

Growth-Innovation-Competitiveness: Fostering Cohesion in Central and East Europe

External trade and foreign direct investment

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***1. Policy
conclusions of
research on
trade***

Weakening
supply capacity:
deteriorating cost
competitiveness

Export performance and supply capacity

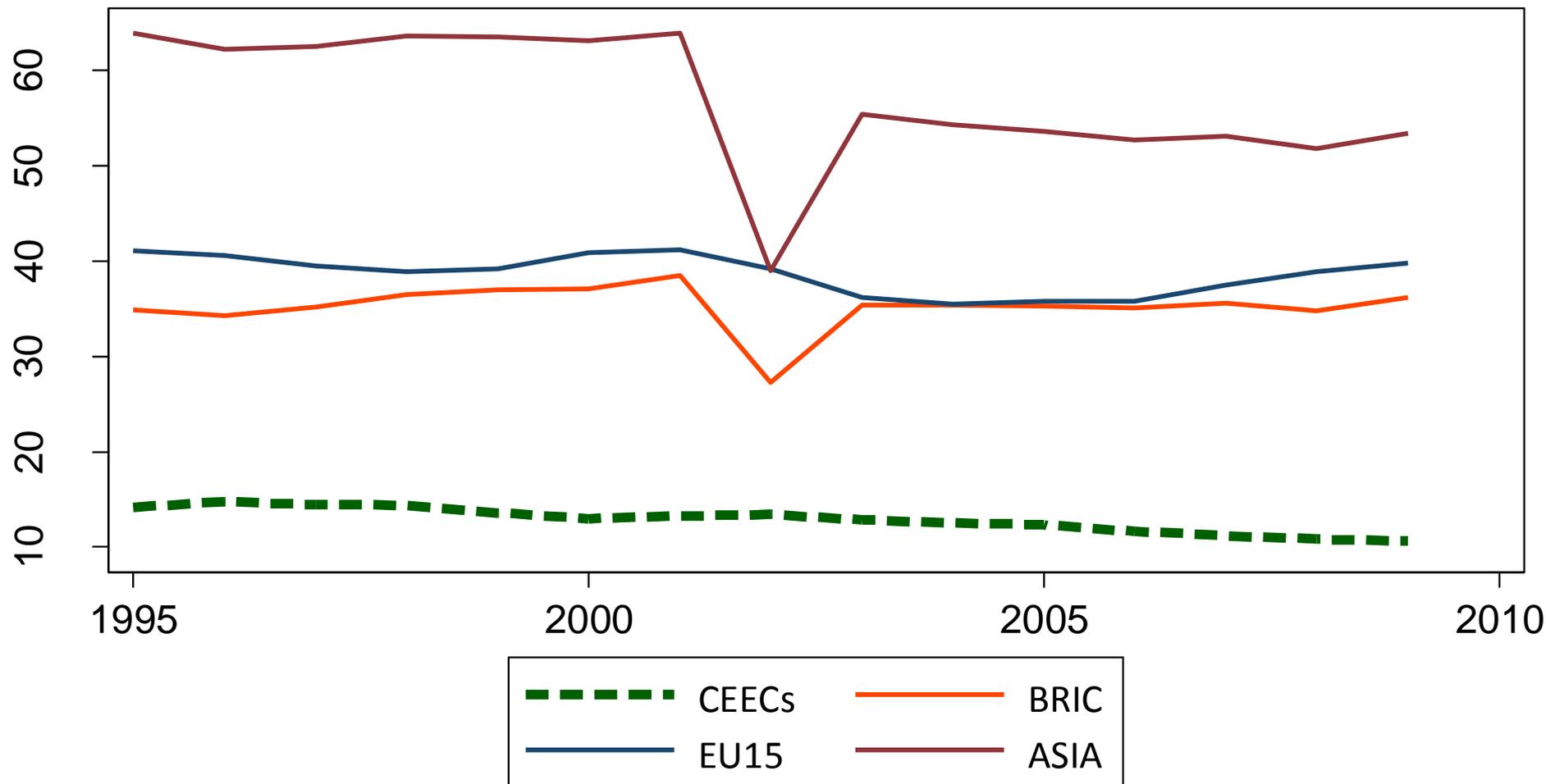
- Any country's export performance depends on
 - ❖ foreign market access on the one hand
 - ❖ and its own supply capacity on the other
- A country can improve its foreign market access, e. g., by joining a regional block (CEECs joined the EU) but otherwise foreign market access – e. g. distance from various markets – is basically given.
- On the other hand, supply capacity depends on the country's economic and other policies.

Components of supply capacity

The main **components of supply capacity** are institutional development, the inflow – particularly into manufacturing - of foreign direct investment, the relative growth of labour productivity and wages, etc.

Dynamics of the contribution of supply capacity to export growth in percent

Lines denote the contribution of supply capacity to export growth, the remaining contribution being foreign market access



Source: Own calculations on the basis of WDI and Eurostat.

Future of export growth in jeopardy: cost competitiveness deteriorating

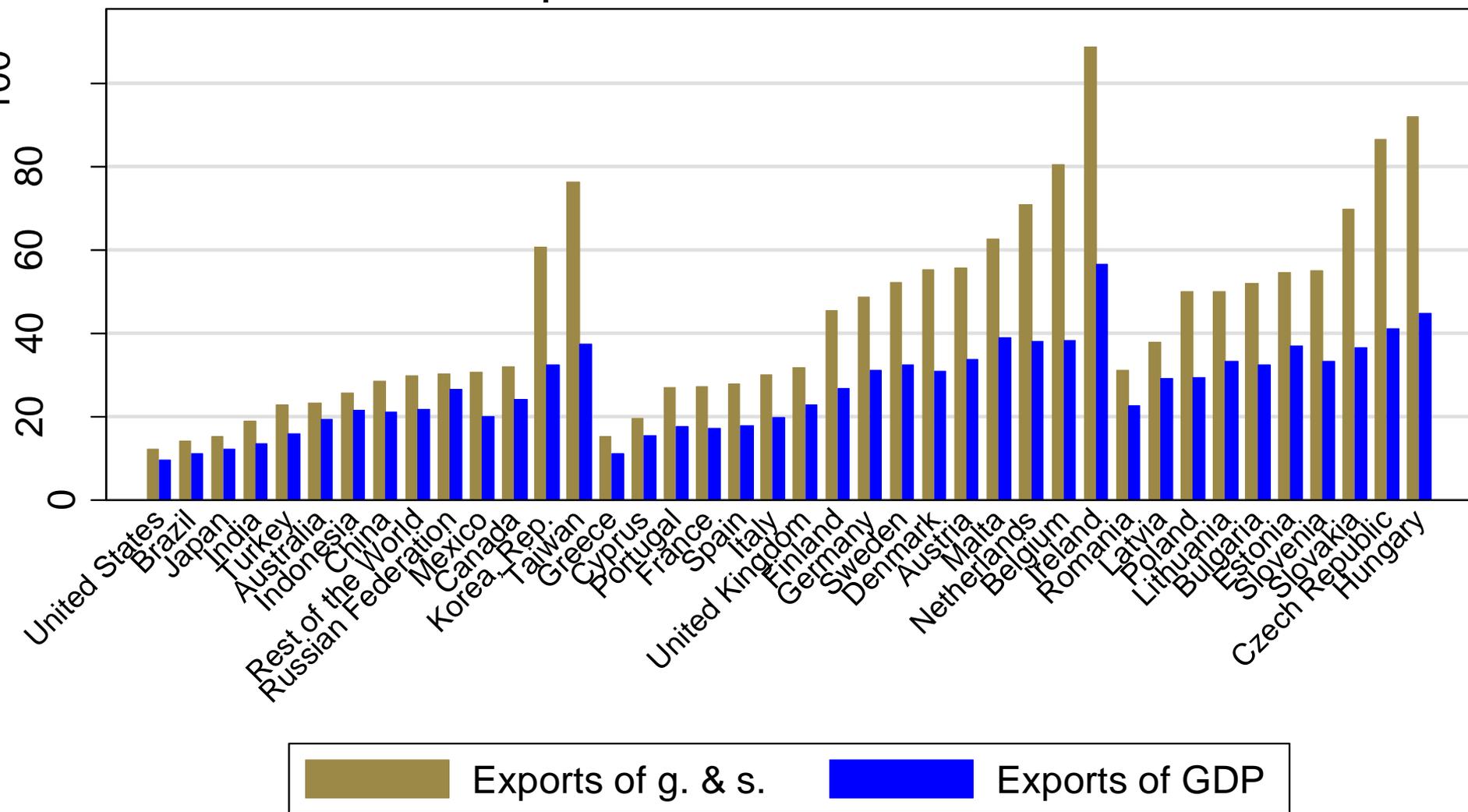
- The benefits of **EU accession** seem to have been mostly **exploited**, and the internal supply capacity is less and less important base of their export performance.
- A key determinant of the latter negative trend is deteriorating cost competitiveness: much more attention has to be paid to the **relationship between the increase of productivity and wages**.

Participation in cross-
border value chains
(production
networks) and
concentration of
exports

Exports of goods and services versus exports of own value added (GDP)

- Statistical data of exports describe exports of goods and services, but these data, besides the exporting country's export of its own value added, i. e., its own contribution to the value of the exported products and services, also include **foreign value added**, namely the **import content of the country's exports**.
- Own value added: input-output table, **wiod.org database**

Exports of goods and services and exports of GDP in percent of GDP in 2011

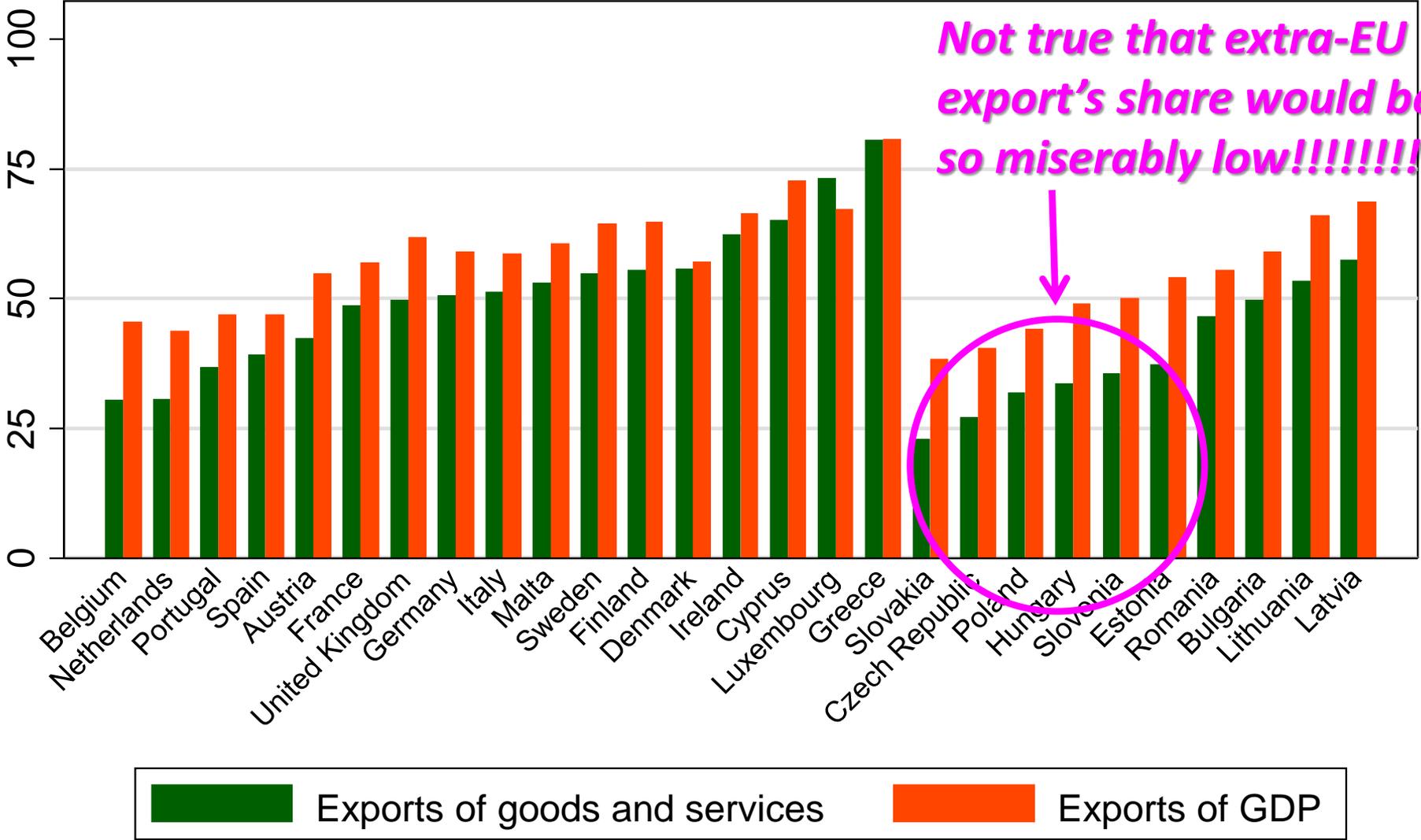


Source: own calculations on the basis of wiod.org.
Remark: Luxembourg omitted.

Export concentration

- If export concentration is high, that means strong dependence on some segment of the market, which is dangerous.
- We have to look at concentration in two respects:
 - ❖ Concentration by countries or by **groups of economically strongly interrelated countries**.
 - ❖ Concentration by **industries**.
- Concentration **has to be measured in exports of GDP**, measurement in exports of goods and services is misleading

Extra-EU exports of goods and services in % of total exports and extra-EU exports of GDP in % of exports of GDP in 2011



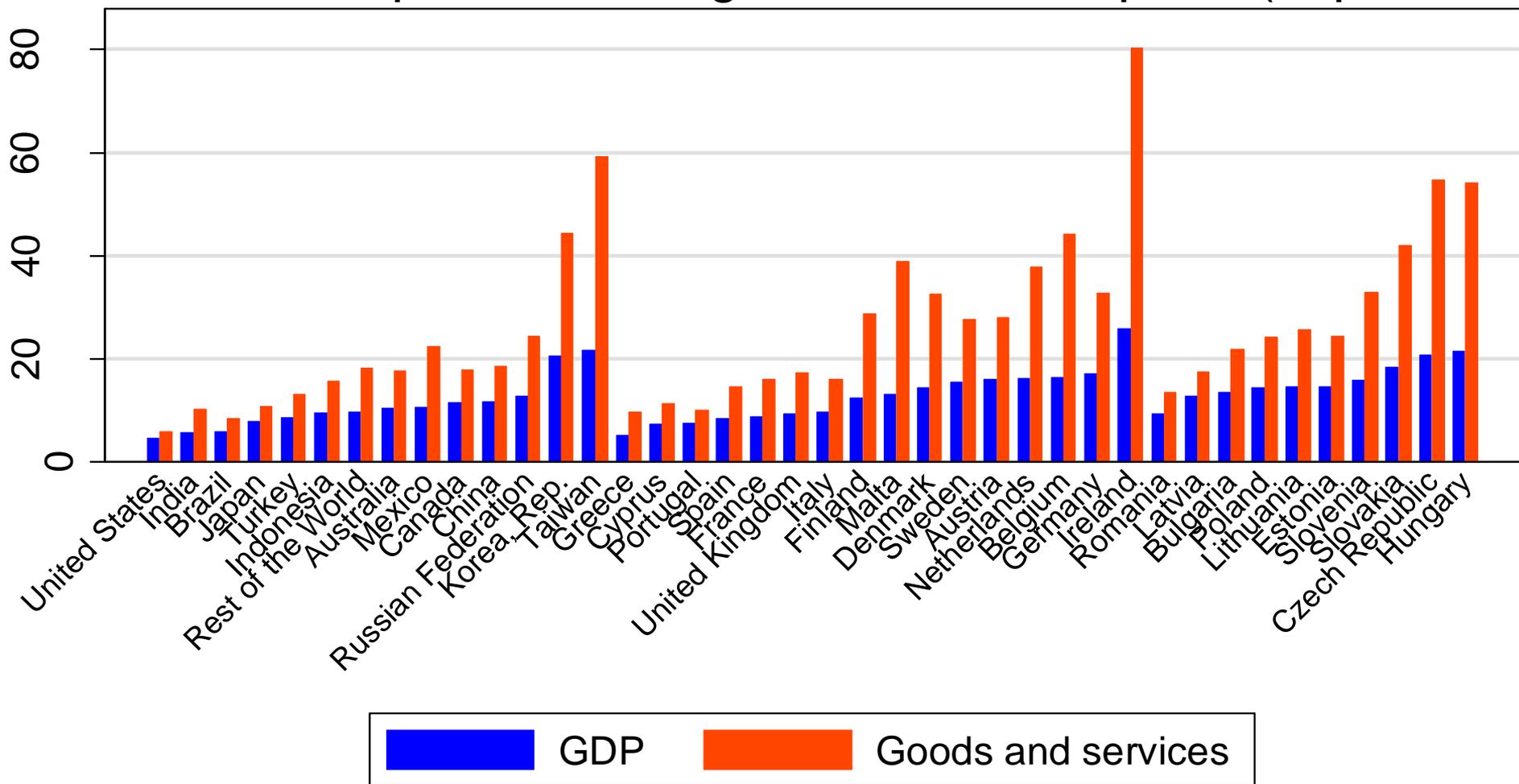
Source: Own calculations on the basis of wiod.org.

The largest GDP-exporting sectors in some countries by wiod.org industries

Czech R.	15	18	13	14	3
Hungary	15	13	14	18	3
Slovakia	15	14	18	3	13
Austria	18	15	13	3	14
Italy	13	15	18	3	4
Netherlands	3	18	15	13	9
China	14	4	18	15	13
Mexico	15	18	14	3	31

wiod industry	Corresponding CPA/NACE rev 1 (ISIC rev 2) industry				
3	15t16	Food, Beverages and Tobacco			
4	17t18	Textiles and Textile Products			
9	24	Chemicals and Chemical Products			
13	29	Machinery, Nec			
14	30t33	Electrical and Optical Equipment			
15	34t35	Transport Equipment			
18	F	Construction			
31	L	Public Admin and Defence; Compulsory Social Security			

The cumulative share of the 5 largest GDP exports in total GDP exports and of the 5 largest goods and services exports in total goods & serv. exports (in percent)



Source: own calculation on the basis of wiod.org.
 Remark: Luxembourg is omitted.

***2. Policy
conclusions of
research on
foreign direct
investment***

Influencing the
regional
allocation and
efficiency of FDI

Regional allocation of FDI

- A rather general and well-known problem in CEECs is the **tendency of foreign investors to prefer locations in the capital and other most advanced regions of the countries**. In other words, FDI tends to enhance, rather than mitigate, regional imbalances of economic **development**. **What can governments do against this unfavourable trend, and how can FDI contribute more strongly to economic development (GDP growth) in a region?**
- Two strands of our research have contributed to answering these questions.

Regional allocation of FDI: investment subsidies

After EU accession, various CEECs' subsidies for investments were differentiated by regions: investors in less developed regions could receive higher subsidies (as a share of their investment costs). In Romania, differently from Hungary and Poland, this differentiation did not work really. Subsidies were scarce and, in particular, actual subsidies mostly remained far below the upper limits allowed by the law.

Regional allocation of FDI: investment subsidies (cont'd)

Thus, we could observe a real-life experiment seldom given to us economists: subsidies aimed at promoting FDI in less developed regions in Hungary, Poland and a „control group”: Roumania, practically without such differentiation of subsidies. The results **vindicate the efficiency of Hungarian and Polish subsidies differentiated by regions**: the latter improved the position of less developed regions in the allocation of FDI, whereas in Romania, where differentiated subsidies were practically not applied, similar changes in the regional distribution of FDI did not happen. **The policy conclusion is self-evident here.**

Regional efficiency of FDI: the role of human capital

Another strand of our research has examined the trends of GDP growth in the regions of CEECs and East Germany as the function of FDI and available human capital (measured by the **human resources in science and technology occupations** – HRSTO – index).

Estimation results have shown that the combined impact of the two factors is highly positive, i. e., **the impact of FDI on economic growth can be strengthened by better availability of human capital.** The policy conclusion is self-evident.