

# Foreign Direct Investments and Their Disproportional Effect on the Economics of the CEE-7 Countries

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## Abstract

*The aim of the article is the disproportional effect of the receipt of foreign direct investments (FDI) into the economics of the CEE-7 countries. To achieve the goal we comprehend disproportional effect of FDI in the structure of foreign investments inflow to the countries of CEE-7 by the types of economics activities in the periods before and after EU accession.*

**Keywords:** *Disproportion, foreign direct investments, extensive, intensive development, integration, speculation, financial crisis.*

**JEL Classification:** F42

## Introduction

World practice testifies that effective usage of the potential of foreign direct investments is the efficient instrument of economic development on the basis of intensification, modernization of production, implementation of innovations, increase of resources usage effectiveness and contemporary management usage.

Due to the change of geopolitical conditions on the European continent, namely after the CEE-7 countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia) accession to EU, investment map of the world was increased by big the group of countries, namely new EU members, with considerable possibilities for foreign direct investments (FDI).

Issues of involvement and regulation of foreign direct investments in general and in the context of integration processes were investigated in the works of such foreign scientists as J. Daninh, J.Keynes, A.Marshall, J.Mil, T.Ozava, R.Mirdala, M.Porter, L.Peltek, M.Rohalski, P.Samuelson, L.Torou, P.Fisher, M. Friedman, D.Holland, H.Hanson. Among Ukrainian researchers this problem was covered by V.Budkin, O.Havrylyuk, P.Haydutsky, V.Heyets, S.Hutkevych, Ye.Hrebennikova, D.Luk Lukyanenko, S.Zaharin, I.Ivanov, V.Lyubimov, O.Kazakova, N.Makariy, Yu.Makohon, V.Martsin, V.Melnyk, O.Nosova, T.Matsybora, A.Navoy, A.Poruchnyk, S.Pysarenko, O.Rohach, V.Fedorenko, A.Filipenko, V.Hobta, O. Shnyrkov, L.Shynkaruk, I.Shkola etc.

However it is important to notice that the topicality of this research is in the concentrated thought that the globalization process which is accompanied by the creation of the common world economic space has rather utopian vision of this process, through significant

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disproportions of economic development of the countries. Discrepancy with the world standards of macroeconomic indexes level, multidirectional politics of further economic development, cultural differences, which to a great extent influence the positioning of the role of economic development in the general concept of nations world view, - all these factors create preconditions for the appearance of integration phenomenon, which is the process of mutual promotion, differentiation and cooperation intensification between national economic systems [1]. Inherently integration processes are directed towards standardization of economic systems of the countries, separate regions with common borders and to the maximum resembling features in all the spheres of people's life activity and unification of regulatory mechanisms.

### **Goal and Methodology**

Increasing scales of foreign capital receipt create new challenges which require more weighed regulative politics, building of clear and transparent system of priorities, which would allow ruling the investment sphere taking into consideration the requirements of national economic safety. Confirmation to this is a global financial crisis of 2008 and post-crisis development that uncovered essential disadvantages in the investment sphere of many countries. It fully concerns also the CEE-7 countries, most of which had rather painfully filled crisis risks peculiar to market economics, which are tightly bounded with disproportions in foreign direct investments into the country receipt and their uncontrolled flow-up during the crisis. That is why the need in the improvement of investment activity regulation with taking into consideration the branch priorities of foreign direct investments involvement in the CEE-7 countries in the conditions of EU membership is the obvious and topical theme, especially in respect to this disproportions overcoming.

It, in its turn, determined the aim of our investigation, which is in the illustrating the influence of disproportional income of foreign direct investments into the economics of the CEE-7 countries. To reach this goal the following task was posed: to comprehend the disproportional influence of the foreign direct investments in the structure of foreign investments receipt into the countries of CEE-7 by the types of economics activities in the periods before and after EU accession.

The object of the research is the foreign direct investments in the conditions of CEE-7 countries integration to EU. The subject of the research is the organizational and economic mechanism of FDI involvement into the CEE-7 countries in the context of integration to EU, financial and economic increase from the side of the country-recipient or speculations from the direction of the investor.

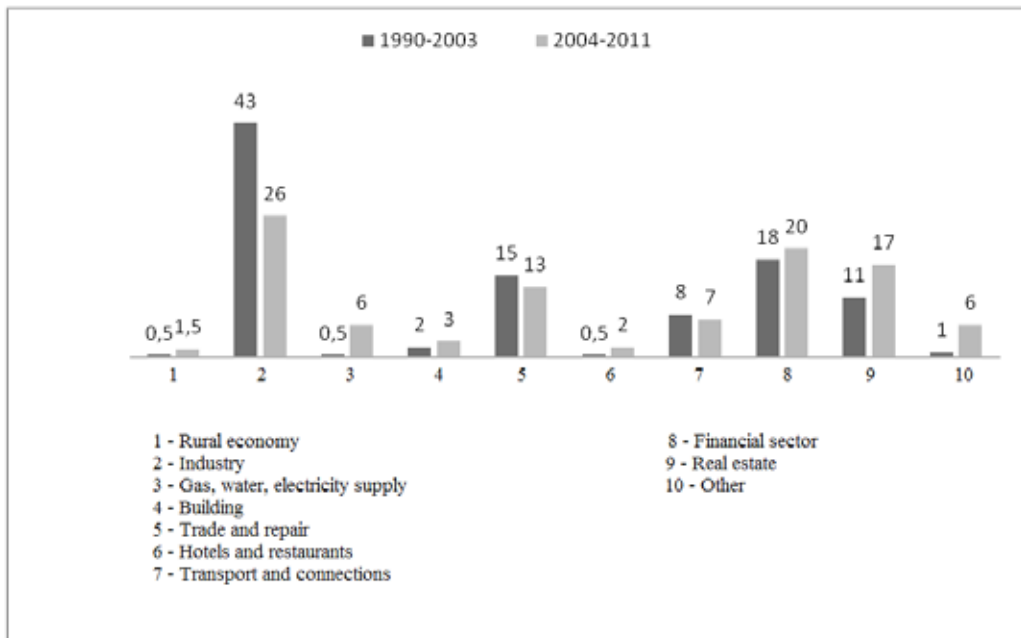
Rather often the receipt of the foreign direct investments into the CEE-7 countries after the EU accession to the privatization and real estate objects acquisition, existing assets, banks and other financial establishments, logistic and trade networks, had abundantly not only short-term, but also speculative character. In its turn, such investment wasn't enough for promotion of modernization, intensification of economics, resource saving, creation of new workplaces, development of small and middle business and intensification of innovation activity.

## Discussion

By conducting the analysis of the report data of the National Banks of CEE countries (see Fig. 1), which concerns the directions and extent of FDI indexes involvement showed that general sum of investments, involved by CEE-7 countries in the period after the EU accession, in comparison with the period before the accession is characterized by significant increase. In such a way we see that the biggest growth of FDI was in rural economy, building and real estate sphere. The scope of FDI in gas, water and electricity supply, mining operations and financial mediation had also increased. The smallest growth of capital investments was marked in industry and hotel and restaurant business [2; 3; 4; 5; 6; 7; 8; 9; 10; 11; 12].

Figure 1

**FDI receipt into the CEE-7 countries by the types of economic activity in the periods 1990-2003 and 2004-2011 (data stated in %)**



Source: own proceeding

By analysing figure 1 we can mark the significant change of the priorities of the foreign investors. But for provision of economic reproduction the FDI into creation of new manufactures, workplaces, new types of production on the basis of modern technologies implementation are considered to be the most effective. Investment to the rural economy is not less effective and profitable for the country-recipient, as this branch is considered to be granted and requires constant financial support. CEE-7 countries, taking into consideration insufficient in comparison with EU-15 countries, infrastructure development, stimulate pointing of foreign direct investments into infrastructure objects, mostly through the mechanisms of state private partnership.

Rather interesting for the examination is the thought of American economist, expert in economics of the developing countries, Dani Rodrik, who considers that the country is able to provide intensive increase of economics with the help of foreign direct investments only in the condition of directing them into branches with high productivity of labour [2]. To confirm this idea we can examine the following situation.

Supporting the conclusions of many experts, we consider, that foreign direct investments in the financial sector and real estate play disproportional ambivalent role. On the one hand they fill the financial system with the circulating capital that promotes stable liquidity of financial system of the country, which has positive meaning. But on the other hand, the predominant part of foreign direct investments into this sector creates grounds for extensive development of national economics, as in the conditions of low-powerful spheres of production and lack of financial market development in the sphere of fictitious capital flow prevention, these investments can play mostly speculative role. In other words, we can state that if the investments are not priory directed into the real sector of economics, then investments into the financial sector testify the transfusion of the capital from one financial institution to the other, change of owners or attempts to achieve high profits on the financial market, and not in the sphere of production. That is why it is worth to take into consideration that investment mostly to financial sectors can bring more risks to the national economics of countries-recipients, which was confirmed by the last financial crisis. We could also feel it by the example of Ukrainian economics.

Each of the CEE countries is potentially interested in the involvement of FDI for the development and support of the branches of national economics. The confirmation of this is the analysis of the each branch of the scopes of FDI receipt to CEE-7 countries before and after EU accession (look pic.1). This comparison will give the possibility to make a conclusion about the sequences of EU membership influence on the involvement of FDI into the concrete branches of their economics.

After the CEE-7 accession to EU the biggest growth of FDI in the comparison with the period before the accession was admitted in rural economics (more than in three times). Stable increase in the agrarian sector is remains not only at the expense of FDI but also by the way of national investment and grants.

To the industry nestles the biggest nominal sum of the involved FDI in the CEE-7 countries during both periods, but the temps of growth demonstrate constant decrease of the interest of foreign investors to this branch. In such a way the temps of growth of foreign direct investments into the industry of investigated countries stay the lowest among all the types of economic activity – 10%.

In the sphere of gas, water and electricity supply can be observed the growth of foreign direct investments almost in all of CEE-7 countries after the EU accession. It indicates the huge interest in the development of the branch.

Receipt of foreign direct investments into the building after the EU accession of CEE-7 countries also increased twice. Countries of this region are interested in such investments,

as building is a labour-intensive branch and it has a big multiplicative influence on the general economic growth.

Significant meaning for the economic development has infrastructure, namely transport and connection. After the EU accession of CEE-7 countries, increase of the scope of foreign direct investments into this sphere was 18%.

After the EU accession of CEU-7 countries, the significant receipt of the foreign direct investments into the investment sector has occurred – 158%. During the membership period scales of foreign direct investments into the real estate sphere reached 48 billion US dollars.

One of the main directions of foreign direct investments receipt to CEE-7 countries is financial mediation. Nominal scopes of foreign capital, involved in this branch, have become the biggest after the scopes of capital investments of foreign investors to the industry. Though, the temps of increase of the foreign investment to the financial mediation considerably outgo the temps of industry investment. In the period after the EU accession financial sector of CEE-7 countries involved in 83% more investments then before the EU accession.

The results of the conducted FDI receipt research in the CEE-7 countries witness that considerable disproportional changes of the direction and structure of FDI had happened. It should be noted that the dynamics of FDI involvement into the branches of economics, which create the ground for the development of new contemporary technologies and innovations implementation, is gradually lost. Bigger interest of foreign investors is caused by the branches which don't belong to the real sector of economics with the fast circulation of capital and high income level. And it, in its turn, speaks of extensive character of DFI. One can suppose that investors intend to gradually buy up the attractive objects in CEE countries and don't aim to provide the development of national economics of new EU members. That is why we consider that each country has to conduct weighed politics of FDI involvement and define branch priorities for direction of the foreign capital flows.

We, in our turn can't disagree with the thought of Krutylko O.I., who indicates that the ties between foreign direct investments and processes of global economics have dual and changeable character and have to be examined in conjunction. Foreign direct investments stimulate globalization of separate processes (international trade, movement of production factors, international cooperation) on conditions of international competitiveness sharpening, visible resources restriction and crisis phenomenon [13].

At the same time movement of the foreign capital and the development of investment market requires:

1. Special level of information ground;
2. Unification of legislative base;
3. Development of investment institutions;
4. Internationalization and integration of organizational infrastructure;
5. Transnationalization of commercial ties, trade and financial markets [14].

From now on, in the process of adaptation of national economics to the realities of world economy, globalization processes become apparent in the internationalization of capital and backwards and cause typical features of the investment. This thought can be represented in the system “globalization (foreign direct investments → national economics → international economics → foreign direct investments) → globalization”

So, two-sided character of correlation of foreign direct investments and globalization must be examined as dualistic relations, which exist and develop in interaction with each other. From the position of foreign direct investment as a factor of globalization they form middling influence through the processes of concentration and centralization of capital, intensification of the role of multinational corporations and forming of global international financial market. Different forms of influence of foreign direct capital stimulate the manifestation of globalization as overall phenomenon. Foreign direct investments get into the constituents of the national economics of the country-recipient and, as a result, form the influence on investment, monetary, protectionist, taxation and social politics of the country. In the frameworks of investigation of the object of the article it should be noted that foreign direct investments immediately influence the integration of the country into the global economic space.

Besides, foreign direct investments are at the same time both the derivative of the integration and its main part, which is functionally realized in the principles of effectiveness, justice, stability, systematic character and adequacy. The character of the interaction of the integration processes and foreign direct investments differs, depending on the level of the integration, accordingly to the intensification of integration phenomenon causes expand of foreign direct investments.

## **Conclusion**

Taking into consideration the aforesaid we can make a conclusion about the necessity of state methods of regulation of involvement and branch direction of FDI, first of all, to the real sector of economics which will provide the intensification of the production and innovative development of the country. The main scopes of FDI were directed towards privatization, real estate, assets of resources and raw-materials and financial companies purchase and very little towards intensification of production, modernization of enterprises and their innovation development. The expand of the FDI was caused, first of all, by the large necessity and a slight, in comparison with countries-founders of EU, satiation of economics of CEE-7 countries with FDI, their geopolitical and fiscal attractiveness. Economic crisis has shown that the CEE-7 countries need active assistance in the involvement of the foreign capital to the real sector of economics. Outlined above directions are per se main branch priorities of FDI involvement for overcoming the disproportion development of CEE-7 countries.

Besides, we can certify that the main consequence of the change of emphasis of FDI among foreign investors was the decrease of the influence of investments into the increase of national economics, and also the weakening of investment tights between EU countries-members inside the association, and it in its turn is disproportion inside the Union itself...

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