CATCHING-UP AND INTEGRATION IN NEW AND FUTURE EU MEMBER STATES THROUGH FDI

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Abstract

The round of new membership had strong impact on the functioning of the European economy, both in terms of regulation, distribution of resources, and place of economic and regional developpment, catching up policies (converging policies).

This goes along with an important flow of foreign capital pouring in the region where the rate of domestic accumulation is still very low and would never match investment requirements to develop a strong industrial base. Firstly, this raises the question of the development of "a capitalist economy without capitalists". Secondly, it highlights the fact that industrial recovery and economic growth are fuelled by foreign investments in the region

In this contribution, our aim is to highlight the transformation of these economies with their linkage through their new specialization, control to EU-15 economies through the strong presence of Western Multinational Corporation (MNC).

Keywords: Economy**,** Capitalisme, Foreign Direct Investment

Codes JEL: F5, P1.

Introduction

The experience of the recent enlargement within the European Union is unique if we consider both the number of countries, the population, the level of economic development, the systemic characteristics of most of these countries, the speed and the cost. Those countries have supported in less than twenty years, three major shocks: a systemic shock with the implosion of the socialist system, an

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economic shock with the adjustment to the new market environment, an institutional shock with the membership to the European Union (EU) for those who have applied to become members. A fourth shock, for some last comers and further EU members has been the violent disintegration of the Former Yugoslavia, which has delayed and hampered negotiations for future membership of the former Republics involved in the conflict (Croatia, Serbia…)

The EU enlargement to 12 new members, of which 10 were communist economies under the control of the Soviet Union, took place in 2004 (10) and in 2007 (2), it has been the outcome of a long transformation process which started right after the fall of the Berlin wall in 1989.

During this process, the leaders of those economies had to handle and manage to reach two main objectives: the transition from a socialist economy to a market economy, on the one hand and the upgrading of these economies in order to allow them to become future members of the EU on the other hand.

Following the June 2003 EU summit in Thessaloniki other candidates are crowding in at the door, all , except Turkey, from the Western Balkans (ex-Yugoslavia States, Albania), some being very close to the requirement to become a member (Croatia will officially join in Juanary 2013), other have been admitted as "accession States" and are discussing with the European Commission the fulfilment of conditions and the timing to become officially members.

The round of new membership had strong impact on the functioning of the European economy, both in terms of regulation, distribution of resources, and place of economic and regional development, catching up policies (converging policies). The structural and regional imbalance among « old » and « new » member states, the need to re-industrialize many regions in order to create new jobs and wealth are real issues. Regional GDP per head among the 271 EU regions (NUTS 2) displays a very high disparity with the poorest region in eastern Bulgaria scoring 27% against 332% for Inner London. In the same time, as it can be witnessed in some regions of Central and Eastern Europe (The Bratislava region, Western Hungary, Warsaw region and Southern Poland), there are strong movements of industrial development, relocation of new industries, even in countries and regions which didn't have specific advantages in this field under the socialist system (see the car industry in Slovakia).

This goes along with an important flow of foreign capital pouring in the region where the rate of domestic accumulation is still very low and would never match investment requirements to develop a strong industrial base. This raises the question of the development of "a capitalist economy without capitalists" which has been underlined earlier at the beginning of the transition Moreover; it highlights the fact that industrial recovery and economic growth are fuelled by foreign investments in the region. FDI has contributed to create a new industrial landscape in the region; it has also created a new economic dependency of these countries: most of them are today the host of big transnational corporations which have a strong impact on domestic industrial structure, specialization, ownership, developing strong links with Western European economies.

Today Eastern European economies appear to be a backyard for Western Economies which, taking advantage of proximity, low costs, qualified labour, have relocated businesses which account, in some countries, for the main parts of fixed capital, added value, exports. These investments have contributed to create strong linkages between western Multinational corporations and their regional subsidiaries. On the one hand, they have taken advantage of existing competencies inherited from the former socialist system (Radosevic, 2004). On the other hand, their presence has contributed to the catching up, the development of new specialisations.

In this contribution, our aim is to highlight the transformation of these economies with their linkage through their new specialization, control to EU-15 economies through the strong presence of Western Multinational Corporation (MNC).

Section 1 presents the main components of transforming policies conducted in the region; section 2 assesses the role of FDI in the region has a driver of sectoral adjustment and catching up. Even for Balkan 'late comers' countries that have lately adjusted, Section 3 concentrates on the development of a new industrial area illustrating the impact of FDI and the linkage strategy with Western companies which has resulted.

1. A Wide Enlargement Strategy

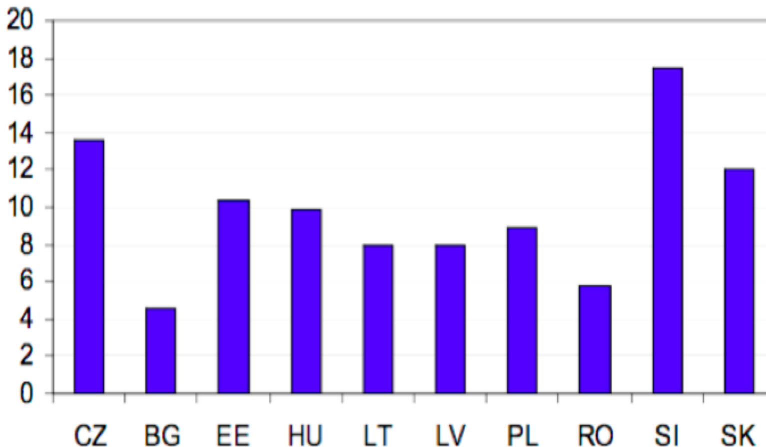
A Difficult Adjustment

Considering the size, the population, history, level of development, the last wave of enlargement, which has taken place in 2004 and 2007, is exceptional if we consider the history of the EU expansion since the foundation of the Common market in the late fifties.

The number of new members entering in one row: up to now, earlier enlargements consisted of the entry of up to three countries, generally of same economic level which had no difficulty to adjust to the new institutional and economic environment as they were already developed market economies (with the notable exception of Spain, Portugal and Greece).

Difference in living standard and income distribution. All the new members, even the most economically advanced (Slovenia, Czech Republic) are still far behind the mean level in the EU-15. With the exception of Cyprus and Malta, the 10 countries from Central and Eastern European countries have a mean GDP per head which is 50% compared to EU-15. The collapse of the former socialist industries has created strong regional inequalities and a high level of unemployment.

Figure 1**: GDP *per capita* (1000 €), 2010**



70%-80% of EMU average: Slovenia, Czech Republic, Slovakia
50%-60% of EMU average: Estonia, Hungary, Poland, Lithuania, Latvia,
Around 40% of EMU average: Bulgaria, Romania
Source: Eurostat

A systemic dimension. It is the first time that the EU integrates former socialist countries with noticeable differences among them: 3 countries (the Baltic States) were part of the Former Soviet Union, one in the former pro-market Yugoslavia (Slovenia), another belonged to the COMECON and had partly specialized their economies in order to serve the Soviet economy and developed an autarkic economies with low specialization and limited exchanges with the world economy. In all cases, those countries had to develop market mechanisms, and then adjust to the standards of the EU to be able to support the competitiveness from the other members' states as stipulated by the EU regulations.

A new geopolitical environment. With this new wave of enlargements, the frontiers of the EU are moving eastward and southward raising new questions: security, political and economic cooperation. The European Commission and the EU leaders have set up a new neighbourhood policy which has to match different aims: assure the integration of the new members without deepening the gap with countries that are not yet members and that will join the EU one day (West Balkans countries), set up specific mechanisms to develop economic cooperation with other countries (especially from the South of Europe, Middle East and North Africa countries), fill up the strategic partnership with Russia, securing peaceful development in the region. The opening of official discussions with Turkey illustrates a sharp question discussed in the EU concerning where up to close the frontier of Eastern border of the EU.

Managing the transition

Integrating the EU is the last step of the long process of transformation. A precedent step has been the transition from non-market to a market economy. This has required from policy makers a set of tools and policies in order to speed up and deepen the process of transformation. Consensus, among decision-makers with the population, has been reached in some countries on the different objectives to match; in other countries, dispenses prevailed and have limited both the scope and the pace of reforms.

In spite of these differences, all former socialist countries shared among them common characteristics concerning the industrial organisation, the control of firms, their financing, their level of technology, their specialisation in basic industries (military, heavy

industries), their poor records in intermediary and consumer goods, the total absence of a financial industry, the under-development of services industries. This has shaped what we could call a "bad industrialisation" if we refer to the mode of allocation of resources among sectors in market economies, to the low rate of innovation, to the under-capitalisation of firms, and, finally to the rigidity of the whole economic system. A socialist company has never been considered has an autonomous centre of decision-making, managing its material, and human and financial assets, following a strategy among competitors. On the contrary, the system had low or even inexistent incentives, the State had a paternalist attitude towards companies, providing finance, capital goods, parts, creating a permanent shortage situation, leading large parts of the population either to "live on the beast" or to enter in illegal (but often tolerated) activities of the unofficial economy. Finally, the autarkic organisation of foreign trade, at the level of the former COMECON, has contributed to develop many comparative disadvantages among the economies of the region.

Transition is not a *tabula rasa*, although that many industries have been difficult to turn around and to adjust and that many "industrial cemeteries" filled up the landscape in countries which had concentrated their industrial development in sector finally difficult or impossible to adjust.

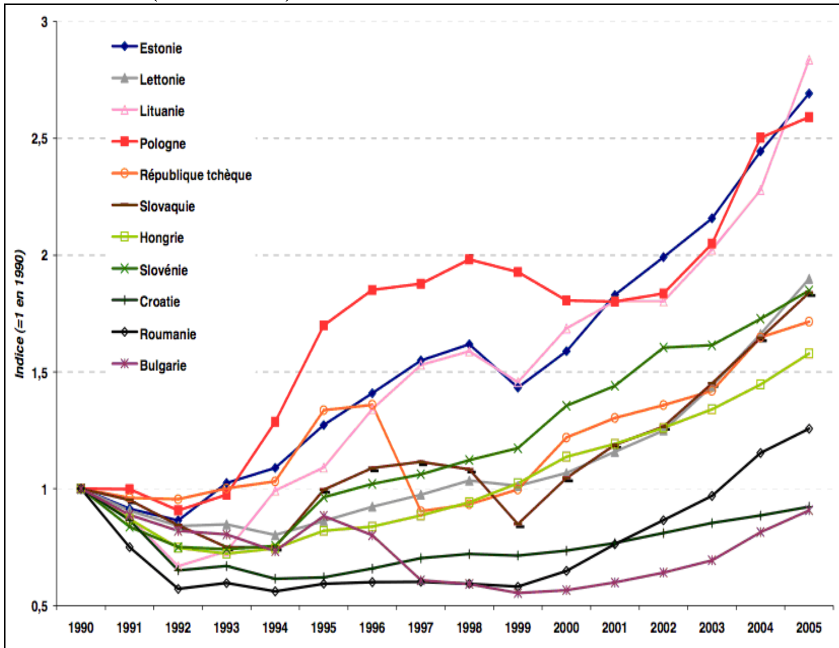
The Great Transformation:

How to go to the market? How to adjust and restructure such economies, how to change the behaviour of workers and consumers confronted with a new environment such as unemployment, strong inequalities, insecurity concerning the future of important fractions of the population? How to create, often from scrape, a market economy? Did privatisations and the right to create new businesses are sufficient to promote entrepreneurship? Is it possible to jump from an administrated economy towards an institutional capitalism, economi-sing on entrepreneurial capitalism which has played a crucial role in the early step of capitalist development in shaping the industry through the growth of big industrial groups? What kind of institutional compromise can be reached in order to control efficiently new private companies? Does a strong financial system is preferable to monopolies, *chaebols* or *keretsu* types of organisation in order to foster growth, fill the technological gap with western developed economies?

The post-socialist transition has focused around four set of policies, each set having specific aims to reach on the one hand, the four set being interlinked, on the other. Concretely, this means that government which have committed themselves, let say only on two sets leaving apart or paying less attention to the two others (which is the reason in the delay of some countries to join the EU) have failed to adjust rapidly their economies and to create the new market environment necessary to support competition in an open economy.

a) *Macro stabilisation* for containing deficits and curbing inflation by reducing subsidies, increasing interest rates, introducing competition through liberalisation of foreign trade. Partial convertibility (before total liberalisation) has created a strong incentive to adjust, to relocate resources in more productive sectors with export prospects. Almost all governments have followed strict macro-policies.
b) *Implementation of market institutions* and adoption of new regulation assuming property right and protection of private investments, establishment, economic laws on companies, for competition, for labour; creation of financial markets, of a two tier banking system.
c) *Re-entering into the world economy*, lowering tariffs and other entry barriers, promoting the development of new specialisations: in few years, all countries will have switched their exports towards Western markets, beneficiating of price advantage but also of specialization of their exports on higher added value segment in part thanks to re-exporting strategies of MNC towards Western markets.
d) *Privatisation and restructuring* former state-owned enterprises in order to de-monopolise big industrial groups by breaking them down through direct selling or through mass privatisation (free distribution to the population or to workers of the units concerned).

Figure 2: **Changes of the manufacturing production in CEES (1990-2005)**



Another dimension of the privatisations strategy, privatisations “from below”, has been the right to new entrepreneurs to enter the market and to establish their businesses (SME), it has also facilitated the entry of foreign enterprises on theses new markets through majority acquisition (through privatisations), new investments (Greenfield investments) or joint-ventures following opportunities, risks, legal environment.

In all cases, new owners (external, former managers and workers, depending on how privatisation has been implemented) had to reshape very quickly their businesses by investing in order to avoid the loss of value of their new assets or to be stuck by strong insiders opposing the necessary restructuring. Corporate governance has become an important issue in the region, along with the development of competition policies and of financial markets.

Transition and integration

Besides the building up of a new institutional environment, privatisation, the search of new competitive advantage concentrating on industries and services which could compete with EU-15 has been the main economic policy objective. The task has been made difficult as there were no more central bodies to promote and finance industrial policies at sectorial levels, there were any managing competencies available, the financial and economic environment was not clear. In the same times, the former specialisations of Central European economies have disappeared with the collapse of the Former Soviet Union as exports destinations shrank.

Price competition, in the first step has played an import role in re-switching exchanges towards Western markets, then, quality effect has taken the lead, mostly thank to the role of FDI in the region which have been attracted by market prospects, low labour cost and high quality of human resources, quality of human resources. Restructuring has pushed non-performing companies to leave the market. Market opportunities have attracted foreign companies, leading to a strong connection with EU-15 economies both in inter and intra trade, the latter showing the level of integration with EU economies (Table 1).

Table 1**: Foreign trade structure with the EU according to the nature of the specialization, early years of the transition (in %)**

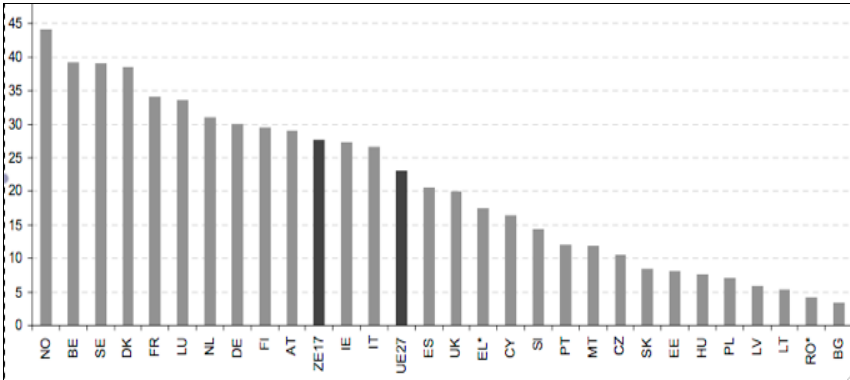
	Intra-Industries Trade			Inter industrial
	Horizontal	Vertical	Total	
Poland (1998)	6.3	25.5	31.8	68.2
Hungary (1998)	7.4	39.1	46.5	53.5
Czech Rep. (1998)	10.9	47.0	57.9	42.1
Slovakia (1996)	5.7	19.7	25.4	74.6
Spain (1995)	19.5	34.2	53.7	46.3
Portugal (1995)	10.5	22.1	32.6	67.4
Greece (1995)	4.6	9.0	13.6	86.4
EU (1995)	19.2	42.3	61.5	38.5

Source: Conjoncture, BNP, September 2004, n° 8,

Concerning labour, new member countries have relied on two advantages: the low cost of labour compared to EU and other

developed market economies, on the one hand (figure 3), and the quality of the work force on the other, which, both have played a major role in attracting foreign investment in the region.

Figure 3: **Estimated Work Force Hourly Cost in manufacturing in the EU**

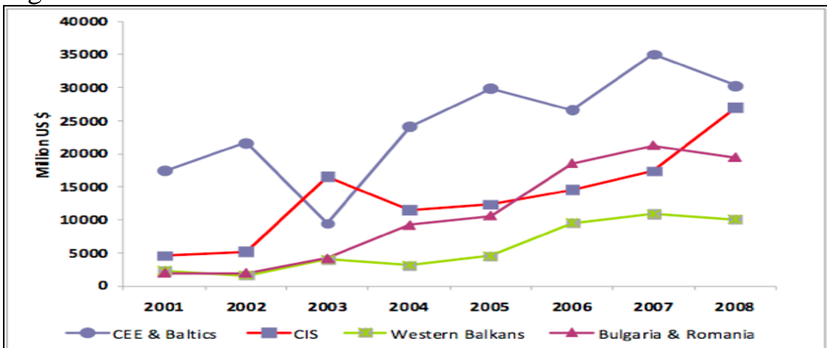


Source: Eurostat

2. FDI, an Engine for Economic Growth and Regional Specialisation

The combination of the different measures implemented during the 90s (stabilisation, institutions building, opening to the world economy, privatisation/restructuring of enterprises) has led to a new competitive environment in the region which shows higher rate of growth than in the EU-15

Figure 4: **FDI in Transition countries**



Source: European Bank for Reconstruction and Development,2009.

Besides these measures, FDI has played the role of a real growth engine; bringing in capital, markets access, management know-how; it has also contributed largely to the spreading of new businesses in the region, often upstream, downstream and around the businesses that has been acquired of created through greenfield investments.

Although the level of FDI is not so important compared to other destinations (around 6% of total world FDI)), nonetheless it accounts for a non neglect able share of GDP, of exports in some countries. Completing the transformation has began to attract big amount of foreign capital in countries which had been reluctant at the beginning of the transition to welcome foreign investment (Czech Republic, Poland).Countries which had been left behind and had not been able to join the first wave of new membership are getting substantial share of FDI, both Bulgaria and Romania, but also West Balkan countries (Figure 4).

Attractivity policies: size, proximity, commitment

Among the different reasons which explain attractivity of countries to FDI (market access, factor costs, there are specific reasons concerning this particular region.

a) Proximity: most FDI outflows come from EU-15 companies (European or affiliates of US companies), quite few directly from overseas countries (Japan, South Korea).
b) Regional integration and division of labour. The proximity factor reduces risks and entry costs, facilitates the development of regional strategies ("linkage") among invested companies in the region. For instance, Skoda-VW, in the Czech Republic assembles its cars and exports parts and components to other assembling units of the group. In the same time, it integrates parts and components produced in Germany or else where among the group's partners. Another impact of the presence of Western companies is to push suppliers (first and second tier) to invest near the new facilities in host countries in order to produce bigger volumes by reducing cost (economies of scale), take advantage of the new markets. Almost all suppliers of big car assemblers have invested near the newly acquired and invested firms in the region. Thus FDI create positives externalities by upgrading existing companies with strong impacts upstream and downstream the business, creating many spill over through the economy.

c) Labour cost and qualifications: The low cost of labour plays an important role in attracting FDI especially in manufacturing industries which requires a qualified manpower. With equivalent training and productivity, the gross cost of the work force in the region was around one/fifth of labour cost un Germany at the start of the transformation. Costs are rising but convergence with Western wages level could take a very long time. Taxation is another issue: the flat tax policy applied by many countries in the region makes a big differential with taxation in the EU raising the accusation of a taxation dumping and retaliation measures from the EU commission.

Finally, mixing proximity, labour cost, workforce qualification and productivity, institutional reform and attractivity policies, country size, the distribution of FDI within the region as favoured both "early reformers" countries (Hungary), biggest countries, even last comers (Romania). Very small countries (Estonia) have taken advantage of powerful neighbourhood (Sweden, Finland) to turn around their economies.

Besides wage costs, high qualification in some manufacturing sectors require very qualified workers, technicians and engineers. Some member States are attracting investments requiring high tech manufacturing (electronics), in high added-value sectors. Big companies relocates some of there research facilities in the region. Nokia and Ericsson have R&D facilities in Hungary, Japanese, Korean and Indian companies are investing in clusters in the Czech Republic. As a result, the content of added-value products in export is increasing.

In less than 15 years Central and East European Economies (CEEE) have deeply changed their economic structure, specialisation and have matched the condition to join, for the majority of them, the EU. They have become fully fledged market economies, able to sustain competition among European economies. Some of them have been able to enter the EMU (EU-17) and adopt the euro as their national currency.

In this adjustment process, socially and economically costly, FDI has played an import role, as a kind of "uninvited guest". Some Western companies have acted as first mover and made a strategic move in future markets with growth potential linked to the former specialization. Other has taken advantage of 'discount prices' of assets in the privatisation.

Table 2: **Growth of Inward Stock and Flow of FDI, 2002-2012**

Countries	Inward FDI Stock, (€ Millions)		Inward FDI Stock per capita, €		Inward FDI stock as % of GDP, (%		FDI inflow as % of Gross Fixed Capital Formation (%)	
	2002	2010	2002	2010	2002	2010	2002	2010
Bulgaria	3927	35901	500	4784	23,1	99,6	31,5	19,4
C. Republic	36884	97191	3615	9238	46,1	67,0	41,0	16,8
Estonia	4035	12269	2975	9156	51,9	84,6	13,3	44,3
Hungary	34575	68522	3409	6856	48,8	69,6	19,5	6,4
Latvia	2676	8250	1148	3713	27,0	45,9	11,4	8,2
Lithuania	3818	10166	1103	3134	25,4	37,1	25,3	10,8
Poland	46139	138000	1207	3600	22,0	39,0	11,1	10,0
Romania	7482	52396	344	2442	15,4	43,0	11,7	9,7
Slovakia	8563	37000	1592	6800	33,0	56,1	61,9	3,0
Slovenia	3948	11242	1979	5492	16,1	31,2	30,4	7,8
NMS-10	152046	470938	1480	4610	29,8	51,4	23,5	11,0
Albania	-	3600	-	1100	-	39,5	7,9	28,5
B&H	799	5700	209	1500	11,3	45,2	-	1,6
Croatia	5794	25725	1304	5800	20,6	56,0	19,1	4,4
Macedonia	1161	3300	574	1600	29,0	47,9	16,9	16,2
Montenegro	81	4060	131	6429	6,0	135,3	38,4	70,6
Serbia	776	15780	104	2164	4,8	54,1	26,3	14,3
SEE	8610	58065	400	2700	14,0	54,5	21,5	12,4

Source: WIIW Database on 2011 Foreign Direct Investment in Central, East and Southeast Europe

Programmes across the region. Other, finally, waited for a safer institutional environment to invest in more secure markets. First movers have been able to negotiate good deal, holiday taxes, even subsidies to control partially or totally strategic assets. Thus they get a strategic advantage, buying market shares, building (temporary) barriers to entry against followers.

Privatization foreign investments have been a hot issue in some countries (Hungary). In both cases, as market mechanisms were not implemented, foreign companies have generally realized good deals fuelling, in some countries, a national resentment against the process of privatisation (selling the crown jewels..)

Table 3: **Investments Entry and Risk Assessment**

Action	Strategy	Examples
First Mover	Entry before the setting of reliable market institutions	VW in the Czech Republic
Opportunistic	Privatisation foreign invested firms	Sanofi, Suez, Hungary
Secured	In the framework of a well established institutional market environment	Tesco, Carrefour, all countries

Levels of risk have been linked to the progress of the economic transformation, to the opening up, to the institutional measures, which have been implemented.

Among the main factors that have accelerated or hampered the entry of FDI, the pace of macro-stabilisation and institutional reforms has played the major role. Except Hungary, all the other countries, at different degrees and for different reasons have hindered policies encouraging FDI entry either frightened by the control of the industry by foreign companies, or willing to keep direct or indirect control on state assets either between the hands of the States, or for possible private appropriation. Countries which have postponed FDI entry have delayed their adjustment but have not closed the door to entry: Bulgaria, Romania, Western Balkan countries are also recipients of FDI which contribute to the up-grading of their economies and to their integration in the new European industrial network. Countries which have the first opened their economies to FDI have beneficiated of a rapid adjustment and regional integration.

Obviously, there is a strong correlation between institutional changes and the growth of FDI in the region as shown in Table 2 some countries taking the lion's share as they have advanced in their adjustment but also beneficiated of their size (Poland, Romania) of their proximity (Czech Republic, Hungary, Slovakia).

- The sectorial distribution of FDI illustrates both the weakness of some industrial sectors under the former socialist system and their growth potential in the framework f a market economy. Most of sectorial FDI among NMS-10 have been directed towards specific sectors: manufacturing (28.8%), trade (13.1%), and financial intermediaries (18.8%), real estate, business activities (19.4%) followed by electricity, gas, water (5.8%), transport, communication

(6.8%). This distribution can be explained both by the 'competitive advantage '(cost, work force qualifications) inherited from the former socialist system which was an asset for investors and by the weak development of other sectors essential for the normal functioning of market economy (trade, finance, transport). FDI distribution among 'late comers' confirms the privileged destination of foreign investors.
Finally, FDI sectoral distribution in the region highlights two interesting points:
- FDI is allocated towards sectors following restructuring or Greenfield investments, are supporting adjustment and up-grading to Western standards to beneficiary companies in order to allow them to integrate industrial networks.
- FDI brings in the flow of capital necessary to develop under-developed or non-existent sectors (trade, consumer, finance).
Proximity is another dimension of the specificity of CEES attar-ctiveness to FDI. Most FDI in the region originate from EU-15 countries with three majors countries: Austria, Germany, and Netherland[1]. Some countries (Italy, France) have a strong presence thanks to big investment in one sector (car industry) or in the financial sector (Austria). Proximity effect can be seen from the case of Austria massively present in neighbour courtiers as Sweden, or Germany. Major investments in specific industries (car, real estate, trade) result in the development of new industrial rings (Western Hungary, Bratislava region, Warsaw, Southern Poland) with cluster effects and strong spin off.

3. Delocalisation, specialization and control: Central and eastern European economies as the backyard of Western economies?

Up-grading and the role of foreign companies

Proximity, as it has been under lined has been a factor which has accelerated the pace of FDI entry in the region. Once institutional barriers have been remove and that transition has neared its completion, FDI has spread in different sectors of host economies even among late EU comers and even, now, the last applicants to become members. Institutional reforms have paved the way and

[1] Netherland is a special case: many European headquarters are located in the Netherland for taxation purpose

broaden attractivity to foreign companies to invest. Investments, as we have pointed out, have been directed in two directions: sectors where they were an obvious need to fill up the gap with the requirements of a standard market economy, particularly to supply new needs (consumer, financial services), to up-grade underdeveloped infrast-ructures (communication, trade).

Besides, FDI have been directed towards sectors which presented potential competitive advantages linked to proximity, to a growing domestic demand, to the qualification and the low cost of the domestic work force. It has been quiet easy for Western managers, once they have taken the control of former socialists companies to turn them around and make them work rapidly on the same standards than in the West.

Case studies have shown that adjustment of those companies have been realized very quickly, often in less than one year, often at a high cost when Western companies have been obliged to post numerous managers in the new facilities to build up the management and organisational system, both inside and outside de firm (networking building). ‘Friendly policies’ towards foreign investors have helped (“holiday taxes”, weak protection of labour. Growth potential of domestic markets, on the one hand, economic stagnation and high wages in Western economies, on the other have contributed to the rapid development of FDI and fuelled, in some countries, relocation of capital in these economies[2].

Table 5: **Largest foreign investors in CE – 2010**

Company	Sector	Origine
1- Volkswagen	Car	Germany
2- E.ON	Energy	Germany
3 -Metro	Distribution	Germany
4 -RWE	Energy, Water	Germany
5-OMV	Energy	Austria
6-Samsung Electronics	Electronics	South Korea
7-Lukoil	Oil and Gas	Russia
8-Tesco	Distribution	UK
9-Deutsche Telekom	Communication	Germany

[2] In the reality, the frontier is not always clear between new investments and relocation: in the first case, there is a net investment when it doesn’t have impact on local jobs (country origin).

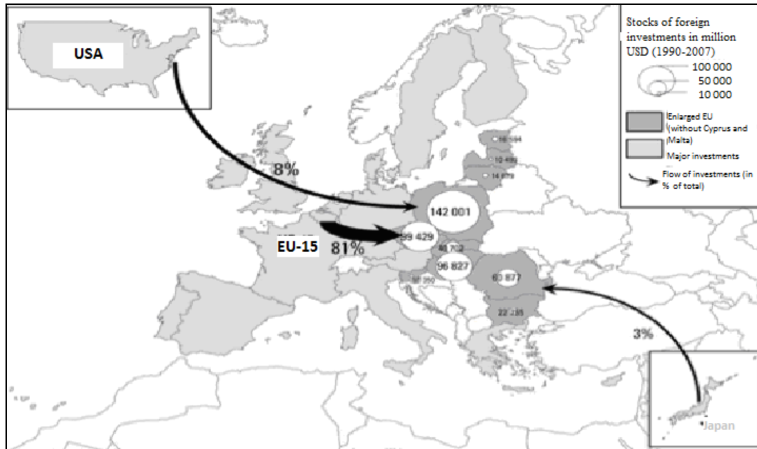
10-Arcelor Mittal	Steel	UK-Luxemburg
11- Foxconn	Communication	Taiwan
12-Nokia	Telecommunication	Finland
13- France Telecom	Telecommunication	France
14- Renault	Car	France
15- Fiat	Car	Italy
16- REWE	Distribution	Germany
17- Kaufland	Distribution	Germany
18- BP	Oil	UK
19 -British American	Tobacco	UK
Tobacco	Electronics	Netherland
20- Philips	Oil	Italy
21- Eni	Oil	UK-Netherland
22-Shell	Steel	US
23- U.S. Steel	Distribution	France
24- Carrefour	Distribution	Germany
25- Lidl		

Source: Deloitte, 2011

Another driver for the development of FDI in the region has been opportunity for Western MNC to realise both horizontal and vertical investments. Horizontal investments, through investments in new facilities to gain market shares (answering local and regional demand), vertical (vertically disintegrated) by transferring parts of the value chain of the process in different locations in the area. As a consequence, the whole productive organization at the European level has been deeply modified with some positive impacts (job creation in host countries) and negative (job losses in original countries).

The outcome of these strategies by European MNC has been the reshaping of the industrial landscape by realizing huge investments in some industries consuming capital and labour (automobile). Table 5 shows the relocation movement in the region. The bulk of FDI comes from Western Europe (81%°, the remaining parts from North America and Asia (Japan, South Korea). Three sub areas have come up from this movement of relocation: a first one in the Baltic with FDI from Nordic States, the biggest one eastward of Germany with Poland, the Czech Republic, Hungary, a third one with Balkan countries.

Figure 5: **Stocks of foreign investments in million USD (1990-2007)**



The reshaping of the Central and East European economies in the framework of enlargement policies had three consequences: a linkage effect, a hierarchical effect and domination effect.

- A Linkage effect

The linkage effect is highlighted by the car industry. Almost inexistent under the former socialist system (only Czechoslovakia had an original and historic car industry; East Germany tried to develop an ersatz of the historic VW, the Trabant), other countries (with the exception of Bulgaria and Hungary barred from the URSS to develop their own industry) mainly Romania and Poland have relied of industrial cooperation and FDI (Fiat, Renault) in to develop cars which never matched the standards both in production (quality, volumes) of Western makers. Hungary was specialized in assembling buses; Slovakia has no car industry at all.

In few years, almost all the biggest European car makers have entered the market, either through acquisition, revamping all facilities (Skoda) either by Greenfield, often both, with the exceptionally growth of the sector (figure..). General Motors came in through its German partner Opel; Asian countries (Japan, South Korea) have also invested in the framework of a larger strategy encompassing other countries (Russia, Central Asia countries).

Western producers have linked these new facilities to parent companies in different way, by designating specific functions, or specializing specifics tasks. For instance, Renault develops its low cost car in Romania, where different functions, even R&D have been relocated. It's from the Romanian headquarter that the regional strategy is set up, to enter new markets, to monitor new investments. The Clio car made in Slovenia by Renault is distributed in Southern Europe, Italy, and the South of France. VW has set up a regional division of labour with some companies producing and assembling whole cars (Skoda), other making motors (Györ, in Hungary), gearboxes (Slovakia), develop jointly a new product (PSA and Toyota making light trucks in the Czech Republic). Skoda produces components for the other group's facilities, in the same time, the company has access to other companies' products. Thus complementarities and economy of scales are two dimensions to the integration with the group. In the same time, first and second tier component suppliers (almost 15 by car makers have located in the area) have set up around the new facilities in order to supply local assembly companies by reducing cost. R&D facilities are developing locally or regionally. Component makers produce for all assemblers in the region. Finally, competition among enlarged car maker group leads to develop best practices. As a result, better equipped, better managed, many of these companies show a better efficiency and competitiveness.

Table 6: **Largest Foreign car maker's investors in CE**

Rank	Top 500 Rank	Company name	Country
1	4	Skoda	Czech Republic
2	7	Fiat	Poland
3	14	Audi Hungaria	Hungary
4	28	Volkswagen Slovakia	Slovakia
5	48	Automobile Dacia	Romania
6	55	Toyota Peugeot Citroën	Czech Republic
7	59	Automobile Czech	Slovakia
8	62	PCA Slovakia	Poland
9	71	Volkswagen	Slovakia
10	82	Kia Motors Slovakia	Hungary
		Magyar Suzuki	

Source: Deloitte, 2011

Today, according to the latest data, the production in the region of light vehicle (including Russia, the biggest market) account for 576352 units, nearly half of Western European (12 179938) itself equals to the US (12280019), but far behind Asia (34210699). Almost from scratch, FDI has contributed to the development of the automobile industry in the region. There are fears, of course that the present economic crisis will have negative impact on the growth of the sector. Competition from Russian (a much bigger market for which Western maker show a big appetite) and Asia are real and could lead to a durable stagnation even a decline of this sector.

Hierarchical and Domination Effects

All governments, international institutions support the role of FDI as a tool for modernizing, catching up and linking backward economies. Removing barriers, setting up attractivity policies have been set up and have contributed to the adjustment of Central and Eastern economies. The presence of FDI, with the benefits of integration, has contributed to sustain economic growth in the region. Even late comers countries (Bulgaria, Romania) have beneficiated from entry of FDI, showing that there was still room, and opportunities in the region to welcome foreign capital.

Although it is not a frequent question, an issue with the massive presence of FDI in the region concerns the hierarchical and domination effect. In other worlds, CE economies have moved from a domestic accumulation of capital strategy (under the socialist system) to a model of international control of domestic assets by foreign investors. Opening up policies and privatizing public assets had to consequence in terms of control of domestic assets. First, big domestic monopolies (energy production and distribution, telecommunication network, some insurance and banking) have been kept under the hand of local governments. In other sectors (car, distribution, telecommunication, technology), big foreign companies have bild up a dominant position (ranking, market shares) with the exception of former national monopolies (telecommunication, energy distribution) which were not offered for sale during the round of privatization of State property.

Hierarchy control can be considered from two views point. First, through the linkage effect which analysed above Western companies has both a strategic and organizational advantage (OLI) which is not

eroded over the time. Does local companies, either by their initial level of technology, by the learning curve, by the relocation of R&D facilities, can become equal players with Western MNC and compete with them? Secondly, through the control effect (capital control, property rights, protection of intellectual property rights) does host country companies further autonomy appear difficult to get. Case studies in different countries of the region (Stephan, 2012) have concluded to interesting conclusions: embedness of technologies in acquired companies, the supply of qualified workforce (intermediate level, university graduates) in certain sectors are source of local technology diffusion and autonomy and constitute a comparative advantage...

Table 7: **Foreign companies, by Country among the 500 First companies in Central Europe**

Status 2010	Non CE private sector	CE private sector	State owned	Total
Bosnia and Herzegovina	/	/	1	1
Bulgaria	11	1	2	14
Croatia	3	7	7	17
Czech Republic	48	14	11	73
Estonia	5	/	1	6
Hungary	50	8	5	63
Latvia	4	2	/	6
Lithuania	1	6	2	9
Poland	97	42	41	180
Republic of Macedonia	1	/	/	1
Romania	26	1	5	32
Serbia	6	2	4	12
Slovakia	17	5	7	29
Slovenia	5	11	2	18
Ukraine	12	19	8	39
Total	285	116	96	500

Source: Deloitte (2011)

Finally, there is a wide consensus on the positive role of FDI in the region both in terms of growth, of catching up, integration. But the question which remains is to which extent the positive externalities created by the presence of FDI can expend? How local companies,

subcontractors, SME can beneficiate of the positive impact of FDI in the region?

Table 8: **Sectorial breakdown by ownership**

Status 2010	Non CE private sector	CE private sector	State owned	Total
Consumer Business and Transportation	91	46	20	157
Energy and Resources	63	31	54	149
Life Sciences and Health Care	15	9	-	23
Manufacturing	79	28	10	116
Public Sector	-	-	5	5
Real Estate	9	2	-	11
Technology, Media and Telecommunications	30	4	5	39
Total	287	119	97	500

Source: Deloitte (2011)

Conclusion

In this paper we have discussed three important points which make CEECs integration and up grading a particular case.

First, the magnitude of the last rounds of enlargement and integration to which the EU has faced and the importance of the institutional shocks to which new comers have been confronted. Speed (less than 15 years for the most advanced countries) and deepness of changes that have occurred (economic adjustment, opening up, development of market mechanisms) at a relatively low cost (for the EU budget) have been the main characteristics of this round of enlargement.

The process of enlargement and integration has been almost continuous with further integration of 'late comers' (Bulgaria, Romania), and further acceding countries from Western Balkans.

The role of FDI has played an important role in the region to transform, adjust, specialized industries, creating jobs, increase exports of higher added value products, and reconstruct an industrial network linking industries of the region with Western companies and markets.

Mostly, the driver to enter these countries has been opportunities for market growth, for competitive advantages (getting good and cheap domestic assets). It has been also an opportunity to deeply reshaping the European industry, introducing a new division of labour through specialisation along the regional value chain.

Entry of Western Balkan still has a positive impact on regional growth both in term of economic adjustment of new specialization. Although the linkage factor in less evident, FDI is pouring in the region, and, at a lesser pace, contribute to the economic transformation of the region.

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