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wiiw FDI Report Central, East and Southeast Europe: Slump despite Global Upturn

Not FDI but EU and other international funds have been the main external financing resources of investments in the region recently. In 2015, the FDI inflow to Central, East and Southeast Europe (CESEE) fell to its lowest level since 2008, while global FDI recovered. The decline was especially severe in the EU member states of Central and Eastern Europe (EU-CEE) as well as in Russia, while expansions were recorded in the Western Balkans and Turkey. Forecasts for FDI in 2016 point downwards again, because the international environment may not support capacity expansions and also economic growth in most of the CESEE will be less robust than last year.

Global FDI flows expanded by 36% in 2015 and reached their highest level since the financial crisis, USD 1.7 trillion (UNCTAD estimate). **FDI inflows to the CESEE declined by 26.7%** in 2015 after an expansion in 2014 (wiiw FDI database). The 2015 decline was as much as 43% in the EU-CEE region, in the CIS+Ukraine 45%. At the same time, the Western Balkans and Turkey booked an increase of 48%.

In the EU-CEE countries FDI inflows are not only much smaller than they had been earlier, but also fluctuate erratically. Croatia, Estonia, the Czech Republic, Hungary and Poland received unusually low inflows in 2015 compensating for the 2014 upbeat; more abundant inflows in Lithuania, Slovakia and Romania followed relatively weak years. Thus the size of FDI inflow has lost connection with economic growth or changes in the business environment in a year when GDP growth accelerated all across the EU-CEE.

The interpretation of FDI flow data has been blurred in more advanced EU-CEE countries: capital reserves, losses and profits are shifted around within multinational conglomerates in various forms of FDI and income. Tax optimization of multinational enterprises has become a main determinant of the economic sector and of the immediate home country of investors. Subsidiaries of various activities have been **organised into holdings** which provide room for balancing profits and losses over various fields of activities and locations. **The Netherlands and Luxembourg are among the top investors** in the CESEE while outward investments target **Cyprus and the Caribbean islands** which allow for the lowest corporate taxes world-wide. **International action to restrict the use of tax havens and offshoring may create more clarity in the future.**

Especially Russian FDI flows have been dominated by the local oligarchy's capital transfers. FDI related capital flight amounted to EUR 15 billion in 2015. Meanwhile FDI in Russia contracted also due to the depreciation of the Rouble. In addition, the embargo on Russia has diverted investors providing technology, while the Russian import ban generated substituting foreign investments in the food sector.

On the positive side, greenfield investment activity grew in the CESEE in 2015 against 2014 (based on fdimarkets.com). The number of freshly announced projects rose by some 8%, the pledged amount of investments by almost 20% and the expected number of new jobs by 11%. Mainly manufacturing multinationals announced to expand by setting up new subsidiaries in the production of parts or assembling products. **The share of manufacturing in new projects increased** from 37% in 2014 to 45% in 2015; and in terms of investment capital pledged the figure rose from 49% to 52%. New foreign manufacturing projects initiated in Russia, Turkey and the Czech Republic were responsible for almost the total CESEE increase in the number of greenfield projects. In terms of capital, the increase was primarily due to projects in the Czech Republic, Slovakia, Turkey and Kazakhstan.

FDI inflows from Austria were sluggish in the Czech Republic and Hungary while Serbia and Montenegro reported increasing Austrian investment activities in 2015. According to the National Bank of Austria (OeNB), the CESEE was the target for 44% of Austrian FDI outflows in 2015, a lower share than in 2014, while the amount of FDI (EUR 4.9 billion) was more than twice as much as in the previous year.

Over the years, the Austrian FDI stock has shifted away from the CESEE countries, mainly in favour of the US and Asia. The CESEE region held 48% of Austrian outward FDI stock in 2010, 46% in 2012, but only 36% in 2015 (OeNB data adjusted to wiiw definition of CESEE). The recent decline was mainly due to **capital withdrawal and loss of assets value in Russia**. The main beneficiaries of Austrian FDI in this period included the US and China, as well as the Netherlands and the United Arab Emirates. The main CESEE destinations for Austrian greenfield investment projects has shifted from neighbouring countries (primarily the Czech Republic) to other destinations, including the Western Balkans (Bosnia and Herzegovina, Serbia) where Austrian firms can still find untapped opportunities.

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Table 1 / Foreign Direct Investment in 2015

	Inflow EUR mn	Inflow growth in %	FDI net EUR mn	Inflow as % of GFCF	Inward stock as % of GDP	Inward stock of AT share in % 2014
Bulgaria	1.593	19	1.516	17	88	15
Croatia	157	-94	145	2	55	29
Czech Republic	1.103	-73	-976	3	63	13
Estonia	187	-51	-88	4	85	2
Hungary	1.163	-79	-218	5	78	10
Latvia	578	29	564	10	55	1
Lithuania	775	. 1)	784	10	36	1
Poland	5.100	-46	3.300	6	39	4
Romania	3.044	26	3.322	8	40	16
Slovakia	724	. 1)	889	4	57	15
Slovenia	896	12	954	12	28	34
EU-CEE	**15.319**	**-43**	**10.192**	**6**	**42**	**11**
Albania	882	1	871	31	46	8
Bosnia and Herzegovina	225	-41	206	8	42	21
Kosovo	324	115	287	24	56	5
Macedonia	157	-23	171	8	46	13
Montenegro	630	68	619	87	117	4
Serbia	2.116	41	1.804	35	80	16
Turkey	15.100	57	10.515	12	21	6
Western Balkans + Turkey	**19.435**	**48**	**14.472**	**13**	**25**	**7**
Belarus	1.444	2	1.336	10	34	3
Kazakhstan	3.627	-43	3.071	10	66	1
Moldova	206	36	191	15	56	.
Russia	8.836	-60	-15.048	3	20	3
Ukraine	2.670	761	2.716	25	69	6
CIS-4 + Ukraine	**16.782**	**-45**	**-7.734**	**5**	**27**	**3**
Total region	**51.536**	**-27**	**16.930**	**7**	**32**	**7**

AT: Austria.
EU-CEE: European Union-Central and Eastern Europe.
CIS: Commonwealth of Independent States.
FDI net: inflow minus outflow.
GFCF: Gross fixed capital formation.

1) No growth rate given due to change from negative to positive values.
Sources: wiiw Databases incorporating national and Eurostat statistics, May 2016.