

6 Geoeconomics in Central and Eastern Europe

Implications of FDI

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1 Introduction

The chapter investigates problems of capital accumulation, the features of post-socialist transition, as well as the geoeconomic features of the externally managed and financed integration of post-socialist transition countries of Central and Eastern Europe (CEE) into the global economy and the European Union (EU). The authors would like to use the principles of geoeconomics in order to analyse the Central and Eastern European region and the role of foreign direct investment (FDI) in transformation. The importance of geoeconomics lays in the importance of this method in the globalized world. Geoeconomics gradually replaced geopolitics in the era of globalization. In contrast to geopolitics, it focuses not primarily on the state and its role, but rather on private enterprises (Soilen, 2012). Its focus is on networks not blocs, connections not iron curtains, and transborder ties instead of national territories.

Global financial capital has played an important role in all transition economies. FDI in the banking, insurance and manufacturing sectors is closely connected to the transition process in CEE and has received considerable attention from both a theoretical and an empirical perspective (Estrin, 1994; Bevan & Estrin, 2004; Csaba, 1995). Much less attention has been devoted to the post-transition period and the impact of the crisis on externally financed and dependent transition models in CEE.

Economic transformation in Central and Eastern Europe followed a development path based on FDI and reinvigorated short-term competitiveness. However, it needs to go beyond low costs and counteract the unfavourable effects of external capital and export dependencies. The economic transition fuelled by a neoliberal approach through economic liberalization, marketization, privatization overlapping with excessive 'foreignization' created the legal and structural frameworks for the dependent mode of reintegration into the EU and into the global division of labour (Sachs, 1990; Sokol, 2001; Smith, 2002). The most important *historical dependencies* of the CEE region, such as financial, technological and market ones, remain constant. This is complemented by the large energy dependency of CEE countries (CEECs) on Russia. This not only further strengthens the external vulnerability

in several geopolitical plans (Mitteleuropa Plan, 1915, and the Nazi ideology of Lebensraum). The main international trade partner of the CEECs was Germany until the end of World War II, providing markets for their (mostly) agrarian products while Germany exploited natural resources of the region. This trade connection was replaced by the Soviet Union with the founding of the Council for Mutual Economic Assistance (COMECON, also known as CMEA) in 1949. By the early 1950s the share of foreign trade with the Soviet Union had become dominant (Schmidt, 2015). Bilateral agreements guaranteed the energy and raw material supply for the CEECs from the USSR while they were mostly paid by industrial products. It also helped the rapid industrialization of the mostly semi-agrarian countries of the region.

The trajectory of CEE differed significantly from that of the West and it was characterized by historical dependencies and perpetual attempts at catching up. The CEE region within the system of capitalist division of labour became the semi-periphery of a transforming West during the early modern age. The 19th and 20th centuries were characterized by three major waves of catching up with the West (Figure 6.1) (Gál & Lux, 2014).

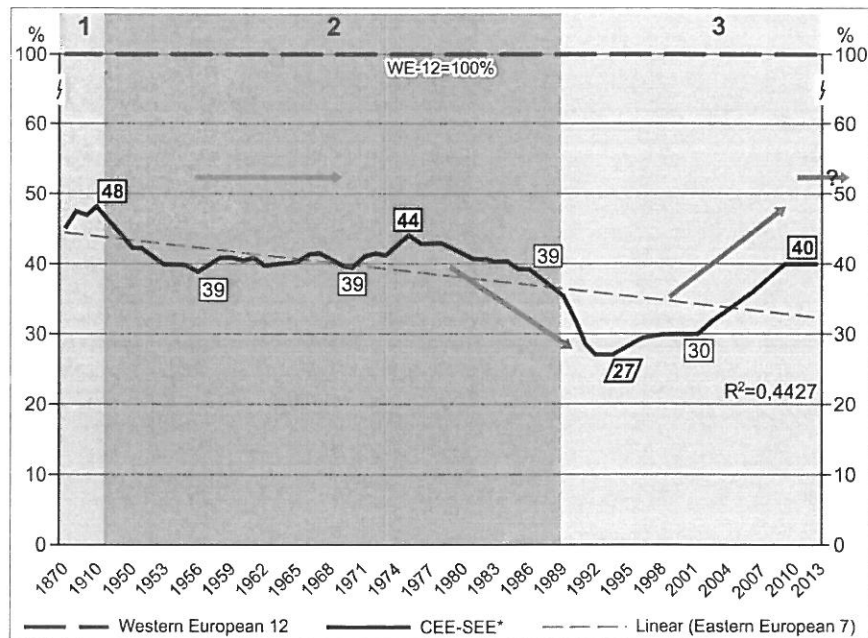


Figure 6.1 Relative development gap between Central and Eastern Europe and Western Europe -12, 1870-2013 (as a percentage of GDP per capita in 1990 Geary-Khamis dollar, WE -12=100%)

(Authors' calculation based on Angus Maddison's database, www.ggdc.net/maddison/maddison-project/data.htm)

- 1 The *turn of the 19th and 20th centuries* experienced the most successful catching up and the region managed to decrease the development gap significantly.
- 2 Modernization under the *centrally planned economy* with its heavy industrialization and forced capital accumulation policy resulted in surprisingly rapid convergence of the region during the 1960s.
- 3 *Post-communist transformation* and rapid privatization led to a tragic decline of gross domestic product (GDP) and industrial output, and CEE entered a period of half a decade of transformation crisis and stagnation.

The deep transformation crisis of the 1990s followed the transition from a command to a market economy. It was the direct consequence of the collapse of Eastern markets, economic decline, unemployment, inflation, doubtful results of privatization and a general decline in living standards. With the return of 4–5% annual growth between 1994 and 2003, per capita GDP reached 35% of the Western European level of development in 2005 (virtually the same level as in 1989), peaking (44%) in 2008 before it began to drop. Our calculation shows that less than half (40%) of the Western GDP per capita level was achieved in Central and South-Eastern European countries. It seems that the development gap between the so-called ‘old’ and ‘new’ member states of the EU has not narrowed, but in fact has increased since the early 20th century (Figure 6.1).

In our interpretation the form of access to international capital is tied to a certain geopolitical situation and also to the changing geoeconomic framework conditions due to the course of globalization. In the case of CEE, three major processes were responsible for the region’s geopolitical and geoeconomic repositioning (Smith, 2002, 2013).

First, the *transition and economic transformation* with its neoliberal marketization (and foreignization) strategy accompanied by one-sided trade liberalization and inflows of FDI. The incorporation of the huge market with its natural and human resources offered several advantages for Western multinational corporations (MNCs), while export ability of CEE enterprises were restrained by protective measures of the EU, particularly in those sectors that were important to CEE recovery (Gowan, 1995). Post-socialist transformation was a top-down driven process conducted by the CEE governments and externally assisted by the neoliberal financialization project and by international institutions (the International Monetary Fund—IMF, the World Bank, the European Bank for Reconstruction and Development—EBRD, G7, EU and the North Atlantic Treaty Organization—NATO), which made the institutional aspects of financial market integration part of an inherently political project of transition (Sokol, 2001; Raviv, 2008).

Second, the international environment in which transformation took place in CEE was shaped by the *economic and financial globalization* providing external framework conditions to economic and political transformation of the 1990s (Schmidt, 2014). US and EU financial capital was seeking new

investment opportunities in the course of financialization and this process was accompanied by the relocation of industrial production of MNCs from developed countries to emerging economies.

The external pressure came from the intertwined virtue of foreign capital and the powerful intervention of international institutions. They created rather strict economic conditions for post-communist countries for their reintegration into the international market economy. As Gowan (1995) argued, the neoliberal economic transformation allowed foreign capital to conquer Eastern European markets and to integrate their captured cheap production lines into the 'hub & spoke' West-East economic relations.

Third, the *Eastern enlargement of the European Union* in 2004, besides being a political project, was committed to the neoliberal, externally dependent, investment-led growth and marketization process. The structural power of EU financial capital has been on the rise, mostly the result of EU policies (Raviv, 2008). This capital flew towards Central and Eastern Europe in the form of FDI even before the accession, but enlargement further stimulated the expansion of MNCs in the new member states.

A key part of the EU's internal interdependencies aims to restructure its global geoeconomic position, creating interdependent trajectories within the EU with the relocation of the more labour-intensive or efficiency-seeking industrial and service value chains to CEE. This internal geoeconomic restructuring within the enlarged EU created new core-periphery relationships that primarily benefit the core, often at the expense of the peripheries. This process hollowed out not only the Mediterranean but even more the Eastern periphery of the EU caused by the resurgence and growing supremacy of the German capital. The Eastward expansion of German capital largely contributed to the global competitiveness of the German economy and to the geoeconomic supremacy of Germany over the EU (Phillips, 2000).

As a result, the main characteristics of this blend of 'imported capitalism' included a relatively fast recovery from transformation crisis but also the dominant role of foreign capital in the process of stabilization. However, foreign investments not only contributed to the modernization of the economy, but also increased its structural and spatial segmentation (Eyal et al., 1998).

3 The role of FDI in CEECs

European and US assistance in reconstruction of the post-socialist region resulted in the appearance of not just foreign capital, but controversial aid programmes launched by the IMF, EBRD¹ and EU, paving the way for foreign private investors. However, both IMF and EU aid programmes, unlike the non-refundable Marshall Plan aid for Western Europe, used their instruments to create the desired goal to open indebted CEECs to FDI.

Foreign investment fundamentally helped the post-socialist countries in shaping the region's diverse development paths. International capital was

seeking market opportunities in Europe at the same time as CEECs started to privatize their state-owned enterprises and the European integration proceeded. The EU's decision to start entry negotiations with selected candidates increased the region's attraction for FDI. During the period of privatization in the indebted countries of CEE there was a far greater cumulative need for external capital than the actual supply of FDI in these economies. As Gerôcs and Pinkasz (2015) argue, this explains the very unequal bargaining position of transition countries suffering from capital shortage vis-à-vis international investors.

FDI inflows into CEE economies have been a vital factor in privatization, and FDI became the predominant type of incoming capital investment in the first stage of the economic transition (Kalotay, 2010) (Table 6.1). Privatization of state-owned enterprises became the cornerstone of economic transition since it shaped the property rights and the corporate government systems. CEECs lacked domestic capitalists with financial resources, therefore privatization opportunities were transferred to foreign investors coming mainly from eurozone countries. Foreign capital was expected to be the engine of transition bringing new capital, new technology, jobs, economic growth and convergence to CEE. However, in low-income countries privatization of state-owned enterprises to foreign investors is considered a negative policy from a development perspective, 'selling the family silver' (Easterly, 2001). Furthermore, IMF-led shock therapy required privatization in the middle of the transformation crisis and, therefore, the assets were acquired by foreigners at very low prices² (Gowan, 1995).

The shift from state socialism to market capitalism in the second phase of the transition was quickly followed by the transition from industrial capitalism to financial capitalism, in which bank capital became the predominant type of investment after the millennium.

FDI inflows have resulted in dramatic changes of ownership structures, first in the banking and insurance sectors being a forerunner in the privatization process, and quickly followed by manufacturing. In 1994, in the wake of the early transition crises, an overwhelming majority of financial intermediaries in the post-communist countries were still publicly owned. In contrast, in 2007, more than a decade later, private foreign ownership already accounted for about 80% of financial intermediaries' assets in the CEE region. These figures are especially striking when we compare them with the 15% in the euro area. Even the average of non-Organisation for Economic Co-operation and Development (OECD) countries is only 50% (Gál, 2013). The post-crisis external adjustment was followed by increasing state intervention with plans to strengthen local financial structures. As a result, the share of foreign ownership dropped significantly in Hungary and also decreased in Poland and Slovenia (Figure 6.2).

The size and weight of foreign ownership in transition countries can be collected from the EU foreign affiliates and other business statistics for the recent period. The overall share of FDI in the GDP is highest in Hungary

Table 6.1 FDI stocks in CEE countries, 1995-2013 (US\$ billion)

<i>Year</i>	<i>Bulgaria</i>	<i>Czech Republic</i>	<i>Hungary</i>	<i>Poland</i>	<i>Romania</i>	<i>Slovakia</i>	<i>Croatia</i>	<i>Slovenia</i>
1995	0.4	7.4	11.3	7.8	0.8	1.3	0.5	1.8
2000	2.7	21.6	22.9	33.5	7.0	7.0	2.7	2.9
2005	13.9	60.7	61.1	88.2	25.4	29.6	13.3	7.1
2008	44.1	113.2	88.1	157.2	64.8	50.4	28.4	12.0
2009	49.2	125.8	98.9	176.9	69.9	52.5	33.5	11.3
2010	47.2	128.5	90.8	195.4	68.1	50.3	32.3	10.7
2011	47.4	120.6	85.3	174.7	69.5	52.0	28.4	11.5
2012	49.4	136.5	104.0	203.3	76.3	55.1	29.3	12.2
2013	51.2	134.1	108.2	271.7	82.7	58.1	29.9	12.3

(WIR database, Eurostat)

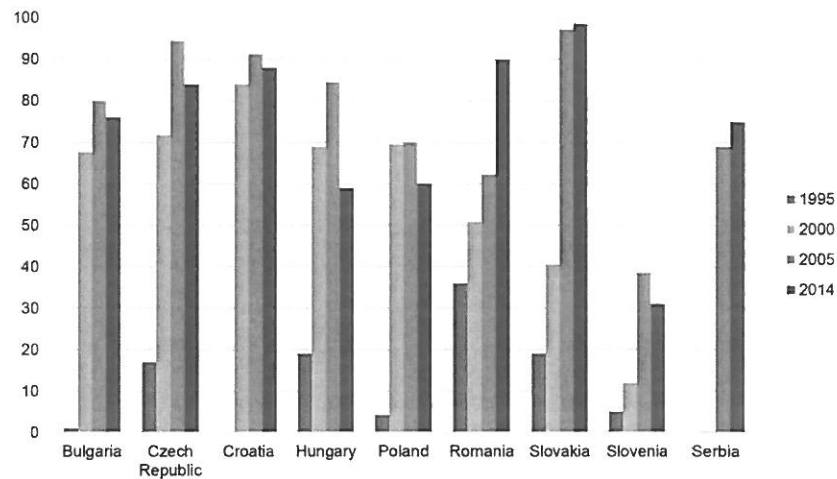


Figure 6.2 Foreign ownership as a percentage of total banking sector assets in Eastern Europe, 1995–2014
 (Author's calculation based on data from Raiffeisen International)

(52%), the Czech Republic (48%), indicating not only the strongest integration of these economies into the EU/global economy but the largest (external) dependencies on MNCs' value chains as well. The share of FDI was lower in Slovakia (32%) and much lower in Poland (25%), which is comparable of the Austrian figure (23%).

The share of foreign affiliates in production value is highest in Slovakia and Hungary, with over 57%, followed by the Czech Republic (Hunya, 2015). Foreign shares in manufacturing production in CEE are dominated by MNCs. Their share in manufacturing is even higher than in the economy as a whole, reaching 80% in Slovakia, almost 70% in Hungary and 67% in the Czech Republic (Figure 6.3). The transition to a market economy helped the growth of the services sector with the increased amount of FDI. From the 2000s, the largest part of this FDI reached was committed to the business and IT services sector.

In terms of the fundamental motives for FDI in the region, these followed first the market-seeking, and later efficiency-seeking strategies. *Market-seeking investments* concentrated on searching for new markets to sell the products or services of the MNCs, while *efficiency (labour)-seeking investment* exploited differences in wages both in labour-intensive production and in knowledge-intensive services (Schmidt, 2015).

The external capital dependency of the region is exacerbated by its manufacturing export dependencies on Western Europe. Economic recovery from the transformation crisis is designed by the IMF to develop trade-led growth, rather than a strong domestic recovery based on domestic consumption. This

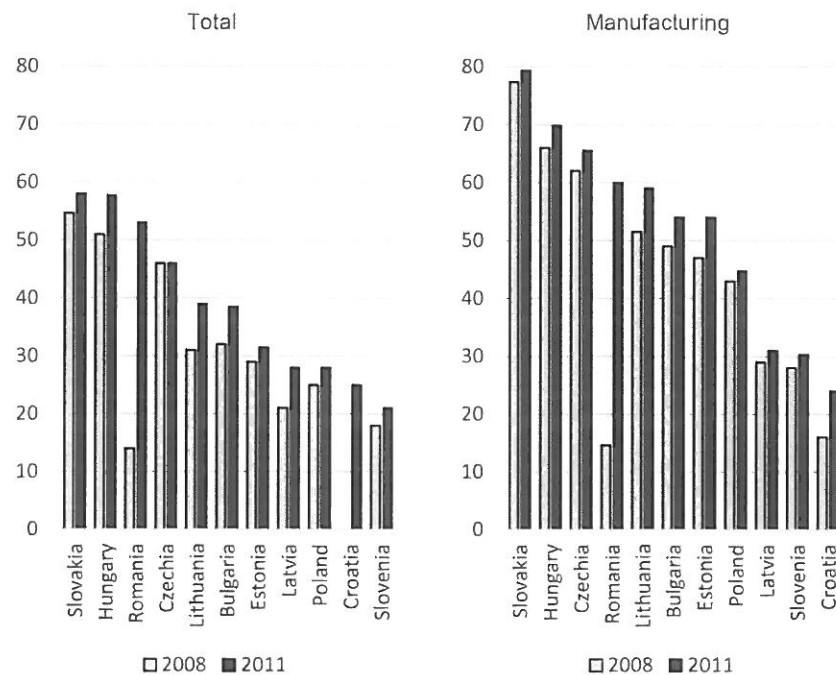


Figure 6.3 Share of foreign affiliates' production value in the non-financial sectors, 2008–11 (%)

Total: all non-financial sectors; Manufacturing: manufacturing sectors.
 (Eurostat, foreign affiliates and other business statistics)

exposure to export dependency on EU-15 markets accompanied by industrial relocation of EU-based (mainly German) companies relying upon assembly production, accelerating in car manufacturing and in electronics, integrated CEECs into their global value chains (Smith & Swain, 2010). At the same time, they provided capital in the form of FDI for industrial upgrading to high-tech production (Pavlinek et al., 2009). In this respect, CEE played a significant role in the consolidation of the German (car) manufacturing industries and contributed to their globally competitive position. The capital and export dependencies of CEE were further aggravated by energy dependency on Russia.

3.1 Impact of FDI on host transition countries

In theory, foreign companies may affect positively the economic performance of the host country (Blomström & Kokko, 1997). FDI has often been viewed as a potential catalyst for the economic transition from a planned to a market economy. It increases productivity and raises the level of competitiveness (Grossman & Helpman, 1991). It can transfer technology and know-how and

spread managerial and marketing skills by transactions with domestic firms. It contributes to the restructuring of existing enterprises. However, these positive impacts do not occur automatically. The emergence of 'dual structure' in transition economies is characterized by deep imbalances between the capitalization knowledge base, market position, and other vital characteristics of foreign and domestic corporations (Hardy, 1998; Barta, 2005). FDI in manufacturing export platforms is considered an economic driving force, although spillover effects remain fairly weak. Despite MNCs occupying all strategic sectors in the transition economies, they may form separate islands in the economy, having very limited contact with domestic enterprises. Moreover, the activity of MNCs can result in *crowding-out* of domestic firms, whereupon MNCs occupy the product and labour markets of local companies (Lux, 2014).

Other controversies emerged in the case of acquisitions by foreigners followed by the closing down of the firms in order to eliminate their Eastern European rivals (Gowan, 1995). There were many privatization cases that were followed by cherry picking of the most valuable assets, general de-skilling as enterprises were 'hollowed out', keeping the lowest value-added activities in the region. Mostly the relatively routine activities were transferred to CEE due to the lower wages for skilled labour there (Myant & Drahokoupil, 2011). As Nölke & Vliegenthart (2009) argue, in contrast to the less regulated liberal market economies (LMEs, e.g. the USA), or the coordinated market economies (CMEs, e.g. Germany), *dependent market economies*' competitiveness is tied to 'a specific type of comparative advantage that is not based on radical innovation (LMEs) or incremental innovation (CMEs), but rather on an assembly platform for semistandardized industrial goods' (p. 679). Contrary to this, market-seeking FDI that targets domestic markets (finance, retail and energy sectors) is more controversial and may be regarded as a risk factor. In the banking sector foreign subsidiaries followed pure commercial market rather than economic development principles regardless of the needs of the domestic economy (Raviv, 2008).

Income effects of FDI are very limited as only a small fraction of income from FDI projects is captured by domestic residents (Lane & Milesi-Ferretti, 2007). The growing gap between GDP and gross national income (GNI) is an inevitable result of FDI inflows in transition countries where the gap has been increasing over time, therefore the GDP to GNI ratio is below 100%. This gap in CEECs on average increased from 0.96% to 4.38% of GDP. This is due to an increasing part of the income generated by foreign investment being transferred back to the capital owners' home country.

FDI is expected to bring growth through increased gross fixed capital accumulation and a wealth of benefits to the local economy and the impetus that knowledge from outside may bring to local processes of technological change (Jensen, 2006). Meneinger (2007) finds negative correlation between FDI and growth in CEECs. The privatization incomes are spent on consumption and imports since FDI generates high import and consumption rather than debt

reduction. The increase of GDP growth increased the capital outflow as well as trade deficit through the investment, trade and current accounts.

FDI inflows have a direct positive impact on the balance of payments as FDI is prominent in financing high current account deficits. Foreign capital is used to finance investment and ultimately FDI tends to substitute incomplete local financial markets. However, a natural consequence of these inflows has been a large current account deficit as FDI also increases the size of profit repatriation over time. This is related to the fact that some parts of FDI (equity capital, reinvested earnings, dividends, other capital) are mobile.

Prasad et al. (2007) find that developing countries which relied more on foreign finance have grown more slowly than those that used their own savings for investments. They also find that the CEECs in this respect resemble industrial countries where larger inflows of foreign capital boost growth. However, other comparative studies argue that transition countries are more similar to developing than to developed countries in terms of their experiences of hosting FDI (Jensen, 2006).

4 Growing imbalances and the crisis in Central and Eastern Europe

As we have seen, FDI inflows resulted in only a temporary remedy for the indebtedness and current account imbalances of transformation crisis-hit countries in the region. During the 2000s, the growing deficit in current accounts was increasingly financed by inflows of bank capital as the shift from FDI towards credit financing occurred. This process in CEE coincided with the global process of financialization. A new pattern of accumulation, in which profits accrue primarily through financial channels, increased the dominance of financial market actors exerting enormous impacts on firms, states and households (Krippner, 2005; Aalbers, 2008).

From a geoeconomic point of view, the promotion of Euro-Atlantic integration of CEECs was underpinned by the wider financialization-led growth regime (Gowan, 2009). This Atlantic system of financialized capitalism led to excessive borrowing in CEE, increasing indebtedness and real estate bubbles that in the short term generated higher growth rates (Smith & Swain, 2010). Already by the year of EU accession in 2004, few CEECs witnessed a massive debt accumulation. As soon as the privatization opportunities decreased, it led to the reduction of inflow of FDI. At the same time, profits made by MNCs began to repatriate from the region, which resulted in a growing gap in the current account.

Another reason for the growing indebtedness and current account deficit is rooted in the household consumption and mortgage lending that generated huge inflows of foreign credit. The financialization-based consumption model relying on short-term bank capital gradually replaced the FDI-based model in terms of external finance (Figure 6.4).

The credit boom in mortgage and consumer credits fuelled the excessive growth in liabilities throughout the CEE region during the pre-crisis era.

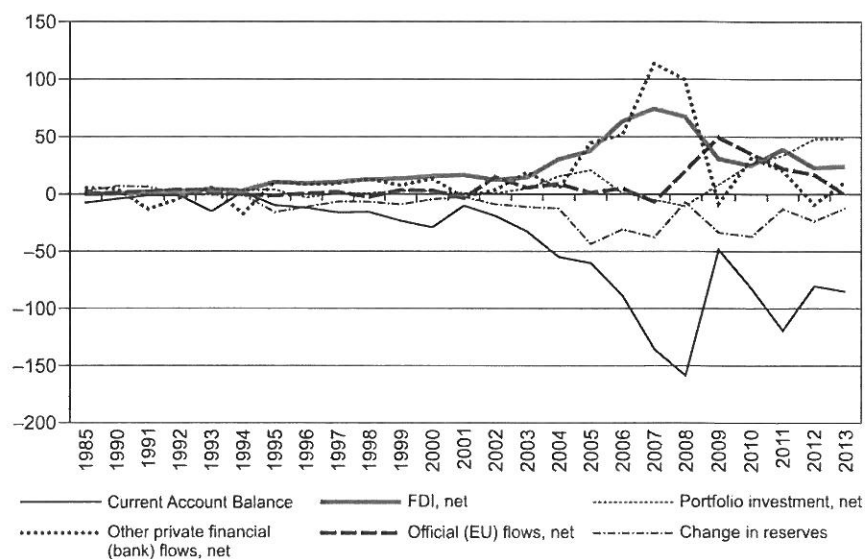


Figure 6.4 Net financial flows and reserves in CEE countries, 1985–2013 (US\$ billion) (Compiled by the authors from the IMF *World Economic Outlook*)

During this period credit growth significantly exceeded the growth rate of domestic deposits, therefore banks' borrowing from external sources increased. As a result the share of deposits within banks' total liabilities may fall significantly. The credit boom-fuelled consumption in many CEECs was extensively financed by the local subsidiaries of foreign parent banks, which entailed a growing dependence on external resources (Gál & Kovács, forthcoming). The share of foreign liabilities in total volumes of liabilities grew from 8% in 2005 to 25% in 2008. Corporate lending developed slowly and the banks increasingly shifted towards the more profitable household lending tapping the upward cycle in the credit boom.

The finance-led growth model further strengthened the ownership, as well as the creditor-debtor control, over CEE. This was able to create very profitable new investment and lending opportunities for foreign banks. Profitability in CEE banking markets during the pre-crisis period was clearly outpaced by that of their Western counterparts (Gál, 2013). In CEECs catching up in the first half of the 2000s was generally accompanied by macroeconomic stability, but most countries of the region became increasingly vulnerable due to the unsustainable trajectories of huge credit booms, high current account deficits and quickly rising external debt.

The household sector's foreign currency borrowing is a recent development in Central and Eastern Europe (commencing in the 2000s), and actually, it soon became the region's equivalent of the subprime mortgage (Figure 6.5). The rapid growth in domestic credit was financed by foreign-owned banks

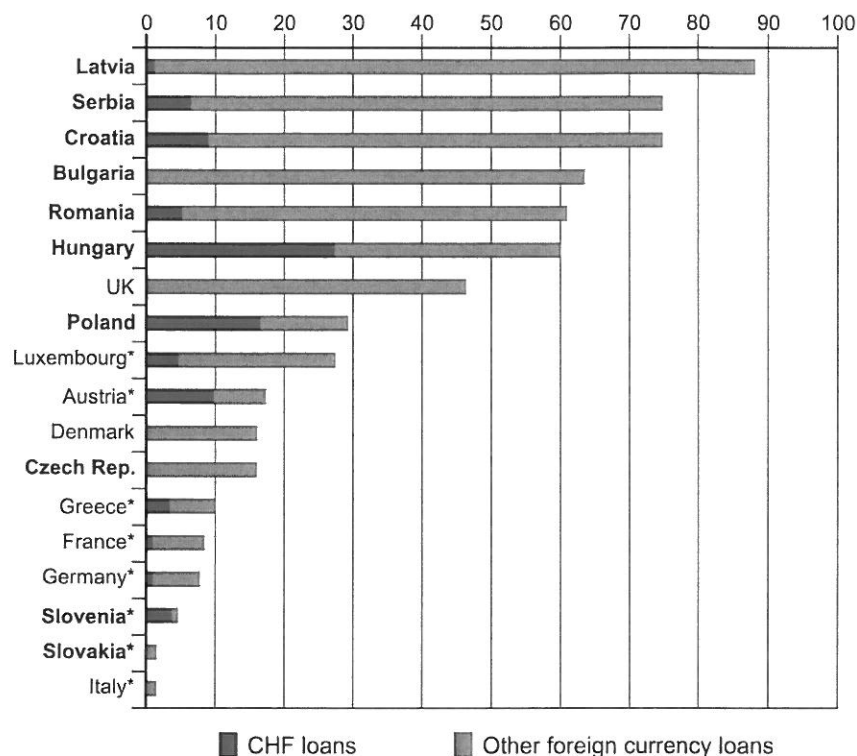


Figure 6.5 Share of foreign currency loans as a percentage of total loans to the non-banking sector in Europe, 2012 (1Q)

Bold: Central and Eastern European countries; * eurozone members; CHF: Swiss franc

(Author's compilation based on data from Raiffeisen International and Swiss National Bank's CHF Lending Monitor)

engaged increasingly in carry trade. Despite its immediate benefits—lower interest rates, longer maturities—foreign exchange loans carry a significant foreign exchange rate risk. Foreign currency indebtedness is a systemic problem with a crippling effect on the whole economy and economic policy in many CEECs (Yeşin, 2013).

As a consequence of this second stage of external capital inflows the CEE region integrated into the geoeconomic structure of the international financial system as a debtor region dependent on importing capital. This increasing dependence on foreign capital led to growing imbalances resulting in transmittance of contagion into CEE and the deepening of the crisis.

The financial crisis in 2008 ended the optimism of the new EU members. It showed the problems of the post-socialist states, as their economies were weak and vulnerable. The attempt to create an economically balanced structure

with the accession of new member states had failed. In the run-up to the crisis, the CEECs attracted large capital inflows and some of them built up large external imbalances. However, the crisis years caused not only a decline in capital inflows but also a deterioration of domestic and foreign demand, which led to a deep economic depression in much of the region. The financial crisis was usually explained as an external shock that affected the CEE countries in different ways. However, Bohle (2010) argues that the unfolding crisis in CEE cannot simply be understood as internal adjustments to an external crisis. Rather, the region's integration into the new geoeconomic structures following the collapse of the Soviet bloc created vulnerabilities that unfolded in the recent crisis.

In 2008, the crisis transmitted to the CEE region too, and a year later the previously prospering countries had to experience a double digit decline in GDP while the average decline of the entire region was around 6%. Households with foreign currency debts began to reduce their consumption due to the sudden increase in their debt.

In the first stage of the financial crisis, due to the increased reliance of the banking sector on foreign funding, the risks were associated with the drying up of international finance. A liquidity crisis occurred at the parent banks and were transmitted immediately to their foreign subsidiaries. In the second stage (from mid-2009) the foreign currency indebtedness captured potential spillover effects directly on the host countries affecting all sectors (state, corporate and private households) and resulted in funding withdrawals.³

External capital inflow significantly declined and the recovery of both bank capital and FDI flows proved to be a long-lasting phenomenon during the crisis, as a legacy of the foreign-funded credit boom and despite the funding withdrawals since the stock of outstanding financing from foreign banks is still large (26–29%). The current slow economic growth in CEE is linked to low investment activity, both domestic and foreign. Despite the increased domestic savings in crisis-hit countries (Estonia, Latvia, Hungary and Romania), the investments and growth declined because domestic savings were spent on foreign debt repayment rather than investment and consumption (Śliwiński, 2009).

Summing up, we argue that the role of foreign savings in promoting economic growth in the ten CEE countries *was* undoubtedly only in the short run but was challenged in the long run, particularly during the crisis period. Since the outbreak of the crisis, not only have FDI inflows decreased but also the role of foreign capital in promoting economic growth has had to be revised.

5 Conclusions

The main argument of this chapter was that the global crisis has exposed the systemic vulnerability of the post-socialist neoliberal transition model which failed to decrease the relative development gap between the 'old' and 'new' EU members, and has contributed to growing geoeconomic dependencies of CEE on foreign capital and transnational export platforms.

The economic transformation (with dramatic transfer of ownership and the reallocation of factors of production in favour of foreign investors) and integration model (joining the EU market in a dependent semi-peripheral position), as well as the transition to financialized capitalism (ending up in short-term boom on the expenses of growing indebtedness) created systemic vulnerabilities to wider economic crisis and to the future of economic convergence of the region. The Atlantic system of a financialized capitalist model was transmitted into the CEE region in the form of a creditor-debtor model, which further strengthened Western control over Central and Eastern Europe (Smith & Swain, 2010).

The crisis led to even higher cost of financing and decreasing capital inflows, which will result in greater economic volatility, lower long-term growth and slower convergence with Western Europe. In the crisis aftermath, up to 2030, only moderate economic growth is expected in the region. The average annual growth forecast is 1.93% for CEE and 1.87% for the EU-15 (Gál & Lux, 2014). If this low growth is the case, the existing gap will hardly change and Central and Eastern Europe will remain on the European periphery.

The financially and industrially integrated debtor countries of the region had become locked into the growth trajectories of the core EU countries. In CEE economic restructuring has mainly followed a development path based on FDI, which has reinvigorated competitiveness but now faces the need to transcend the low-income trap, and counteract the unfavourable effects of external capital dependency.

External dependency poses long-term disadvantages for the accumulation of financial, human, and even social capital. Dependent market economies are heavily reliant on external capital, a problem that can be considered an historical weakness of CEE, especially after periodic ‘transformation crises’ caused by frequent regime change and the accompanying transformation losses (Gál, 2013). Low- and middle-income competitiveness leads to a development trap in CEE: it hinders the formation of new, well-capitalized domestic enterprises, while encouraging skilled workers to move Westwards in pursuit of higher wages—leading to long-term human capital loss and faster ageing in Central Europe, and undermining the potential sources of catching up to the West (Lux, 2014).

In this chapter we have tried to answer the question of why even the most successful CEECs, being highly dependent on foreign capital and on (non-indigenous) MNCs, suffer setbacks from time to time and cannot fill the income gap existing between CEE and Western Europe.

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Notes

- 1 Est. 1989 in London.
- 2 Average purchase prices were minimal in CEE: the average amount of foreign equity invested in developed countries was US\$18 million, and in developing country subsidiaries it averaged \$4 million, while in CEE it has been only \$380,000 (Gowan, 1995).
- 3 CEE/South-Eastern Europe excluding Russia and Turkey lost the funding equivalent of 4.6% of GDP over this period.

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