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FOREIGN DIRECT INVESTMENT IN CENTRAL AND EASTERN EUROPE AFTER TWO DECADES OF EU ENLARGEMENT: SLOVENIAN AND HUNGARIAN PERSPECTIVES

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ABSTRACT

This article examines foreign direct investment (FDI) as an indicator of economic integration, focusing on Central and Eastern Europe (CEE) in the two decades they have been EU members. Although CEE countries have remained on the EU's periphery and struggled with development gaps, they have attracted substantial FDI, especially in the first decade after accession, fuelling the growth of outward FDI and integration into global value chains. Despite CEE economies like Slovenia and Hungary having seen differences in their use of FDI, such investment and European integration will remain central to the region's economic development, even amid the ongoing geopolitical tensions.

Key words: foreign direct investment, economic integration, Central and Eastern European (CEE) countries, global value chains (GVCs), Slovenia, Hungary

GLI INVESTIMENTI ESTERI DIRETTI IN EUROPA CENTRO-ORIENTALE DOPO DUE DECENNI DI AMPLIAMENTO DELL'UE: PROSPETTIVE SLOVENE E UNGHERESI

SINTESI

Questo articolo esamina gli investimenti esteri diretti (IDE) come un indicatore dell'integrazione economica, osservando nello specifico l'Europa centro-orientale (CEE) nei due decenni in cui è divenuta parte dell'UE. Sebbene i Paesi della CEE siano rimasti nella periferia dell'UE e abbiano lottato contro divari di sviluppo, hanno attratto ingenti IDE, specialmente nel primo decennio dopo l'adesione, alimentando la crescita di IDE diretti all'esterno e l'integrazione *nelle catene globali del valore. Sebbene le economie CEE come quella slovena e ungherese abbiano conosciuto differenze nell'uso degli IDE, questi investimenti e l'integrazione europea rimarranno centrali nello sviluppo economico della regione, nonostante le tensioni geopolitiche attuali.*

Parole chiave: investimenti esteri diretti, integrazione economica, Paesi dell'Europa centro-orientale (CEE), catene globali del valore (GVCs), Slovenia, Ungheria

INTRODUCTION[1]

During the 1990s, following a turbulent period of newly created states emerging in Central and Eastern Europe (CEE), countries in this region were looking for proven and fast recipes to propel their development. Liberalisation, arising entrepreneurial spirits and ambitions for growth met with limited domestic markets (low purchasing power) and insufficient financial resources for technology and innovation. The West, and all Western markets and enterprises (along with Western products and services) were highly appreciated and viewed as the preferred model of development.

Both foreign direct investment (FDI) and economic integration were seen as facilitators of economic growth and development and therefore as the best tools, almost a short-cut making the required developmental leap. FDI in CEE was primarily regarded as a source of capital, managerial knowledge and modern technology (Javorcik, 2004; Alfaro et al., 2004; Bloom et al., 2012), while European integration as an accelerator of trade and investment, but also as a synonym of the rule of law, stable and quality institutions and security for the mainly small, yet geopolitically exposed CEE states (Chen, 2009). Notwithstanding certain fears that FDI would take the national silverware and economic sovereignty away (Šušteršic & Rojec, 2010), FDI played an important role in the process of transforming CEE countries into market economies, contributed to productivity and considerably influenced their export capacity (Hunya, 1997; Svetličič & Rojec, 2003; Bevan & Estrin, 2004; Kalotay, 2006; Greenaway & Kneller, 2007; Damjan et al., 2013). During the 1990s, individual countries' attractiveness to foreign investors varied, where the level and method of privatisation and the country risk had important roles in determining where the flows of FDI ended up. The region became more appealing to investors especially after the association agreements were signed in 1991, with most FDI in the CEE region chiefly stemming from the EU, indicating that the trade and agreements had an impact on investment flows (Gelbuda et al., 2008; Baldwin et al., 1997). The goal of

1 This article is the result of the research programme P5-0177 *Slovenia and its Actors in International Relations and European Integrations*, funded by the Slovenian Research and Innovation Agency (ARIS).

advanced economic integration thereby played a role in shaping FDI flows by reducing barriers to trade and investment, harmonising regulations, and expanding market access.

The 'FDI & integration' approach's attractiveness as a toolbox for the transition process of CEE economies was based on theory (such as the effects of regional free-trade agreements on trade and investment flows (Egger & Pfaffermay, 2004) or empirical evidence from the gravity models (Blonigen & Piger, 2014)), but also on the experience of the single market, which showed that FDI and economic integration have always been closely linked and significantly influenced each other (Dunning, 1997; Neary, 2002; Kalotay, 2006) and were also included in the advice given to them by international organisations like the International Monetary Fund (IMF) and the World Bank (WB) early on in the transition (cf. Fischer & Gelb, 1991).

FDI can accordingly be used not simply as an indicator of success in the transition process, but also as an indicator of success with economic integration. Although the impact of economic integration on FDI was rarely discussed in the main textbooks on European economic integration at the start of the enlarged EU (Baldwin & Wyplosz, 2006; De Grauwe, 2018; El-Agraa, 2011), it can occur in many dimensions and increases as the integration deepens (e.g., common market vs. free-trade agreements). Successful economic integration typically enlarges the market and lowers (bilateral) trade costs, making it more attractive for foreign investors to invest in integrated markets. Such a cutting of costs can lead to increased inflows of FDI as companies can supply larger markets from a single location and, in turn, optimise their operations and costs. However, the success of integration in attracting FDI can vary between the member states of a union. More attractive countries tend to receive a bigger slice of the FDI pie, while less attractive countries may experience lower FDI due to the relocation of investment within the integrated region. When FDI is reallocated, the benefits of integration might not be evenly distributed. A country's ability to attract FDI is closely linked to its institutional framework, including the rule of law, property rights and regulatory efficiency. Countries with higher quality institutions and greater economic freedom tend to attract more FDI since these factors reduce investment risks and add to investor confidence (Carstensen & Toubal, 2004). FDI creates stable and lasting links between countries and facilitates not only the flow of capital, but also the transfer of technology, exchange of knowledge, and creation of jobs. These links are vital for sustainable economic growth and the success of integration because they promote interdependence between member states and support regional stability.

This contribution investigates the relationship between the FDI and European integration, more specifically how the EU's 'big bang' enlargement in 2004 has influenced FDI in CEE countries. We review the trajectories of FDI in CEE in the two decades of their full EU membership. The analysis considers the CEE countries that joined the EU on 1 May 2004 (Cyprus, Czechia, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia) and Croatia, which on 1 July 2013 became the 28th EU member country.

Available studies on FDI and EU integration reveal positive development effects (Blomstrom & Kokko, 2003; Egger & Pfaffermayr, 2004), enhanced productivity horizontally within industries (Rojec & Jaklič, 2004; Haskel et al., 2007) and vertically up and down supply chains (Javorcik, 2004; Damjan et al., 2013) coupled with other spillover effects (Rojec & Knell, 2018) apart from less positive impacts (Gál & Lux, 2022). Nevertheless, historical overviews can help with understanding: (i) how has 20 years of EU membership influenced the FDI landscape in CEE economies; (ii) how has FDI influenced CEE economies' integration into the EU; and (iii) how has FDI in CEE influenced EU FDI overall. Analysing perspectives from Hungary and Slovenia (as an example of a middle power state and a low power state, respectively) provides deeper insights into the varied experiences of FDI and EU integration among countries in CEE. To accomplish these goals, we first discuss FDI developments in the EU following the enlargement in 2004 on both the EU level as a whole and within the new member states, the position of CEE economies within global value chains (GVCs) and present the experiences of two countries – Hungary and Slovenia – in more detail. The concluding section discusses the challenges posed by FDI in CEE and the EU in the future where a new complexity of geopolitics is shaping FDI and the development of integration in the EU.

THE EVOLUTION OF FDI AFTER THE EASTERN ENLARGEMENT

The volume of FDI inflows (and stocks) can be used as a performance measure to assess the effectiveness of economic integration initiatives. A high level of FDI may indicate successful integration, whereas stagnant or declining FDI may indicate challenges in the integration process or unattractive conditions for investors. Beyond mere inflows, the quality of investment – such as the creation of well-paid jobs and sustainable practices – can also serve as an important measure of integration success.

EU membership has been associated with an *FDI premium* (a rise in FDI), suggesting additional benefits for countries within the union, with membership having been found to have boosted FDI inflows by 14%–38% between 1985 and 2013 (Bruno et al., 2016). When exploring the impact of EU membership on FDI for a later period (1985–2018), Bruno et al. (2021) established that EU membership led to about 60% higher FDI investment in the host economy from outside the EU, and around 50% higher intra-EU FDI. A positive FDI premium was identified in all previous EU enlargements (e.g., Spain and Portugal in 1994) and a negative one for the United Kingdom following Brexit (Baldwin & Wyplosz, 2023).

A case study on Central and Eastern European countries is meaningful given that the increase in inward FDI already followed the announcements about future EU membership on FDI in the 1990s (Svetličič & Rojec, 2003; Bevan & Estrin, 2004; Medve-Bálint, 2013; Bruno & Cipollina, 2018). Despite variation across CEE regions and time periods, FDI was a significant investment source during the transition process. FDI increased further upon full EU membership. CEE countries that joined the EU attracted FDI earlier and, even from a global perspective, the CEE region today stands out in terms of both degree of global value chain participation and size of inward FDI stock – two strongly interrelated phenomena. The evolving FDI landscape following the EU's 'big bang' enlargement and its implications for investment patterns and economic dynamics within the region are depicted in Charts 1 and 2. Chart 1 shows the steady rise of inward and outward FDI stocks, taken as a percentage of GDP in the EU in the first decade. Until the beginning of the Great Recession (2008), EU countries were particularly prominent among global investors as their share in world outward FDI was nearly 50% (at the same time almost 90% of global outward FDI flows came from advanced economies). The EU and other advanced economies attracted between 60% and 70% of total inward FDI flows, and CEE economies held the lion's share.

The global economic and financial crisis had a strong impact on FDI. The CEE region was among those hardest hit by the economic crisis, with FDI inflows plummeting by almost 40% after 2009 (Kalotay & Filipov, 2009; UNCTAD, 2010; 2013). The recovery in CEE and the EU was gradual. As a region of high technological competence and sophisticated brands, the EU strengthened by the single market and the Union's innovation policies (El-Agraa, 2011) attracted much of the FDI from developed but increasingly also from emerging markets. Mainly market- and strategic asset-seeking FDI from emerging markets began to dominate in the EU following the global recession. Similar trends were noticed in CEE.

Charts 2 and 3 shows the increase in FDI inward and outward stocks (measured in % of GDP) in the 'new' EU member states that joined the EU after 2004. Inward FDI flows and stocks rose rapidly in all CEE countries after entering the EU and in most countries remained stable afterwards (they encountered small(er) fluctuations than during the transition).

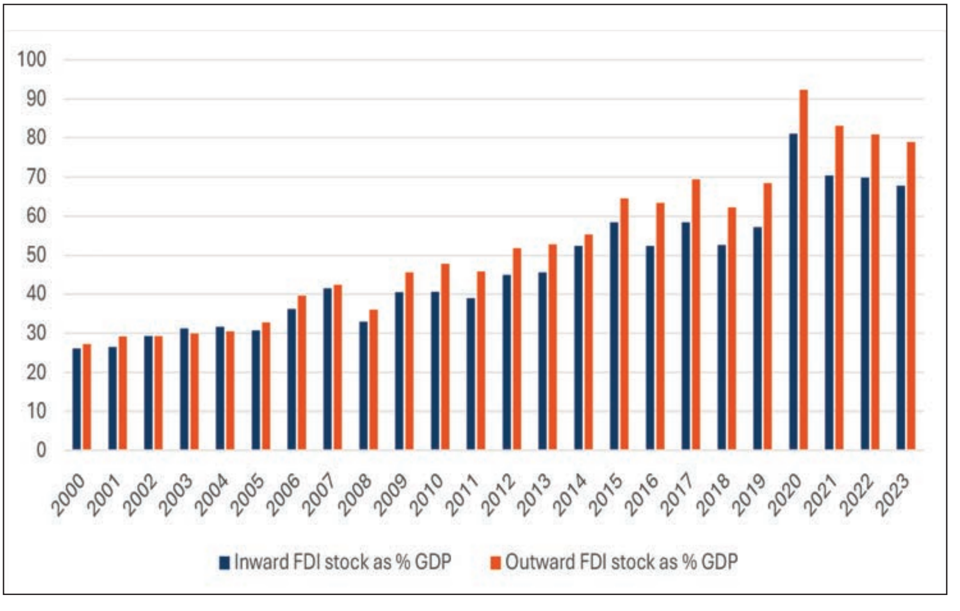

Chart 1: Inward and outward FDI stocks in percentage of GDP in the EU (2000–2023) (UNCTAD Statistics).

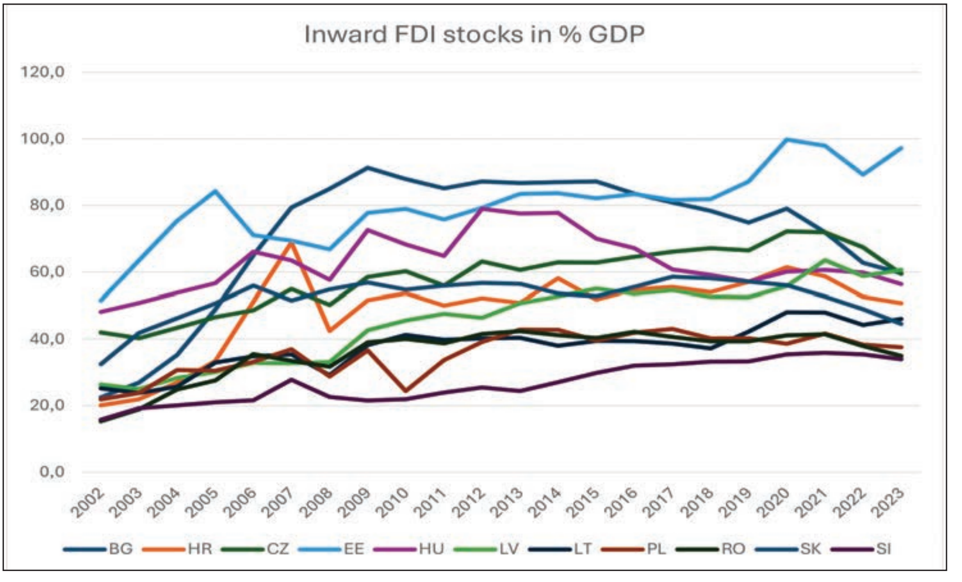

Chart 2: FDI inward stocks in % of GDP in CEE economies that entered the EU (2002–2023) (wiiw FDI Database. https://wiiw.ac.at/fdi-database.html).

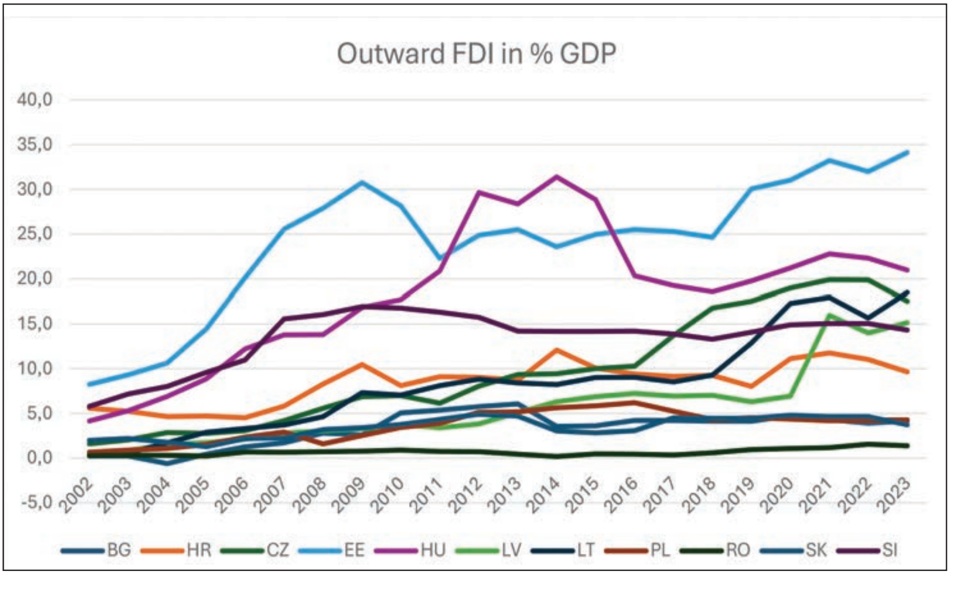

Chart 3: FDI outward stocks in % of GDP in CEE economies that entered the EU (2002–2023) (wiiw FDI Database. https://wiiw.ac.at/fdi-database.html).

CEE economies generally attracted FDI to their manufacturing industries (Damjan et al., 2013) and these industries were also the most important exporters and outward investors (Svetličič & Rojec, 2003; Jaklič & Svetličič, 2010). The commitment to exports and technological innovation attracted foreign investment that proved crucial for economic development. Even though CEE countries still lag behind old EU members in research and development spending (noting that R&D remains largely based in Western European corporate headquarters), they were actively promoting policies that fostered innovation and supported the establishing of advanced manufacturing facilities, thereby creating jobs and boosting local economies.

The shift to high-tech manufacturing called for a workforce equipped with new skills. CEE countries were investing in education and training programmes to address the skills gap in areas like business, engineering, IT, and data analytics. This investment was essential for maintaining competitiveness, attracting FDI and ensuring that local industries effectively participated in advanced supply chains (Rojec & Jaklič, 2013). FDI was important for knowledge and technology transfer and led to spillover effects for domestic producers (Damijan et al., 2013), albeit often below the initial expectations.

The tradition of manufacturing along with technological innovation (further spurred by the European research and innovation policy and smart specialisation strategy) also acted as a key driver of supply chain localisation in the CEE region after the COVID-19 pandemic. By enhancing manufacturing capabilities (including digitalisation and robotisation), responding to geopolitical challenges, attracting investment, and fostering the development of skills, CEE countries were well positioned to capitalise on the opportunities created by the evolving global supply chain landscape and the reshoring/friendshoring/nearshoring trend (Ponikvar et al., 2023). This transformation not only supported economic growth but also helped with the region's integration into the broader European and global economies.

THE INTEGRATION OF CEE INTO GVCS

The strategic geographical and economic advantages and tradition of FDI and skilled labour in CEE countries have been harnessed to consolidate their status as major hubs in several industries. This shift was accelerated by major global events such as the COVID-19 pandemic and the conflict in Ukraine, which have not only disrupted immediate operations but also required that the stability and security of supply chains be reassessed on a long-term basis. CEE has emerged as an important player in the reshaping of global supply chains.

The CEE countries have been increasingly positioning themselves as dynamic players in the global supply chain, offering a wealth of opportunities for economic progress, innovation and a defining role in the development of international trade. While traditionally regarded as a peripheral region, over the last two decades CEE has become an important hub within the EU in the complex web of global production, logistics and trade that connects virtually every corner of the globe. 'Made in Europe' is thus ever more likely to involve CEE.

The urgent need to diversify supply chains and possibly to relocalise to reduce the risks of geopolitical unrest, transport costs and delays has become apparent. Multinational companies are looking for ‘permanent’ changes in global supply chains and a balance between localisation and globalisation. A recent report by PwC (2022) states that one-third of CEOs in Central and Eastern Europe mention supply chain instability as a critical factor influencing future business strategies.

The automotive sector is an example of the region’s growing importance. Countries like Poland, Czechia, Hungary, Slovakia, Slovenia and Romania have become important players in the global automotive supply chain. These countries have attracted considerable investment from car manufacturers around the world due to their skilled labour, strategic location, and favourable economic policies. In addition, the shift to electric vehicles has led to the region playing an important role in battery production and assembly, representing an important contribution to sustainable mobility.

Next is the rise of CEE countries from an outsourcing destination to an innovation centre, especially in the manufacturing and IT sectors. Countries such as Estonia, Slovenia, Lithuania, Romania and Poland are known for their IT expertise, competitive cost structures, and burgeoning technology ecosystems, making them attractive to companies looking for IT outsourcing or R&D centres. These countries put strong emphasis on STEM education, government support and an entrepreneurial spirit that is driving innovation in software development, cybersecurity and AI.

The ongoing conflict in Ukraine has, however, shown the region’s vulnerability and resilience. The initial disruptions and high energy prices have underscored the impact on industries reliant on Ukrainian and Russian resources. Despite these challenges, CEE countries have shown remarkable adaptability and made efforts to diversify their supply chains and strengthen regional cooperation and economic integration. The Three Seas Initiative (3SI) is an example of such efforts aimed at improving the region’s infrastructure and consolidating its role on the global stage.

The fact that firms from CEE countries are integrating ever more strongly into global supply chains means the region is on the cusp of a transformative era. With their strategic geographic advantages (even in the new context of geopolitical risks), commitment to innovation and a skilled labour force, CEE countries are vital for the dynamism of global industry. The region’s resilience and ability to adapt to challenges give the foundations for future growth and it may play an important role in shaping the landscape of global trade and investment also in the future.

INSIGHTS FROM HUNGARY AND SLOVENIA

Hungary and Slovenia are interesting case studies for considering the interplay of FDI and European integration given their unique historical backgrounds, economic transformations, and strategic positions within the EU. The transition to market-oriented systems in both countries required FDI to stimulate economic growth, modernise industry and integrate into European markets. Although Slovenia experienced FDI to and from abroad much earlier than Hungary – inward FDI in Slovenia already existed during the socialist regime, with Slovenia also being a pioneer among CEE countries in outward FDI early on in the transition period – FDI accounted for a relatively small share of GDP (Charts 2 and 3) and has been relatively lower than in Hungary. Between 2004 and 2023, inward FDI stocks in Slovenia rose from 20% to 33% of GDP. Hungary, in contrast, became a much larger and significant recipient of FDI, attracting around 50% of total FDI flows to transition countries in the last decade. FDI stocks in Hungary accounted for 53.8% of GDP in 2004 and 56.4% 20 years later (wiiw FDI Database). Regarding outward FDI, Slovenia's relative advantage after it joined the EU disappeared completely within two decades; in 2023, outward FDI in Hungary amounted to 21% of GDP and in Slovenia to just 14.3%. The following two sections present insights into country-specific characteristics.

FDI in Hungary

Among countries that started to promote FDI at the start of the transition process, Hungary was a leader in opening its economy to FDI. Hungary was a 'heavily indebted' country according to the World Bank classification (Bod, 2018) since, based on the experience with the 1956 revolution, Hungary's political regime had prioritised the population's well-being and maintenance of high living standards even during periods of stagnation and recession (Kornai, 1995). The net foreign debt stock of Hungary amounted to EUR 11.8 billion at the end of 1990, representing around 70% of GDP (KSH, 2010). The rescheduling of the large foreign debt was infeasible given the related negative consequences and because most of it was owed to foreign commercial banks. Among others, opening to FDI was part of the solution because FDI provided financial means to repay debt and could positively impact Hungary's transition to a market economy. This has been reflected in the active FDI policy pursued by consecutive governments (Antalóczy & Sass, 2023).

In 1990, the first freely elected government aimed to attract large investors despite the unstable circumstances of an evolving market economy. The government provided direct support to foreign investors in the form of fiscal (tax) and other (mainly industrial free-trade zones) incentives. Moreover, foreign investors were allowed to participate in privatisation and acquire full ownership. Connected to privatisation, EUR 4.6 billion in FDI was realised between 1991 and 1997 and the stock of FDI exceeded EUR 10 billion in 1996 (KSH, 2010). Major MNCs (the German Audi, the Swedish Electrolux, the US General Electric and General Motors, the Japanese Suzuki) invested in Hungary. In 1996, the country joined the OECD, declared limited external convertibility of the currency and began negotiations on EU accession. New investors: the Dutch Philips, the Finnish Nokia or the US IBM implemented large greenfield projects. As privatisation was largely over, reinvested earnings and other capital along with the arrival of suppliers and subcontractors of foreign-owned subsidiaries already in operation were the biggest sources of FDI (Antalóczy & Sass, 2023).

The EU accession negotiations entered their final phase in 2002. This provided a boost to FDI by joining the EU's large internal market and regulatory framework and offering low-wage (skilled) labour and geographically close production sites with good infrastructure for EU MNCs (Kalotay, 2006). At the same time, by complying with EU state aid regulations all of the countries in the accession process had to change their incentive systems, which led to an easing of the ever stronger competition over incentives in the CEE region, establishing a level playing field for the countries affected (Bellak, 2004). Rising wages and changes in FDI policy towards trying to attract projects with a positive impact on the economy encouraged the exit of some assembly activities, such as IBM in 2003. On the other hand, foreign MNCs started to extend their activities to R&D (the German Audi, Bosch and Knorr-Bremse) and export-oriented services (the US GE, Morgan Stanley, the French Lexmark or the Indian Genpact or Tata etc.). In 2005, privatisation-related FDI again came to prominence due to the increasing external imbalances and urgent need for financing. This led to another period of FDI policy being subordinated to other policy aims (Antalóczy & Sass, 2023). In 2007, the stock of FDI represented over 60% of GDP (Chart 2).

In 2010, the incoming government introduced a new FDI policy, favouring efficiency-seeking, GVC-related, export-oriented FDI and aiming to do away with market-seeking projects, especially in various (public) services (Sass, 2017), causing a slight decline in FDI stock from the peak of above 80% of GDP in 2012 to around 60% by 2019 and afterwards (Chart 2). Particularly after the COVID-induced crisis, government policy chiefly targeted export-platform type Asian investors (Korean, Japanese, Chinese, Indian), producing for EU-markets especially in the production of electric cars and their parts and components – due in part to their availability and the positive response to incentives and access to EU markets offered by Hungary.

Hungary's FDI-based strategy was stimulated by various requirements linked to EU accession, which contributed to the modernising of basic state institutions and thus had a positive development impact (Bruszt et al., 2020). FDI assisted with a quick transition to a market economy, to economic growth, to the creation of mostly good jobs and to increasing innovative activities. In certain industries, through growing competition (banking – OTP Bank, today one of the important players in Slovenia) or through supplier linkages (plastics: Jászplasztik or Karsai Holding), it helped successful Hungarian MNCs to emerge and hence the increase in outward FDI. EU countries (notably Germany, whose share has fluctuated around one-quarter) and Austria (around 10%) were the main sources of FDI. Foreign-owned subsidiaries soon played a determining role in the economy, especially in some manufacturing industries (automotive and electronics), but also up until the mid-2010s in certain (public) services (some were nationalised or returned by the Orbán government to domestic hands (Hunya, 2017)). FDI inflows are closely linked to the fact that Hungary is deeply involved in GVCs led by German, other European, US and most recently Asian firms and has contributed significantly to maintaining the international competitiveness of several EU industries. Hungary's development path may be classified as a dependent market economy (Nölke & Vliegenthart, 2009) or the FDI-led and GVC-related growth model. Still, the problem with this GVC-related model is that in the present circumstances the manoeuvring room of the government of a small EU economy is very limited in the short to medium term when it comes to ensuring and increasing the positive impact of the GVC-linked FDI on the host economy. Indeed, a 'dual economy' was developing in Hungary already in the 1990s with limited backward and forward linkages and other positive spillovers from foreign-owned companies, thus seeing many domestic firms dealing with productivity and competitiveness problems. Drahokoupil and Fabo (2020) showed the limited contribution of foreign-owned firms to the development of local skills and capabilities, while other studies provided mixed evidence on technology transfers and the spillovers from them (Iwasaki & Tokunaga, 2016).

The vulnerability of this FDI-based development model to external shocks and its lower-than-expected positive impact on the domestic economy has become especially clear following the 2008–2009 crisis. This led to a change in FDI policies in 2010 whereby efficiency-seeking export-intensive projects were generously supported (Éltető & Antalóczy, 2017), but attempts were made to push out those aimed at the domestic market. Nonetheless, despite the rhetoric, the FDI-based development path has been maintained in Hungary, still mainly reliant on EU, but also increasingly on Asian FDI. (Actually, 2021 and 2022 were both all-time record years in terms of FDI inflows.) Correcting the shortcomings of this path by magnifying the positive and minimising the negative impacts is crucial with respect to the Hungarian economy's future development.

FDI in Slovenia

Slovenia has always presented itself as a European country, with exports to Western Europe already occurring during socialism and internationalisation through FDI started even before the transition. The strong export orientation stemming from the small domestic market and pre-transition experience with (inward and outward) FDI helped Slovenian enterprises internationalise rapidly after the disintegration of former Yugoslavia, giving the country access to new technologies and knowledge via inward FDI and making it a pioneering outward investor among transition economies (Jaklič & Svetličič, 2010). This facilitated the reorientation from the markets of former Yugoslavia to developed (generally Western European) markets. Since the country's independence, the dynamics of FDI were determined by changes and developments in the macroeconomic situation, the privatisation process, and changes in the regulatory framework concerning FDI, but even more by external factors, the EU integration process of Slovenia and other transition economies, as well as globalisation trends (Jaklič et al., 2009).

The early transition stage (1990–1993), namely the first wave of internationalisation, was characterised by FDI from Western companies, the rapid growth of outward FDI, but also divestments and restructuring. The mid-1990s (1994–1998) saw a rise in inward FDI due to the privatisation process and slow progress in outward FDI activity, which was mostly carried out by existing Slovenian MNEs that consolidated and strengthened their networks of foreign affiliates. A new, turn-of-the-millennium internationalisation wave, after the Europe Agreement had arrived in 1999, sped up FDI inflows into attractive companies, the growth of existing foreign affiliates along with outward FDI by existing Slovenian MNEs and newcomers which broadened and strengthened their networks of foreign affiliates.

FDI then enjoyed continuous growth from the end of the 1990s until the global economic crisis commenced. EU membership further facilitated trade and FDI between Slovenia and other EU member states as well as with non-EU countries. Apart from some larger peaks because of individual larger foreign acquisitions, FDI inflows exhibited steady trends until 2008 and inward FDI stock rose from EUR 5.5 billion in 2004 to almost EUR 12 billion in 2009. In the 2000–2010 period, Slovenia's economy grew faster than most other EU member states, with rising incomes, growing domestic consumption, falling unemployment, low inflation, and burgeoning consumer confidence. However, Slovenia had the lowest (only 20%) share of FDI stock in GDP among the new EU member states in 2004 and kept this position throughout the first and second decades of its EU membership. Inward FDI amounted to 27% of GDP in 2014 and 34% in 2023 (Chart 2). All other new EU member states recorded higher absolute and relative FDI growth. Apart from Slovenia, Romania and Lithuania, all CEE members of the EU exceed the EU average (47%) inward FDI stock to GDP ratio.

Following the global recession, FDI inflows became more volatile (where any major investment/divestment was quite noticeable in a small market). A sharp decline in FDI inflows was observed in 2009 and 2013, while in 2014 FDI inflows recovered slightly after the privatisation process was resumed. FDI inflows dropped again in 2020, likely an effect of the COVID-19 pandemic, rebounded in 2021 (joining the global trend of a booming M&A market with acquisitions in banking and manufacturing), and declined again in 2022 when even FDI in Europe had generally stalled. While foreign owners in the past generally came from the West (EU, Switzerland, USA), a considerable number of foreign investors in the last decade of EU enlargement came from other 'new EU member states' and EU candidate countries. Examples of CEE-CEE ('South-South') investments are the Croatian investment in the retail and food industry, the Hungarian investment in banking (OTP's acquisition of SKB), the Serbian investment in the food and tourism industry etc.).

FDI outflows also saw greater volatility in the second decade of EU membership. An increase in outflows was detected after the global recession (2013) and again after 2020, largely due to the post-COVID adjustment related to the disruptions in GVCs and the need to establish closer contacts with new and existing markets. In 2022, Slovenia saw a record volume of FDI outflows, reflecting the adjustment made in response to risks and disruptions in the GVCs and the search for new markets post-pandemic, the war in Ukraine and increased political risks. Still, Slovenia (with 15% of outward FDI stock in GDP) also lags behind Czechia (18%), Estonia (22.6%), Hungary (22.7%), Latvia (16%) and Lithuania (18%) in the share of outward FDI in GDP (WiiW data).

FDI in the second decade of EU membership thus contributed less to growth and development than in the first decade when foreign affiliates represented between 4%–5% of firms in the corporate sector, yet foreign affiliates were responsible for over 40% of exports and over 25% of employment and value added of the corporate sector (Bank of Slovenia). FDI effects were observed in firms' productivity growth, greater export intensity, innovation, but also spillover effects (Damijan et al., 2013). Slovenia also did not realise the full potential of the emergence of nearshoring (friendshoring) FDI near to Western Europe that began to develop after the pandemic between 2022 and 2023 (Irwin-Hunt, 2024), and attracted only a minor share of investments in CEE.

Both foreign and domestic investors identified similar obstacles in the business environment that are felt even faster and more intensively in the country's small domestic market. Surveys of foreign direct investors mentioned several barriers to direct investment (Jaklič & Rojec, 2014; Jaklič & Koleša, 2018; 2020; 2022), such as the weak rule of law (lack of legal certainty and unpredictable court rulings and timetables), uncoordinated macroeconomic policies, poor communication between public institutions, slow progress on key infrastructure and, more recently, elevated political risks and limited availability of (skilled) labour (Jaklič & Koleša, 2022). The European Commission's 2022 Country Report – Slovenia attributes Slovenia's persistently poor performance in attracting FDI to the role of the state and the strong influence of state-owned enterprises.

In any case, Slovenia's membership in the EU has overall helped it to maintain the country's competitiveness, as reflected in the ever increasing participation in GVCs, especially during the era when GVCs were booming. Looking at the 20 years of membership today through the lens of the economy, this appears to be an underutilised opportunity that has not quite lived up to the expectations. The awakening of productivity and integration of Slovenian companies into GVCs was accompanied by dormant national policies and institutional development and an invisible contribution to EU policies, despite access to EU funds and programmes that support economic growth, innovation and development.

The key lessons emerging after two decades are in line with the predictions made in textbooks: While the economic integration of a small economy has increased economies of scale and the speed and complexity of internationalisation strategies, which has proven essential for integrating into the GVCs, any hopes for the rapid development of quality institutions with long-awaited structural reforms to boost productivity have unfortunately been dashed. Even though EU accession has not brought the expected progress in the domestic business environment and in the development of institutions, the (most competitive) companies have appreciated the benefits of a larger common market and integration into the EU.

CHALLENGES AND OPPORTUNITIES AHEAD – CEE AND THE EU IN THE NEW COMPLEXITY OF GEOPOLITICS

Two decades of full EU membership have given CEE economies an advantage in attracting FDI, not only in volume but also in type. Although the expected effects were higher than what was achieved, CEE economies have managed to attract FDI in manufacturing, trade, banking and knowledge-intensive services, often also associated with R&D. Once known for its traditional labour-intensive manufacturing, the region is now on the cusp of a profound transformation driven by automation, reconfigured supply chains and the urgent demand for new skills. The most profitable industries in CEE are still foreign-owned. The development of a domestic economic base remains limited, albeit they have managed to develop some multinationals of their own. Two decades of promoting entrepreneurship (largely thanks to European policies) have led to many new companies and successful start-ups, but most of them end up abroad in the growth phase due to the poorly developed domestic capital markets and (still unpredictable) institutions.

The region's future also depends greatly on both FDI and the development/survival of EU integration. The two countries under study both demonstrate challenges related to their FDI strategies and European integration. Slovenia, for instance, is keeping the status quo in the FDI market. It is grappling with concerns about its ability to influence EU decision-making processes as a smaller member state, particularly in the light of discussions on differentiated integration within the EU (Bučar & Udovič, 2023). Hungary, on the other hand, has seen a decline in intra-EU investments, but reassessed its attractiveness as an investment destination while further diversifying its economic relations. Both Hungary and Slovenia exemplify the critical role that FDI has in facilitating economic transformation and integration into the European Union. Their experiences show the complexities and opportunities that arise from navigating the intersection of foreign investment and European economic policies. While the glamour of the West and the EU may have faded, FDI and economic integration continue to be an important path to growth and development for CEE countries (notably the small ones).

CEE is seeking to retain a stable position in the FDI landscape, yet a major role as both the source and destination of FDI is now being taken on by emerging markets. This is proving increasingly challenging as the new phase of reorganising GVCs comes with greater protectionism. The number of restrictions worldwide with effects on cross-border trade and FDI has risen sharply in recent years. Investment and financial flows are driven ever more by geopolitical alignment rather than economic distance. Access to the market is not only difficult in non-EU markets, but new barriers and costs are also continuously emerging in the region along with higher taxes in national economies. The EU and the USA plan to discourage imports from China by raising tariffs, and amplifying a China+1 strategy by diversifying sourcing, have led to a considerable reconfiguration of global capital flows. Chinese investments are moving to countries from where exporting to the USA and the EU is free and easy. Some CEE economies (like Poland and Hungary) are beneficiaries of the relocation (apart from some other emerging market economies like Morocco, Vietnam, Indonesia), while others (especially smaller ones) mainly face increased costs caused by new barriers, war risks, and the changing world order. The integration of CEE into GVCs will not simply determine their development, but also the position of the EU as a whole.

Foreign direct investment is an important mechanism for overcoming trade barriers, combating protectionism, promoting economic integration and reducing the risks associated with geopolitical conflicts. The scale, scope, nature and political support for FDI play a role in the management and movement of capital. Therefore, FDI has been the engine of growth, but also the reason for the different positions among CEE economies before EU integration, over the two decades of EU integration and will continue to do so in the future.

TUJE NEPOSREDNE INVESTICIJE V SREDNJI IN VZHODNI EVROPI 20 LET PO VELIKI ŠIRITVI EU: PRIMERA SLOVENIJE IN MADŽARSKE

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POVZETEK

V prispevku obravnavamo neposredne tuje naložbe (NTI) kot večplastno merilo uspešnosti ekonomske integracije in prikažemo zgodovinski pregled dinamike NTI v državah srednje in vzhodne Evrope (SVE) v dveh desetletjih polnopravnega članstva v EU. Čeprav so srednje in vzhodnoevropska gospodarstva ostala večinoma na obrobju EU, se soočala z zamudami pri dohitevanju razvoja in so imela relativno majhen vpliv na oblikovanje politik EU, jim je v dveh desetletjih uspelo (tudi če jih primerjamo z drugimi državami v svetu) pritegniti znatne količine vhodnih NTI (zlasti v prvem desetletju polnopravnega članstva), povečati izhodne NTI in razviti lastna domača večnacionalna podjetja (MNE) ter doseči visoko stopnjo vključenosti v globalne verige vrednosti (GVV). Nadgradnja in napredovanje znotraj GVV (na pozicije razvojnih dobaviteljev z višjo dodano vrednostjo) je sicer potekalo počasneje od pričakovanj. Spremembe v modelu rasti, ki je v zadnjih 20 letih temeljil na neposrednih tujih naložbah, zahtevajo revizijo industrijskih politik, povečano uporabo novih tehnologij, ohranjanje in povečevanja (nivoja) znanja in večja vlaganja v inovacije v gospodarstvih SVE. NTI in evropsko povezovanje bodo še naprej med najpomembnejšimi dejavniki gospodarskega razvoja v državah SVE tudi v obdobju povečanih geopilitičnih trenj, predelovalna industrija in vpetost teh držav v GVV je pomembna za EU kot celoto. Primerjava izkušenj iz Slovenije in Madžarske pa kaže, da kljub skupni poti obstajajo razlike v izkoriščenosti neposrednih tujih investicij in gospodarskem povezovanju.

Ključne besede: neposredne tuje investicije, gospodarsko povezovanje, države srednje in vzhodne Evrope (CEE), Slovenija, Madžarska

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APPENDIX

Table 1: FDI inflows and outflows (in Million EUR) in CEE economies that entered the EU (2003–2023) (wiiw FDI Database 2024).

Country	Direction	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Bulgaria	inflow	1851	2736	3152	6222	9052	6728	2437	1170	1476	1321	1384	347	1998	940	1606	968	1639	2974	1517	2631	3619
Bulgaria	outflow	23	-166	249	141	206	522	-68	237	287	253	141	201	124	366	293	211	401	216	268	533	553
Croatia	inflow	1762	950	1468	2576	3600	3691	2122	885	1144	1021	682	2175	68	250	468	1016	2660	966	3793	3409	2542
Croatia	outflow	106	279	192	202	214	1053	847	75	214	-40	-54	1490	-126	-1761	-652	175	-779	230	783	-241	1089
Czechia	inflow	1863	4007	9374	4355	7634	4415	2110	4637	1668	6217	2769	4141	419	8873	8454	9330	9030	8261	7651	8794	7199
Czechia	outflow	183	817	-15	1170	1184	2959	684	881	-236	1394	3055	1221	2243	1973	6712	7341	3688	2624	6538	5396	6521
Estonia	inflow	822	771	2307	1432	1985	1249	1324	1139	723	1078	516	416	100	933	1131	1208	2727	3100	89	959	4233
Estonia	outflow	137	217	556	882	1277	780	990	126	-1046	680	329	-73	250	431	224	-39	1669	256	-651	799	1393
Hungary	inflow	1888	3439	6172	5454	2852	3145	1415	1352	1727	4096	2062	5150	2298	3880	5136	5566	3123	4641	6707	8566	5365
Hungary	outflow	1914	1114	1808	3576	3235	700	1156	307	576	1538	830	2071	860	1318	3021	2954	2296	2430	2955	3623	2784
Latvia	inflow	271	513	568	1326	1698	863	68	286	1045	863	680	676	666	230	659	814	827	878	2794	1333	1122
Latvia	outflow	44	89	103	136	270	166	-45	14	44	150	310	408	63	145	126	175	-92	223	1965	109	539
Lithuania	inflow	160	623	826	1448	1473	1225	-323	770	1294	624	432	-100	951	273	904	827	2699	3080	2366	2055	1764
Lithuania	outflow	34	212	278	232	437	419	399	32	539	421	99	44	340	39	71	596	1560	2516	1119	348	966
Poland	inflow	4067	9978	7069	12720	15896	8415	7239	9659	11453	9667	2730	10755	13758	14181	8142	13555	12069	12135	24719	29931	25732
Poland	outflow	269	498	1531	4116	2674	1273	1303	4640	738	2257	-340	2184	4501	10484	1926	755	1656	1136	2679	6016	9332
Romania	inflow	1946	5183	5213	9061	7250	9210	3358	2263	1700	2489	2713	2421	3461	4517	4797	5266	5173	3005	8940	10039	6594
Romania	outflow	36	56	-24	337	204	187	-69	-38	-20	-89	-211	-282	507	4	-86	321	324	46	119	1233	37
Slovakia	inflow	1914	2441	1952	3741	2618	3200	-4	1336	2512	2321	-455	-386	96	728	3556	1418	2243	-2104	1539	2756	167
Slovakia	outflow	219	-17	120	408	438	362	651	714	513	7	-236	32	5	86	1173	272	39	305	251	411	82
Slovenia	inflow	271	665	473	513	1106	832	-343	80	782	264	-114	791	1510	1126	795	1172	1307	193	1561	1937	1020
Slovenia	outflow	421	441	516	687	1362	961	154	-14	143	-201	-161	207	241	262	300	238	545	454	1146	649	500