Introduction
Foreign direct investment in eastern and southern European countries: still an engine of growth?

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1. Introduction

Foreign direct investment (FDI) has been driving economic growth in many countries of eastern and southern Europe. Eastern enlargement of the European Union was accompanied by an expansion of industrial capacities on the part of multinational corporations in the new member states, particularly in the 'Visegrád Four' countries (Czechia, Hungary, Slovakia and Poland). Capital inflows in banking and finance contributed to unsustainable growth patterns in some parts of the region, in particular in the Baltic states and southern Europe. These bubbles eventually burst in the economic crisis that hit in 2008. On aggregate, cross-border investments fell even more than domestic investment in 2009–2010. At the same time, however, foreign investors played a stabilising role in many sectors and central and eastern European exports, due mainly to foreign affiliates, bounced back. At the same time, the lack of competitive export potential had been exposed as one of the core problems in the economic structure of some southern European countries particularly hard hit by the crisis (Greece and Portugal).

This book investigates the role that foreign direct investment has played in the post-crisis period, comparing patterns across countries and sectors. An overarching objective of this publication is to assess the extent to which FDI can still be seen as a key driver of economic development, modernisation and convergence for Europe's low- and middle-income economies, taking into account also the risks and limiting factors associated with FDI. The book also maps the measures aimed at enhancing competitiveness pursued at both the EU and the national level. The main questions include the following. What role has foreign investment played in the period since 2008? Have we seen a qualitative change in the patterns that characterised the pre-crisis economic expansion? What have been the differences between countries and across sectors? What explains these differences?

FDI has apparently lost the growth-driving role that it had before the crisis. Apart from the forms of FDI that contributed to housing and asset bubbles – which have clearly proved to be unsustainable – also non-financial FDI has lost its dynamics and countries with high FDI penetration – such as as the 'Visegrád countries', but also Spain – were equally affected. In these countries, multinationals are no longer rapidly expanding their production capacities, but have entered a consolidation stage of expanding profitable operations through reinvestment. The main challenge at this stage is to upgrade the ways in which affiliates are integrated in European and global production networks and also to increase local income and investment from participation in these value chains.

In this publication we look at both country- and sector- specific FDI patterns. We focus on southern Europe (Spain, Portugal and Greece) and on a number of central and eastern European countries. Chapters with a sectoral focus examine the automobile, ICT manufacturing, business services, clothing and steel sectors. The former two are the leading manufacturing sectors with high FDI concentration in CEE and Spain, while the latter three feature important foreign capital-driven sectors with opposite dynamics (business services are expanding, while clothing and steel are on the decline). In order to provide a full picture the sectoral aspect also compares recent FDI trends with those in the pre-crisis boom period.

2. FDI and economic development

The strong reliance on FDI in central and eastern Europe and, to a lesser extent, in Spain appeared to represent a risk factor during the downturn in 2008 and 2009, having raised doubts about the sustainability of these countries' export-based and FDI-driven growth model. At the time, the political narrative in these countries was dominated by concerns about 'FDI dependence' and 'export dependence'. However, exports in nearly all central and eastern European countries began to surge from early 2010, in particular because the German economy, with which the central and eastern European countries are closely interlinked through subcontracting chains, started to exert a strong pull effect. At the same time, a number of the economic problems of the southern European countries during the intensifying euro-zone crisis proved to be linked to low levels of export potential and productive FDI penetration (in particular in Greece and to a smaller extent in Portugal). As a result, high

FDI penetration in central and eastern Europe again was seen more as a strength than a weakness, but concerns about its longer term sustainability remained.

Our approach to FDI in this publication synthesises macroeconomic analysis based on a balance of payments perspective with a sectoral view based on investor strategies and the branch-specific business models by multinational companies. In bridging the two perspectives we refer to the theoretical model of FDI and the multinational companies (Helpman 1984; Markusen 2004). One key element, as regards type of FDI, is to distinguish between horizontal and vertical FDI. In the case of horizontal FDI, the strategic aim of the investment is to explore new markets. In manufacturing, multinational companies replicate the same production process in a foreign country in order to explore its markets; they may also use their new production platform to explore the markets of neighbouring countries.

In the case of vertical FDI, multinationals organise a vertical division of labour between the domestic and host country locations in order to exploit differences of factor endowments and to increase efficiency by optimising value chains. Specific stages of production – often ancillary business services, such as accounting, but also labour-intensive elements of the manufacturing value chain – are relocated to foreign-based companies or subsidiaries to increase the competitiveness of the production chain as a whole.

Even if the distinction between purely ‘horizontal’ and ‘vertical’ FDI is more blurred in practice, it remains a useful basic discussion framework. Productive FDI in manufacturing industry creates export potential and can be considered an advantage and an economic driving force, although the spillover effects that strengthen the role of domestic firms remain fairly weak in most central and eastern European countries. In contrast, FDI that targets exploitation of the domestic market (finance, retail chains, real estate) is more controversial and may well be regarded as a risk factor.

An overview of the potential impact of FDI on host economies is provided in Table 1. These impacts can be analysed on the balance-of-payments, enterprise and whole-economy levels. We discuss them together with the experience of, in particular, the central and eastern European countries (see also Myant and Drahokoupil 2011).

Table 1 **Potential effects of FDI**

Positive	Negative
Balance of payments level	
Financial inflows as FDI comes in	Repatriated profits
Higher exports from multinational companies	Higher imports from market-seeking investors
Enterprise level *Privatisation specific*	
Survival; access to capital, technology, know how, distribution networks	Closure of privatised enterprises to eliminate competitors; labour shedding, reduced production
Increased R&D	Centralisation of functions in centres
Greenfield/General	
High-tech activities, higher skill levels, higher productivity, wages	Concentration on low-skilled, labour intensive, activities
Benefits from multinational company network	External control, dependence on decisions made abroad
Whole-economy level	
Spillovers to local firms of higher productivity, wages, management methods	Attraction of skilled workers away from local companies
Development of new activities, leading to higher competitiveness	Local firms unable to compete with multinational companies (+ multinational companies enjoy government incentives)
	Subordination of economic development to strategies of multinational companies
	Multinational companies may favour home base when difficulties arise

Source: Adapted from Myant and Drahokoupil (2011), Table 15.3

The effect on the balance of payments should immediately be positive due to the inflow registered on the financial account. The long-term effect depends on the activities undertaken by the foreign company and has sometimes been associated with a worsening rather than an improvement in current account performance (for example, Mencinger 2007). In central and eastern Europe, the initial capital inflow was gradually balanced by an outflow of repatriated profits, meaning that, over time, the effect on the balance of payments could be increasingly negative unless balanced by a continuing inflow of new capital or by a strong trade surplus from export-oriented manufacturing.

Profit repatriation associated with high FDI stock indeed proved an important phenomenon as the investment cycles matured. A study by the Czech Office of Government revealed that it achieved a particularly high level in Czechia, where it exceeded 6 per cent of GDP in 2013 (Chmelař 2014). The biggest repatriators were the infrastructure sectors (electricity, gas, heating), financial services and telecoms. These sectors also generate low export earnings and foreign involvement may also have led to higher imports in 2013. Manufacturing investors were also substantial repatriators, but these sectors also generated high export earnings.

On the enterprise level, a concern specific to privatisation to foreign investors in central and eastern Europe was that foreign companies might want to buy firms to eliminate a potentially troublesome rival, but this was not confirmed by experience. The worry reflected an exaggerated belief in the strength of the inherited technological base. However, there were more persuasive arguments that privatisation sale prices, particularly for some raw material producers, were very low and that domestic producers could have done just as well as foreign-controlled firms by continuing to produce products that were relatively easy to sell.

This was less of an issue for major export-oriented manufacturing enterprises, which had no future without a foreign partner. Foreign ownership met clear strategic objectives and, where major multinational companies were involved, prevented asset stripping. It brought financial strength and the resources to overcome difficulties arising from inherited debt. These firms were able to invest in new technology and modernisation. It also brought access to outside markets through international networks and brand names; the probing or dependence on the outward processing trade of domestically owned firms was therefore unnecessary. Foreign-owned firms could focus more on their long-term strategy (see Myant and Drahokoupil 2011).

A general concern at the enterprise level is related to the extent to which foreign ownership leads to an increase or decrease in activities that require higher skill levels – which contribute most to value added – and the extent to which it brings, or destroys, the higher-level activities that are typically concentrated in companies' home bases. Acquisition by foreigners could be followed by a general deskilling as enterprises are 'hollowed out', leaving only the lowest-level activities. However, evidence from the motor-vehicle sector points rather to an increase in research and development (R&D) activity, albeit much of it relatively routine and transferred to central and eastern Europe because of the lower wages for skilled labour there (Myant and Drahokoupil 2011). Much R&D has also been concentrated in a few larger establishments. Greenfield investment was less likely to be associated with significant R&D and that was particularly true of smaller-scale production activities, especially with small plants set up in industrial zones in later years, which required only basic skill levels. These were also more footloose and could easily be moved to a country with even lower labour costs once that appeared favourable. This provided employment and exports, but not a general upgrading of technology levels. The evidence in the chapters that follow points out to an uneven pattern of selective upgrading, with dynamics specific to individual sectors.

Finally, the whole-economy level covers impacts beyond the individual foreign-owned company. Media reports of poaching skilled labour and squeezing domestic firms were relatively frequent in central and eastern Europe, but its impact has not been quantified. Another possibility is that inward investment may have little impact on the wider economy, creating only what have been described as 'cathedrals in the desert' (Grabher 1992; cf. Hardy 1998). Studies have looked in many countries for spillovers to domestically owned firms in terms of better technology and management practices, but came up with only a very modest impact (Knell 2000: 200; Pavlínek 2004, 2008). However, seeking spillovers alone misses the extent to which FDI brought revival and development across whole sectors (see Pavlínek 2008; Myant and Drahokoupil 2011).

The extent of foreign ownership also brought dangers if the investors had only limited commitment to the national economy or if there was an over-reliance on a few sectors (notably automotive) should that sector face a general decline in demand. In such a case multinational companies would evaluate where to cut capacity and more peripheral operations would be likely to suffer first. The experience after 2008 discussed in this book represents a test case in this respect. It provides examples of relocations from the region and also of sectors that struggled (textiles) or experienced a prolonged decline (steel), but the overall pattern is that of a high level of commitment on the part of (non-financial) foreign investors to countries in which they are active. An overview of the main findings is provided in the next section, first from a macroeconomic perspective, then from the standpoint of sectoral patterns.

3. FDI after the crisis – a macro-perspective

The changing characteristics of FDI in the 11 new EU member states, as well as in two southern European member states Greece and Portugal in the years 2008 through 2014 are investigated in the chapter by Gábor Hunya. Data presented in the chapter show that FDI was one of the driving factors of the pre-crisis economic boom in the east and the south of the European Union when large capital inflows – especially in the banking and real estate sectors – contributed to economic overheating in several countries. In response to the new macroeconomic environment and financing conditions after 2008, FDI flows suffered a sharp decline. The partial recovery of cross-border investment in 2011 and 2012 was followed by an even deeper setback in 2013. FDI has lost its growth-engine function, while economic growth has become sluggish and new EU members' catching up to the EU15 slowed down.

There was no clear link between FDI stock and changes in GDP during the crisis. On one hand, Poland experienced soaring FDI and good growth performance; Lithuania, Slovakia, Estonia and Bulgaria also witnessed FDI expansion and growth during the four years of the crisis (see also Hunya 2014). In a number of countries – including Portugal, Hungary, Croatia and Slovenia – FDI growth was not sufficient to prevent economic contraction and thus GDP decreased even as FDI rose. Greece, on the other hand, has experienced an enormous drop in FDI and a significant decrease in GDP. The chapter comes to the conclusion that countries with high FDI penetration survived the crisis better than those with little inward FDI, but sees little chance that FDI will resume its growth-driving role in the near future.

In the second chapter, Gergő Medve-Bálint compares pre- and post-crisis FDI trends in the Visegrád countries at the regional and sectoral levels. While the general impact of FDI on regional development was positive, it also cemented or even sharpened regional disparities as a result of regions' asymmetrical integration into world markets. Regional distribution of FDI over time did not show any major shift in the locational preferences of foreign investors when comparing pre- and post-crisis periods; territorial concentration of foreign companies and their revenues even grew further. The author also underlines that capital cities were responsible for most of the revenues and the regions that had been preferred before the crisis retained valuable investments also after the downturn. As regards the sectoral composition of FDI, data indicate a decline in the share of capital-intensive manufacturing investments in the post-crisis period. On the other hand, an increase in the share of the services sector (especially wholesale and retail and in professional, scientific and business services) can be observed and the average size of newly established firms got smaller.

The chapter concludes that the crisis did not entail significant disinvestment in the Visegrád Four region and post-crisis regional economic performance shows a strong correlation with FDI penetration. Data indicate no shift in the locational preferences of foreign investors in the post-crisis period, which means that regional disparities are here to stay. A sectoral shift towards services seems to be a clear trend in all the examined countries. Data also showed that neither pre-crisis manufacturing nor post-crisis service FDI seem to be knowledge-intensive or high value-added; foreign firms still seem inclined rather to take advantage of the region's cheap, skilled workforce.

The relationship between FDI flows and competitiveness enhancing measures is addressed in the chapter by Tibor Meszmann. By way of a content and discourse analysis of the collected empirical material, it seeks to answer the question of how competitiveness enhancing measures in the southern and eastern EU peripheries in the adjustment period targeted FDI increases. Hungary, Latvia, Portugal, Spain and Greece are examined in detail, as these were also the countries where the EU launched a special financial assistance programme to remedy economic imbalances.

The author finds that approaches to competitiveness are fragmentary and change over time, especially in the adjustment period, compared with 2008. The notion of 'national competitiveness' is strongly linked with issues of external market shares (often also referred to as 'external competitiveness'), trade at various levels, costs and productivity (cf. Delgado et al. 2012: 6), but it is also closely associated with presence in strategic industries, investment or endowments in economies of scale. 'National competitiveness' thus includes both cost and non-cost competitiveness and although 'external competitiveness (of nations)' was initially used as a synonym, its use became narrowed to 'cost competitiveness' over time.

There is also a major difference in measures proposed and associated definitions of competitiveness between the European Commission, on one hand, and the IMF and the OECD, on the other. The IMF and – to a lesser extent – the OECD documents stress 'external competitiveness' (meaning 'cost competitiveness'); European Commission documents and recommendations were originally more concerned about R&D and innovation in a context of non-cost competitiveness (for example, the Lisbon Strategy), but during the adjustment period EC recommendations also shifted their focus to 'external competitiveness' in the sense used by the IMF and the OECD. As regards types of measure, the heaviest stress – especially in the adjustment period – was on improving the cost-competitiveness of business through decreasing labour costs and other administrative costs, improving the general business environment and by increasing price competitiveness by liberalisation and privatisation in sheltered sectors.

The recommendations for central and eastern European countries (Latvia and Hungary), on one hand, and two southern European countries (Portugal and Spain), on the other hand, differed. In particular, improving cost-competitiveness featured higher on the agenda in the south, especially in the form of wage cuts or moderation, whereas in the east the stress was more on structural measures, such as 'regaining investors' trust' in Hungary, or on improving the business environment in Latvia. The other difference is the complete lack of involvement of the social partners in the east. Social dialogue is judged as an important mechanism in the south for implementing competitiveness enhancing measures, but its significance fades in the adjustment period. The most radical case is that of Greece, as it combines extremes of both. Similar to Spain and Portugal, recommendations focused on cutting labour costs.

The exercise shows that targeting an increase of FDI or private investment within the broad category of competitiveness-enhancing measures (cost or non-cost based competitiveness alike) appeared only sporadically and in an indirect way. Supporting private investment by government measures only appeared now and then in a number of countries. The findings indicate also that the main structural reforms in all five cases, with varying intensities, addressed the 'institutional environment' for investors (including also foreign investors), but also institutions of industrial relations and public governance.

The author concludes that although structural reforms during the adjustment period produced significant changes, they did not necessarily increase national competitiveness in a qualitative and sustainable manner. While the balance of trade in goods and services improved and with the exception of Greece export shares in GDP also grew, 'structural reforms' did not produce the anticipated positive effect on growth and investment in any of the examined countries. The impact of competitiveness enhancing measures on private investment and more particularly FDI is inconclusive. Competitiveness enhancing measures specifically targeting FDI varied substantially in the five cases analysed: from general FDI (Greece), export-driven FDI (Latvia) to sector-specific 'good FDI' (Hungary, perhaps Portugal) or no FDI in the case of Spain. As the contributions to this volume show, the record varies greatly, but overall FDI stagnated or fell below its 2008 level.

The link between competitiveness enhancing measures and FDI inflow is addressed also in two other chapters. The chapter by Ricardo Aláez-Aller, Carlos Gil-Canaleta and Miren Ullibarri-Arce on auto assembly in Spain and its role in the respective value chain observes that recent decisions by MNCs to allocate production in Spanish plants may be linked to adjustment measures that resulted in labour cost reductions and greater flexibility of work. This apparent increase in the advantages of locating assembly operations in Spain was cited in the context of decisions made by Ford and GM to restructure their operations in Europe. The chapter shows that Spanish plants have benefited in terms of workload and quality of car models as firms sought to restore profitability in their European operations. As other major European assemblers have not made such radical changes in the location of their operations, it remains to be seen whether greater pressure on profit margins will result in a similar relocation of high-end models from previous core areas towards the old periphery. Only then will it be possible to state that the Great Recession has brought about a structural change in the geography of the value chain in the EU and that the place occupied by Spain in particular in that value chain has improved.

The chapter by Joaquim Ramos Silva on FDI in Portugal argues that the attraction of FDI to this country – with its low foreign investment penetration – after 2008 was driven mainly by short-term objectives such as the privatisation programme (prescribed to tackle the public deficit and debt problems) and other measures such as the fast-tracking of 'golden visas' to rich non-EU residents investing in real estate. Whatever the measures, FDI inflows have not been significant by international standards. As far as FDI outflows are concerned, it is a negative indication of the institutional environment that Portuguese firms intensified their relocation to other countries, mainly to the Netherlands, where conditions for conducting international operations are more favourable.

The author concludes that a strategic approach continues to be lacking in all dimensions of Portuguese policy towards (inward) FDI. What is effectively missing is an approach that is articulated with the necessary structural transformation of the economy towards increased international competitiveness and improved productivity, both based on advanced factors (such as technology and the use of better qualified employees). Clearly, this was not the path that was followed and short-term objectives – relatively easy to implement given the circumstances – largely prevailed over any other policy consideration.

4. Developments in key sectors

The second part of the book looks at FDI developments in some key sectors – automotive, ICT manufacturing, business services, clothing and steel – in more detail and compares them with the patterns observed before 2008. The automotive sector in Europe, at the time of economic expansion in the period up to the crisis, was characterised by a division of labour that benefitted both source and target countries, with an expansion of employment in target countries and stabilising employment in the source countries. In ICT manufacturing, a volatile market with footloose contract manufacturers was in search of new market opportunities. As the market was expanding, tensions were only local, but the overall trend was employment growth (a win-win situation of a kind, but in an insecure environment). FDI in business services in central and eastern Europe was in its initial phase during the early 2000s and started to gain momentum when the crisis came and brought a temporary setback, then expansion continued. In contrast, the clothing industry was leaving Europe and represented a negative sum game even in boom times. Similarly, in the steel sector, downscaling and reorganisation had been the major processes in the early and mid-2000s. This was linked in central and eastern Europe to the commitments associated with EU accession. In that phase, however, FDI still played a crucial role in the form of takeovers and reorganisation.

The *automotive* sector is characterised by vertically integrated production networks organised by original equipment manufacturers (OEMs) that work closely with first-tier suppliers.[1] Petr Pavlínek's analysis of developments in this sector argues that the 2008–2009 global economic crisis

1. First-tier suppliers are direct suppliers to OEMs.

coincided with the end of the period of rapid expansion of the central and eastern European automotive industry related to the opening up of the central and eastern European region to foreign trade and FDI in the 1990s and the European Union membership in the 2000s. Development is no longer based predominantly on building new greenfield factories, but increasingly on consolidating the existing spatial structure of the automotive industry in the form of expanding profitable investments through reinvestment. This consolidation phase is typified by continuing process and product upgrading and by the much more selective and uneven functional upgrading of the central and eastern European automotive industry. Although this upgrading is crucial for maintaining the competitiveness of the CEE automotive industry, it is unlikely to alter its peripheral position in the European automotive industry division of labour, which will continue to be based largely on low labour costs compared with the western European automotive industry core. The pressure to control rising wages in the central and eastern European automotive industry is likely to intensify through inter-plant competition, the intensification of the labour process in the form of process upgrading and also through the selective devaluation of national currencies. This chapter also argues that large inflows of FDI led to the restructuring and rapid development of the automotive industry in central and eastern European countries at the expense of excessive foreign domination and control, possibly limiting the industry's potential for future economic development and for closing the gap between central and eastern European and western European economies.

The *information communication technology (ICT) manufacturing* sector can be regarded as a forerunner in international production-sharing. In ICT manufacturing vertical specialisation of original equipment manufacturers resulted in the disintegration of the production chain as contract manufacturers took over different stages of manufacturing. They then reintegrated the manufacturing process and emerged as electronics manufacturing service providers with a global footprint. The chapter by Magdolna Sass shows that central and eastern European countries became important locations for electronics manufacturing. The foreign-owned operators were even able to gain in terms of their relative shares of production, employment, value added or R&D during the crisis, while domestically-owned companies proved vulnerable in the crisis. Overall, the five CEE countries were able during the crisis to increase their shares in European electronics FDI, production and, to a lesser extent, value added, and probably were able to slightly reduce their dependence on imported inputs. At the same time, the Mediterranean countries basically stagnated in all areas, due less to the increase in the CEE shares and more to larger shares of certain 'old' EU member states – especially Germany – in European production and value added.

Thus the restructuring of European electronics production progressed further during the crisis years and changed direction to some extent, reflecting the changes in the competitiveness of individual EU member states and their differing specialisation in the various, heterogeneous segments of the electronics industry. Overall, if we assume the continuation of these trends, a further increase in the importance of the CEE countries can be expected in the European electronics industry.

The chapter by Grzegorz Micek examines recent FDI trends in *knowledge-intensive business services (KIBS)* in central and eastern Europe, focusing on Poland. In statistical terminology the KIBS sector includes IT services, legal services and accounting, activities of head offices, architectural and engineering activities, scientific R&D, advertising and market research. The author emphasises that knowledge-intensive business services may vary significantly in terms of the type of knowledge and skills used and these operations may be standardised and easily offshored. It is not a uniform sector, either, in view of the wide variety of occupations represented. While FDI in the sector is on the decline globally, in the CEE region both FDI stock and employment have been growing continuously during the crisis. Poland has become an emerging core of the sector in the region as the crisis brought more investments from the United States and developing countries. Trends of spatial de-concentration – away from Warsaw, towards cities with 300,000 inhabitants – were observed, with locational factors of lower wages and targeted government incentives as a key factors. Availability of skilled labour was an important but not a decisive factor for investors, given that most business services FDI is not knowledge-intensive. As regards the sustainability of FDI-based growth in the sector, the author finds a high likelihood of further growth in the short term. At the same time, long-term threats can be identified, such as the relocation to countries outside Europe as a result of growing wage and labour costs in Poland. A related risk factor appears to be lock-in in the less attractive, less knowledge-intensive FDI segment of the sector.

The chapter by Smith and Pickles explores the ways in which regional concentrations of export-oriented *clothing production* sustained employment in often peripheral regional economies when, particularly during the

1990s, de-industrialisation was occurring in other branches. It examines how increasing competitive pressures started to unravel these regional production systems, leading to a much more differentiated landscape of firm-level strategies and uneven upgrading capacities among enterprises. Within the context of further economic crisis-induced restructuring over the past five years, the chapter highlights the ways in which proximity to key western buyers – often through joint ventures and foreign direct investment – has been one way in which production has been sustained in some peripheral regional economies. The chapter highlights the role of foreign ownership in firm responses to these increasing competitive pressures, especially the role of proximity to buyers, foreign investors and consequent connections to primary markets in sustaining production of particular products during times of liberalisation and crisis.

Finally, the chapter by Vera Trappmann addresses the evolution of the central and eastern European *steel sector* in a European context. Although crisis in the European steel sector is not a new phenomenon, the current downturn has amplified some earlier negative trends. In western Europe steel was the first sector to be subject to supranational regulation, but national intervention continues due to overcapacities and the threat of site relocation. CEE countries were forced to reduce capacities in the EU accession process, while subsequent restructuring-related modernisation made them more resistant to closures in the post-2008 period. Shrinking overall demand was due to the downturn in the auto industry and the more long-lasting collapse of the construction sector and led to persisting overcapacities in the steel sector. The European steel sector lost 66,000 jobs between 2008 and 2014: western European steel producers suffered five plant closures, while in central and eastern Europe the biggest job losses due to bankruptcies and restructuring were seen in Poland and Czechia.

As for FDI trends, the author argues that because the energy-intensive sector has gradually reduced its capital stock since 2009 German metal producers have been cutting their investments in central and eastern Europe. As further consolidation and mergers continue to take place, investment is targeting non-European locations due mainly to cheaper energy, access to raw materials and large-scale auto industries. In terms of international competition, Chinese steel exports to Europe remain the biggest challenge due to lower costs, subsidies and cheap credit (hence the ongoing anti-dumping lawsuit). The chapter also identifies firm strategies that result in fierce downward competition, adversely affecting labour and social standards and giving rise to large-scale social dumping. Growing pressure for flexibility is associated with potential or actual relocation and an illustrative case demonstrates how benchmarking of site performance is used by multinational companies to play off individual sites against each other. Finally, the author calls for policy intervention at the EU level. Employment standards need to be modernised and stabilised in order to halt the downward spiral.

5. Limits of the FDI-driven growth model

The crisis has marked a breaking point in the growth and development model of European middle income economies in eastern and southern Europe. The period of high growth fuelled by external financing of different kinds – cross-border bank loans, leveraged financial investments, horizontal and vertical FDI – has apparently come to an end since the onset of the crisis in 2008. Financial and asset bubbles were burst and the structural weaknesses and vulnerabilities of these economies, masked earlier by high growth, were fully exposed. These structural weaknesses also called into question the role of productive FDI as a driver of modernisation and sustainable growth. At the same time, the crisis coincided with the end of a longer cycle that was marked by FDI expansion in central and eastern Europe linked to the opening up of the region and its subsequent EU accession.

All this suggests that the golden era of FDI is over, as, on one hand, FDI flows from 2008 onwards suffered a substantial setback that seems to be more than just a cyclical effect. With the single exception of business services, all sector-specific chapters in the present publication describe an FDI downturn. FDI has lost its growth-engine function, while economic growth has become sluggish and the catching up of new EU members to the EU15 has slowed down. Moreover, as is evident from both the macroeconomic and sectoral chapters, there is also a deeper-rooted qualitative issue that limits the development effect of FDI in the longer run. Apart from scattered anecdotal evidence, spillover effects of foreign affiliates to the domestic economy are scarce (even in ICT manufacturing and the business-services sector, as chapter authors emphasise); upgrading of value added content by foreign affiliates is at best selective and uneven; and the specialisation of central and eastern European economies in international value chains largely remains linked to the comparative advantage of low labour costs.

The value-capture problem thus appears to be a factor limiting the benefits of FDI: although upgrading in multinational company subsidiaries can improve employment quality and wages, it does not automatically allow affiliates to capture a higher share of the total value added (cf. Szalavetz 2015). Even more depressing is the fact – reflected in a number of chapters in this publication – that the targeted policy interventions to attract and upgrade FDI in terms of quality or to broaden its regional dimension seem to have had only a limited effect. Government declarations and policy objectives were clearly aimed at attracting more productive, manufacturing FDI, but evidence shows lower FDI and a shrinking share of manufacturing.

The overview of competitiveness enhancing measures at both national and European level found no link between these measures and FDI flows. The author also concludes that although structural reforms during the adjustment period produced significant changes, they did not necessarily increase national competitiveness in a qualitative and sustainable manner. The chapters on Spain and Portugal also show that, apart from ad hoc effects, the competitiveness of these countries did not improve and concepts and policies for qualitative development in raising non-price competitiveness were entirely missing. The focus of European adjustment policies on price and cost competitiveness can be regarded as counter-productive also for CEE countries. While one of the major challenges these economies are facing is how to abandon the low-wage specialisation trap, crisis adjustment policies further strengthened this profile. The sectoral and regional overview underlines that, despite policy efforts to broaden the regional scope of FDI towards less developed regions a concentration of FDI intensified further during the crisis and thus contributed to growing regional inequalities.

The overall picture thus seems to confirm a view that middle income economies on the southern and eastern periphery of the EU need to rely on other growth engines than FDI to continue the process of convergence with the high-income countries. The reliance on FDI seemed to work as a convenient policy shortcut. It has thus been argued that FDI can compensate for a weakness of domestic institutions, such as those providing companies access to skills and capital (Nölke and Vliegenthart 2009). However, future development may need to combine utilisation of capabilities developed in the foreign-controlled sector with reliance on domestic sources of innovation and growth.

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