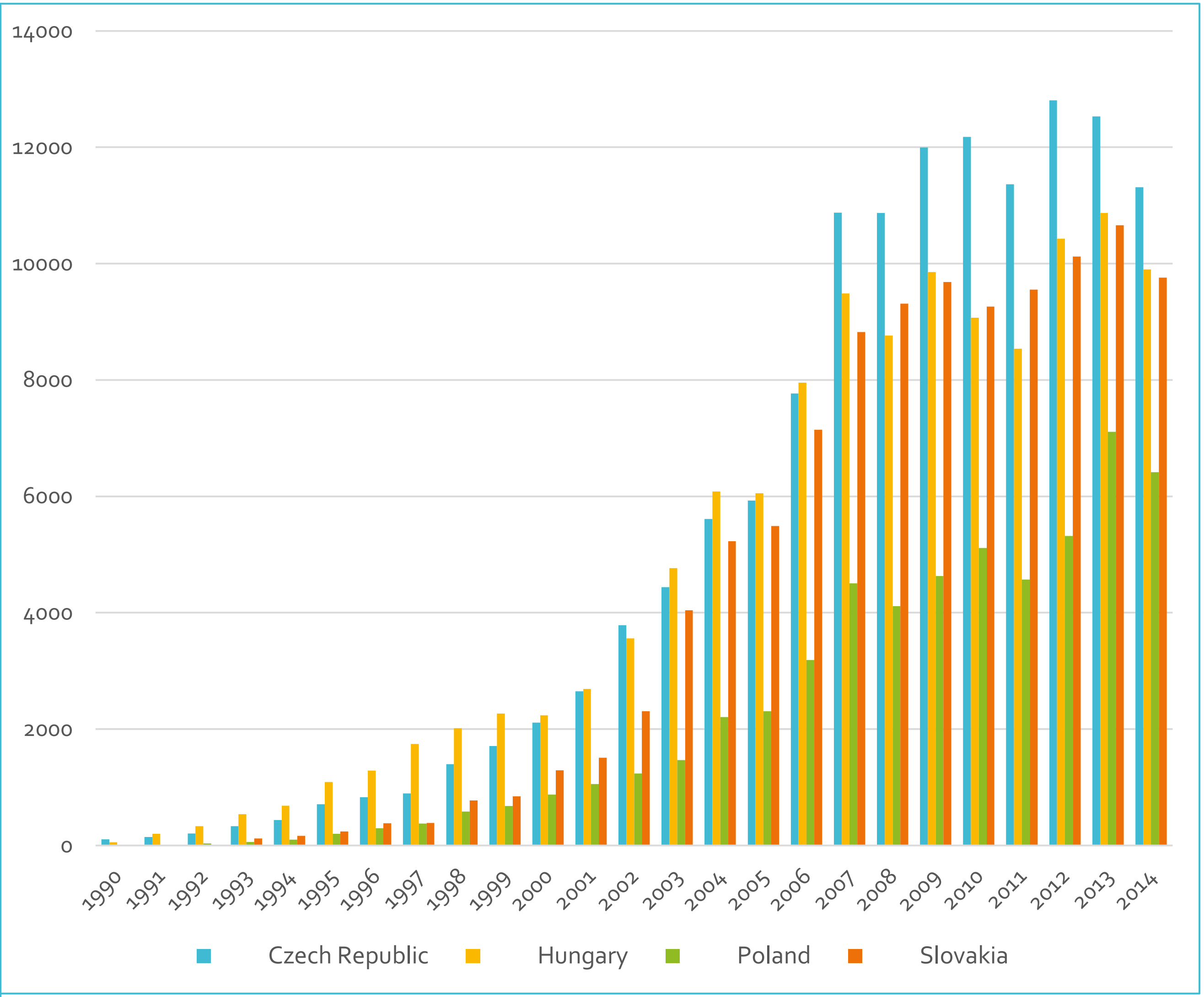
Inward FDI stock US Dollars at current prices and current exchange rates per capita

Patterns of FDI in the V4 region



Source of data: UNCTAD

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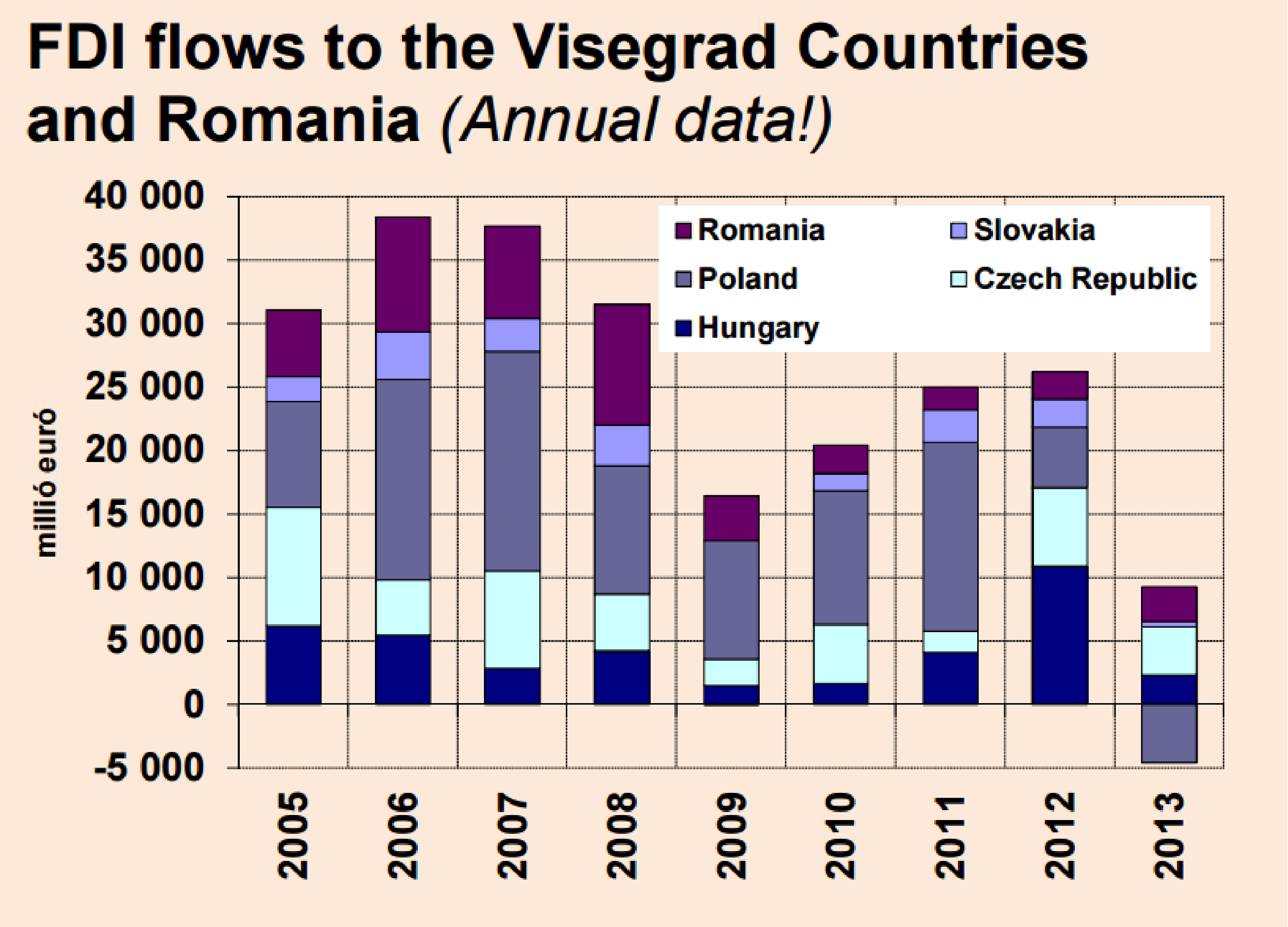
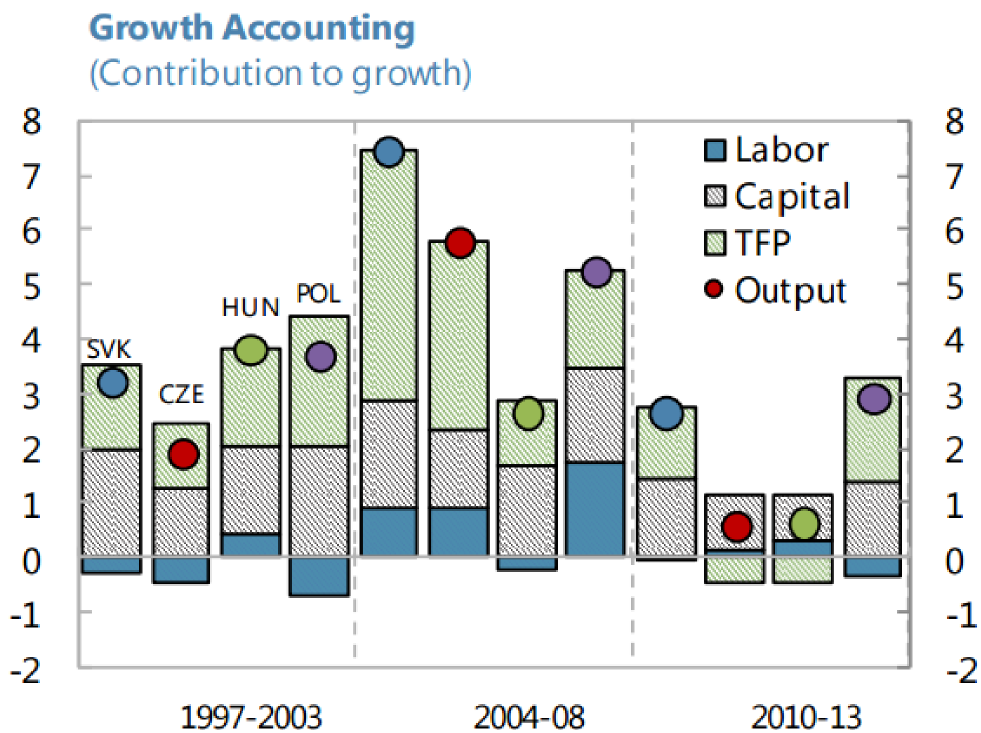
Patterns of FDI in the V4 region



Source: Ministry of National Economy, 2014

Main drivers of growth for V4 region

- Capital accumulation and total factor productivity (how efficiently and intensely the inputs are utilized in production) have been the main drivers of output growth
- The contribution of TFP sizeable in the aftermath of EU accession, reflecting major restructuring and reform of the corporate sector
- Crisis: decline in HUN and CZE



Source: IMF, 2014

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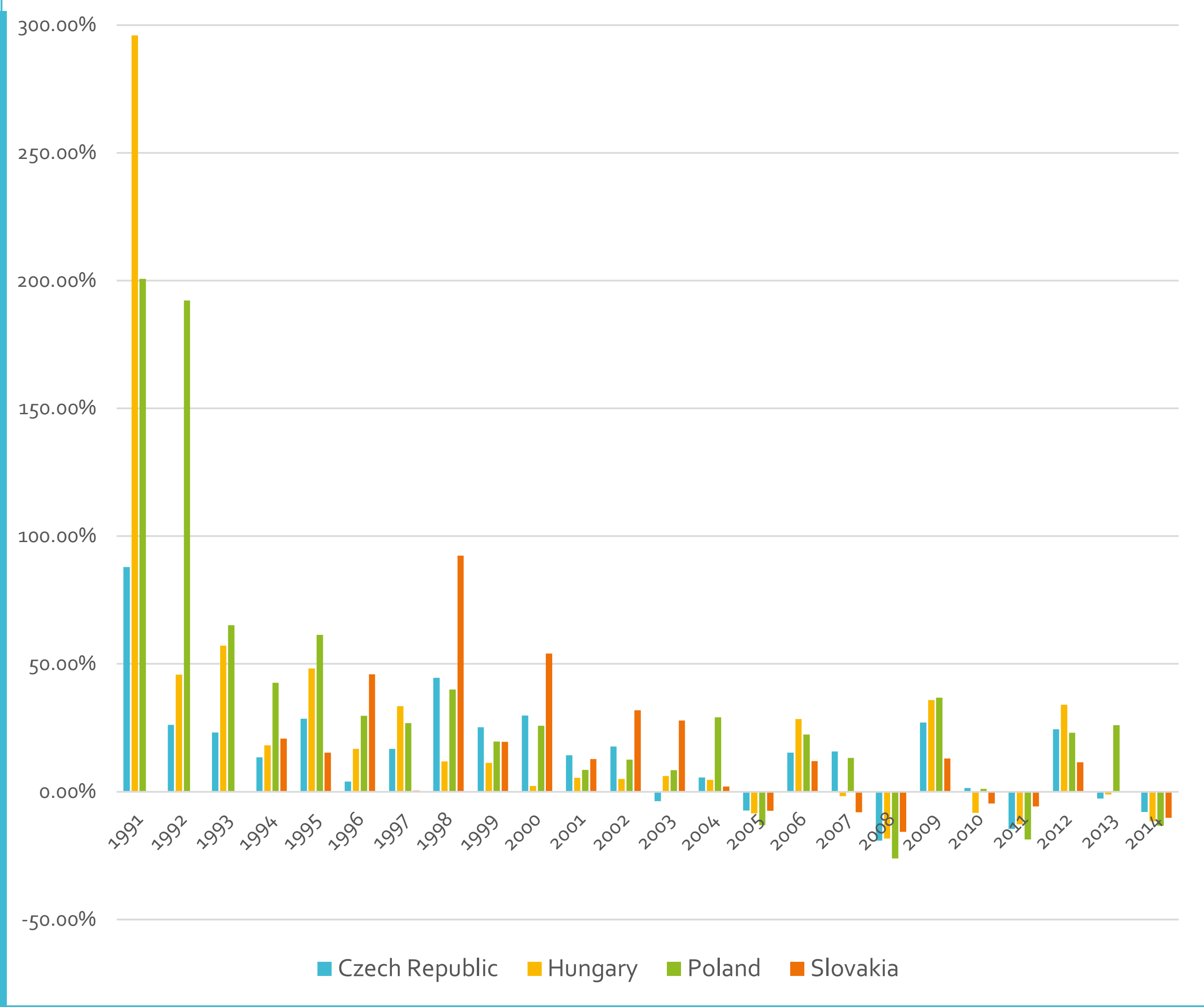
Patterns of FDI in the V4 region - periodisation

Annual growth of Inward FDI stock (percentage)



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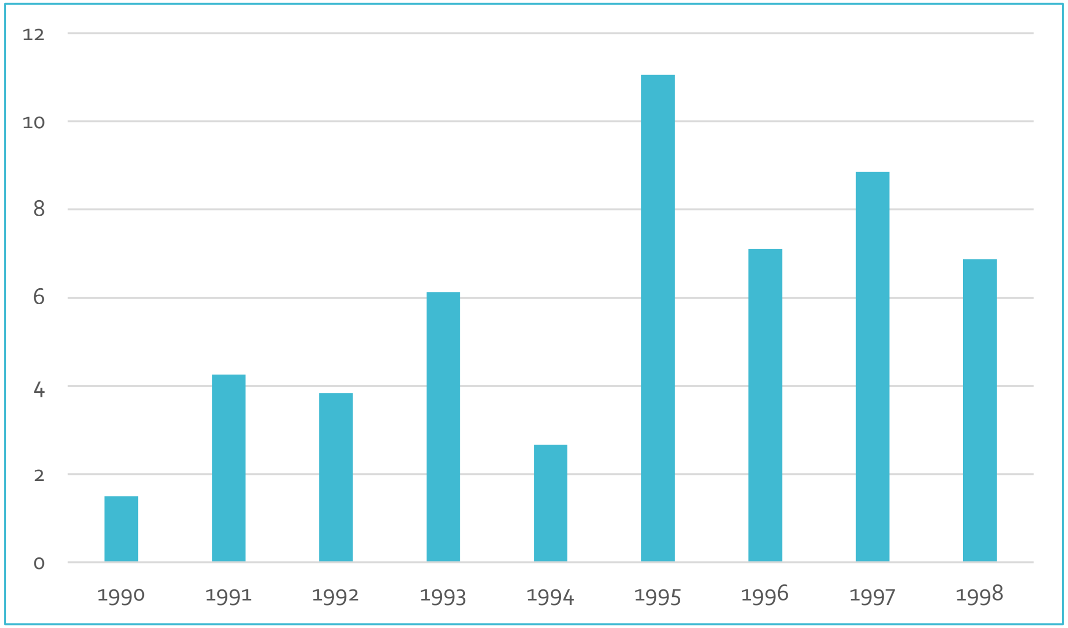
FDI patterns in Hungary – transition period

- A law which allowed foreign companies to establish a subsidiary in the country from as early as 1972 (until 1989 FDI in Hungary was rather limited)
- Highest FDI dynamics until 1996 (initial high growth rate due to the low base + privatization)
- Hungary: the most successful of the CEE countries in attracting FDI – 3 factors
    - Privatization policy - direct sales of companies to foreigners (due to large foreign debt)
    - Introduction of market elements into the economy (1968 – exceptional position within CMEA)
    - Market socialism (different perception of potential foreign investors) – international orientation
- Consequently early FDI inflows in Hungary have had a positive effect on subsequent FDI inflows in Hungary

FDI patterns in Hungary – transition period

Inward FDI flow in Hungary (percentage of GDP)



- FDI data = both investments in privatization, greenfield investments and supplementary investment projects
- 1995: some of the largest privatization deals (energy and telecommunication sectors)
- FDI in Hungary stabilized in 1996 and 1997

FDI patterns in Hungary – pre-accession period

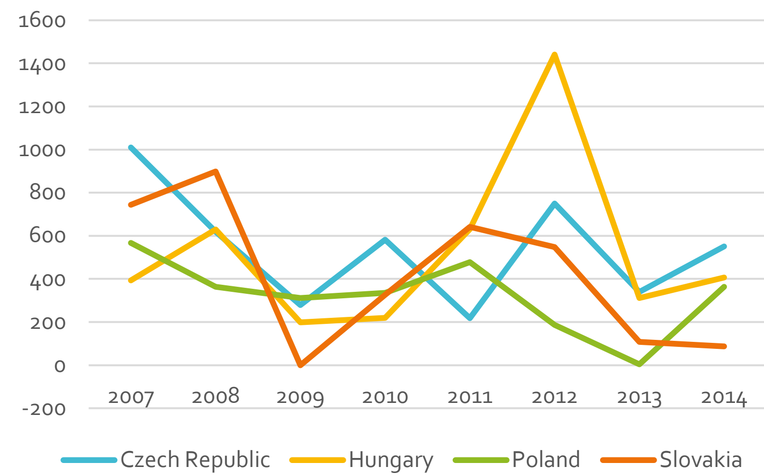
- New period: dominantly greenfield investments
- 1998: greenfield investments became constant between 1-2 billion EUR, then started to decrease, the role of proprietary loans changed, profit repatriation became stable, the volume of reinvestments increased, disinvestment appeared
- Volume of inflow became constant, in 2002 decreased (international environment)
- Hungary lost its leading position in attracting FDI, the highest growth rate was recorded for Slovakia (late comer)
- Inward FDI during the eight years before EU accession was considerably higher than during the subsequent time period (may support the argument that EU membership in the did not result in higher increases in FDI in the V4 countries)
- R&D activities became more and more important after 1998

FDI patterns in Hungary – post-accession period

- EU membership brought institutional capital inflows through access to the structural funds provided by the EU for infrastructure development and educational projects in the public and NGO sectors
- V4 countries' membership in the European Union has not resulted in the speeding up of FDI dynamics
- Greenfield investments: new sectors (extracting capital from the old ones)
- Growing rate of profit repatriation, the amount of reinvested earnings remained stable
- 2004-2008: investments in services doubled
- Hungary lost its leading position in FDI stock per capita

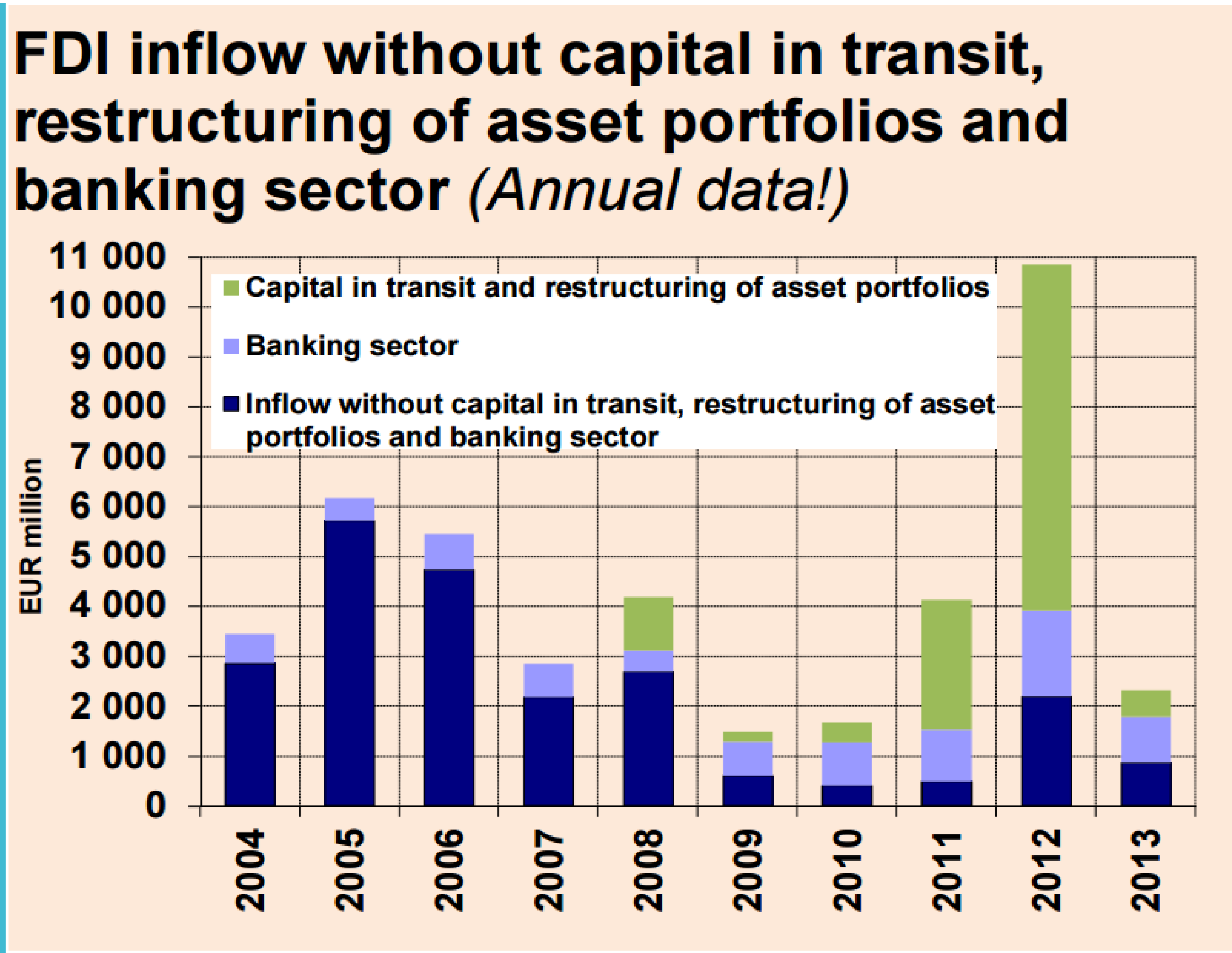
FDI patterns in Hungary – financial and economic crisis period

Inward FDI flow in V4 (USD at current prices and current exchange rates per capita)



- 2009: dramatic decrease of FDI inflows
- Immediate recovery in 2010
- No clear link between economic performance and FDI
- Doubt: FDI resume as growth-driving factor
- Increasing share of services
- Little increase of knowledge-intensive or high value-added investments - cheap skilled labour force remain the main advantage

2012?

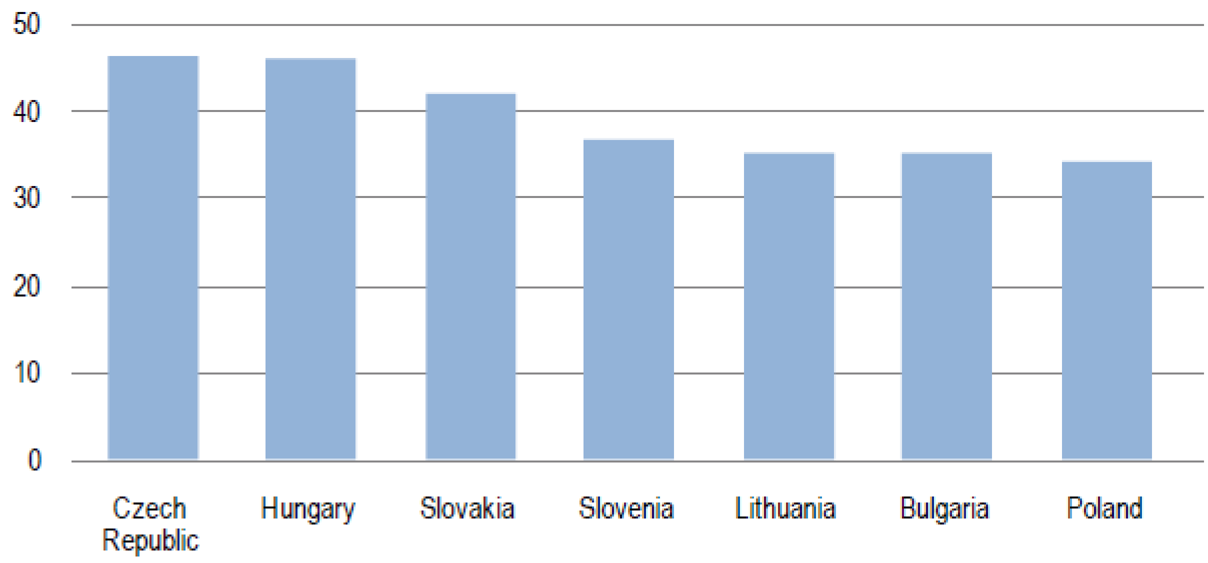


Source: Ministry of National Economy, 2014

GVC in V4 countries

- Hungary, the Czech Republic and Slovakia are especially strongly linked to Global Value Chains, for Poland it is less strong
- German companies integrated these economies into their production networks (already before legal accession to the EU)
- GVCs as rapid transmission of shocks: the reason behind relocation (positive and negative effects)

Share of foreign vale-added in exports, 2011



Source: Éltető, 2015

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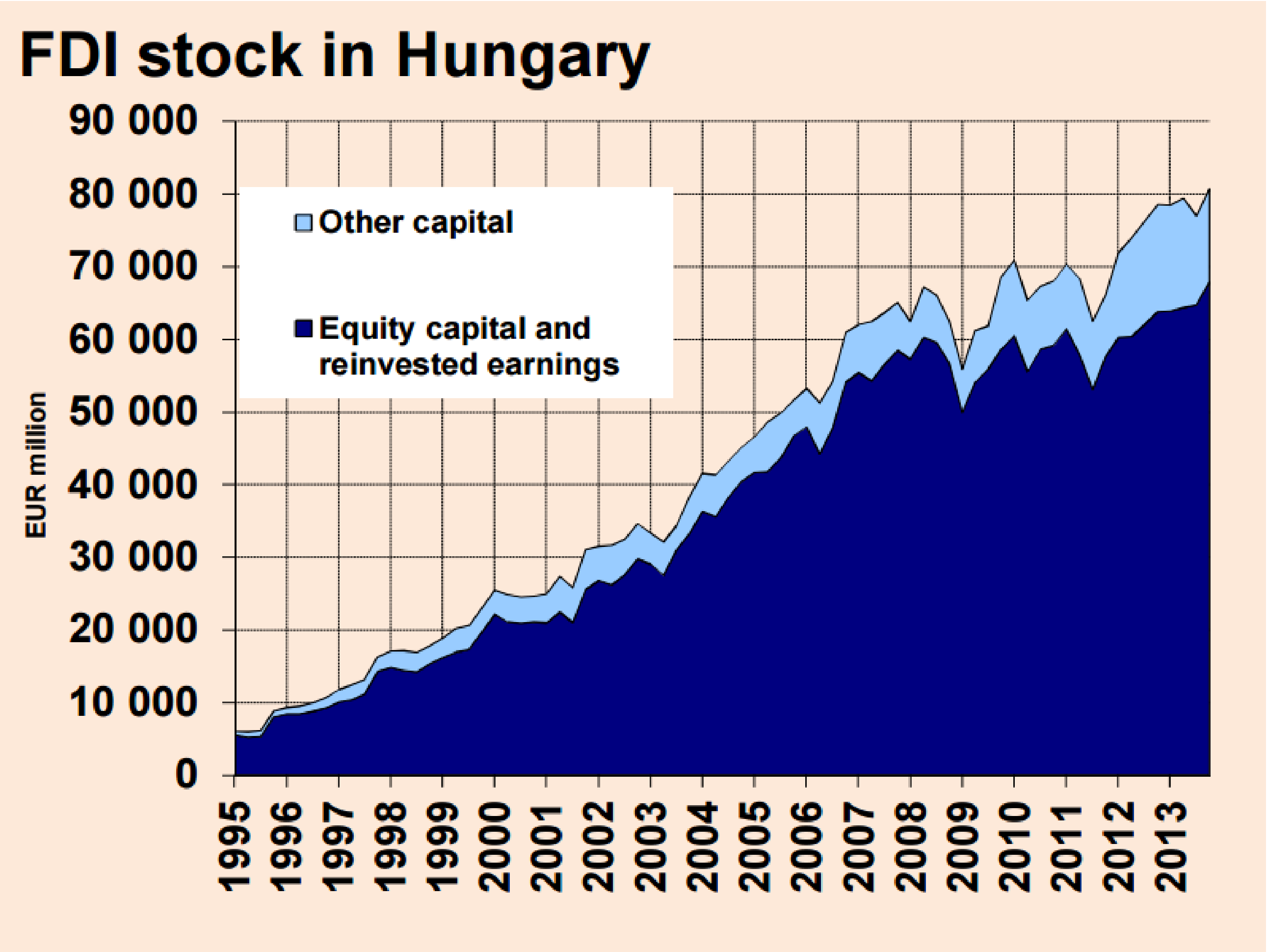
Summary figures



Source: Ministry of National Economy, 2014

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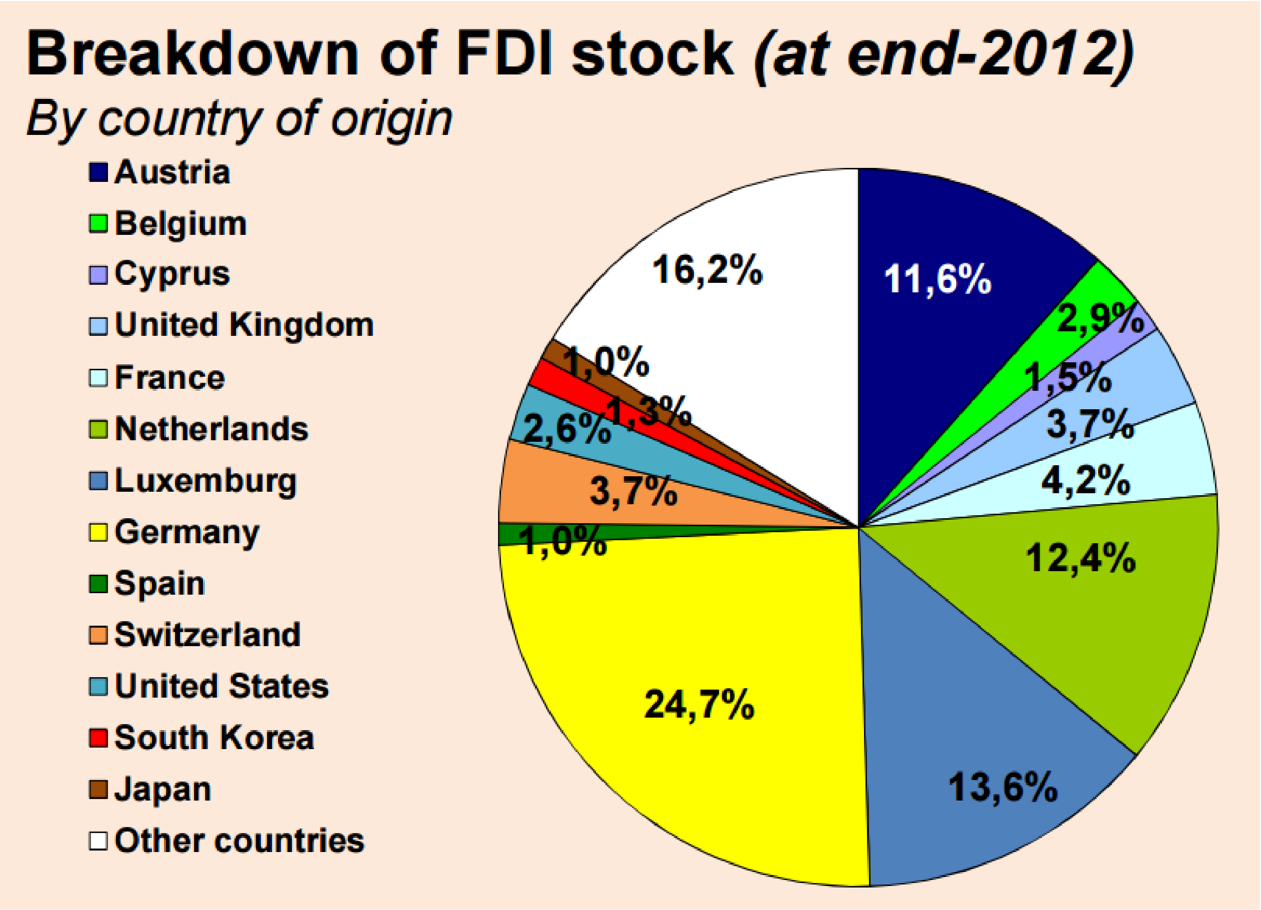
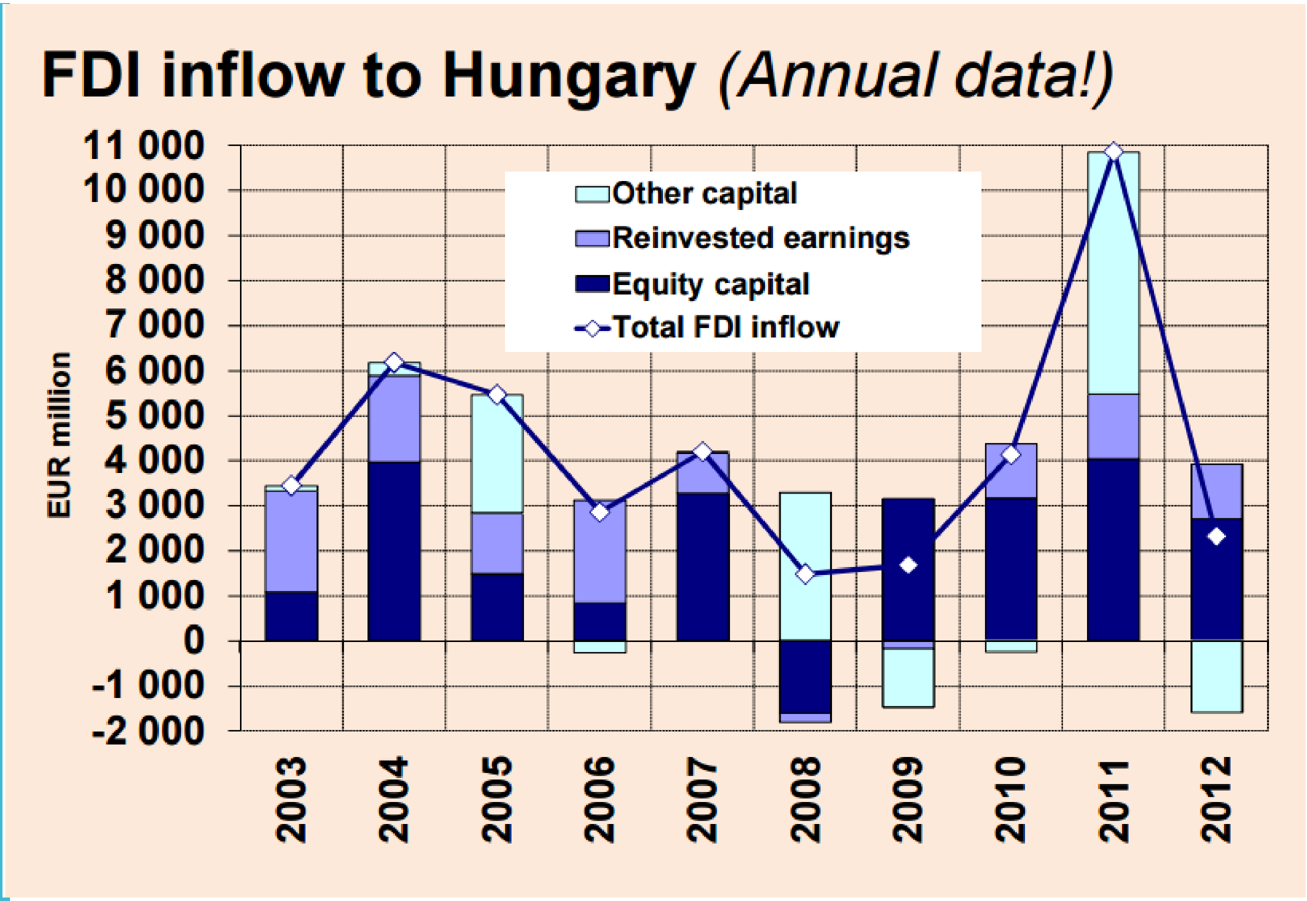
Summary figures



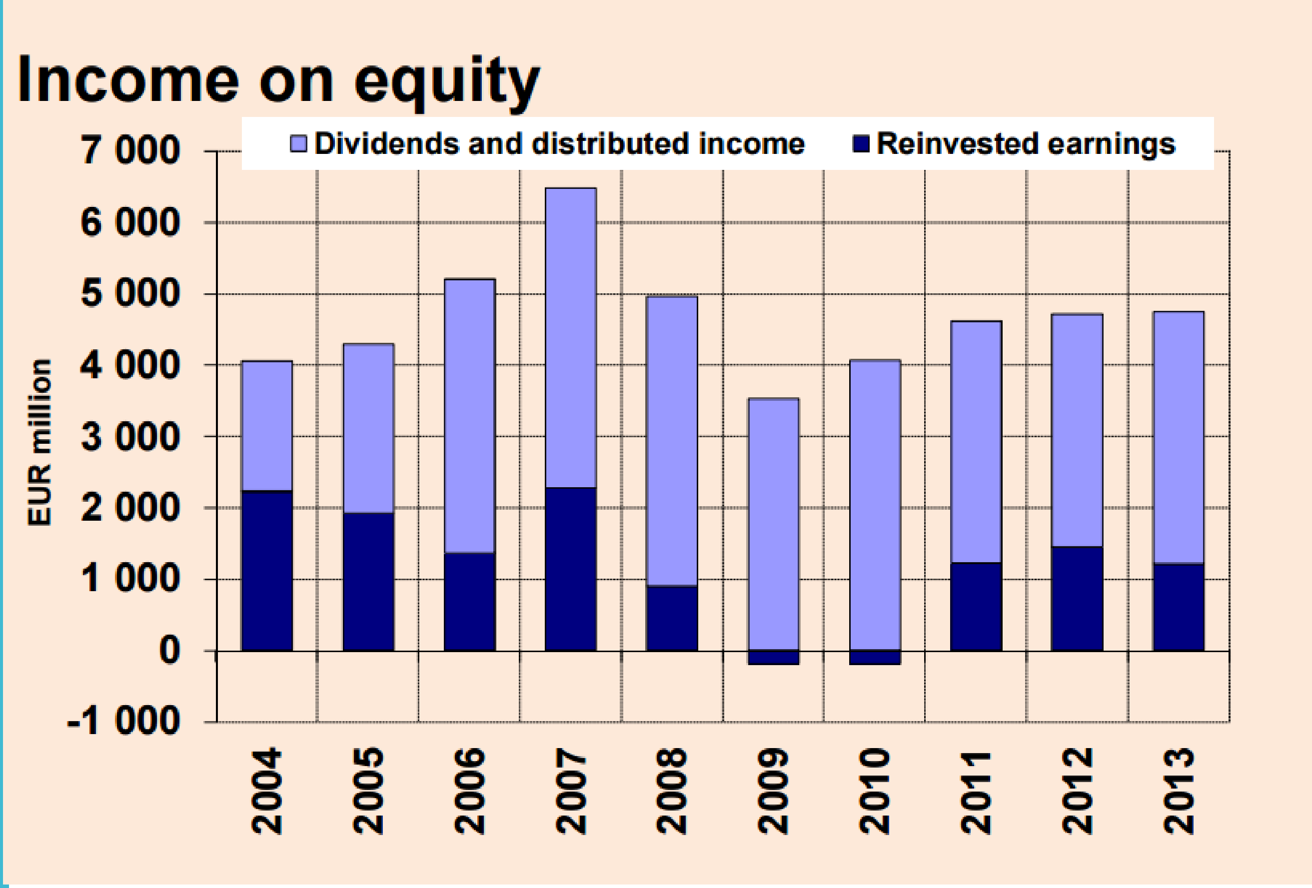
Source: Ministry of National Economy, 2014

Summary figures



Source: Ministry of National Economy, 2014

Summary figures



Source: Ministry of National Economy, 2014

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Concluding remarks

- In attracting FDI structural changes crucial (FDI is shifting towards knowledge-and skill-intensive manufacturing and services)
- FDI played a key role in the successful restructuring of the Hungarian economy (productivity growth, technological modernisation, the creation of an export capacity, job creation, non-debt generating FDI is a key factor in improving the country's external balances)
- No clear link between FDI stock and changes in GDP (Poland vs. Hungary)
- FDI will not resume a growth-driving factor any more
- Sharpening regional disparities

Concluding remarks

- Decline in the share of capital-intensive manufacturing investments, increasing share of services
- Little increase of knowledge-intensive or high value-added investments - cheap skilled labour force remain the main advantage
- Limited effect of targeted policies to attract FDI (Galgóczi et al., 2015)
- FDI convenient policy shortcut compensating for the weaknesses of domestic institutions