

Governmental Change and FDI Inflow to Poland and Hungary in 2010-2016

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ABSTRACT

Objective: The purpose of this article is to explain if and how FDI flows have changed due to the most recent parliamentary elections in Poland and Hungary. The shift in governmental policies are said to affect the institutional settings in the host country and hence the willingness of foreign firms to invest. In the study we tried to identify any interdependencies between the FDI inflow and unexpected electoral results.

Research Design & Methods: Based on statistical data we applied a cross-country analysis to verify whether the perceived higher investment risk truly undermined the choices of firms. Qualitative analysis and critical discussion drawing on available reports and databases were applied.

Findings: Hungary and Poland have recently suffered a drop in the inflow of FDI as revealed by the statistical databases. It is, however, hard to determine whether this decline will continue and to what extent it has been dependent on recent policy changes, particularly in the light of evidence stressing unabating investment attractiveness and new projects coming.

Implications & Recommendations: The recent election results in numerous countries suggest an alteration in perceiving the necessity for further international openness and integration. The new nationalism, protectionism and economic patriotism have gained new supporters.

Contribution & Value Added: We tried to show the idiosyncrasy of the relationship between institutional election-induced changes in the political landscape and the subsequent modification of attractiveness sentiment leading presumably to changes in actual FDI flows.

Article type: research paper

Keywords: FDI; Poland; Hungary; political uncertainty; institutions; governments; policy

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INTRODUCTION

As the process of integration in Europe grew stronger, a lot of foreign direct investment (FDI) flows were directed towards the 'new EU members' which in the vast majority constituted the transition economies (Kersan-Skabic & Orlic, 2007; Popovici, 2015). The question of why those countries were targeted opened field for research which could determine a new logic in the FDI location pattern. One of the factors studied was the so-called 'institutional quality' which included, among others, political stability. Whilst economic determinants received considerable attention, political framework is still understudied, most probably since it is harder to define and measure (Busse & Hefeker, 2005). Nevertheless, the issue of how policy changes and political risk perception influence FDI inflow is still valid and of much importance. These political aspects relate to policy as such, in particular, a policy towards foreign investors. The Oxford Dictionary (2015) defines 'policy' as a course or principle of action adopted or proposed by an organisation or an individual. It encompasses various instruments with which certain goals can be achieved. Policy can refer to conceptual aspects, such as general direction of the pursued strategy, as well as to the administrative, operational dimension including approvals, issuance, etc. Policy towards foreign investors is modelled in studies on FDI as one of the factors influencing an investor's decision on where to locate; usually as one of independent variables in regression equation assessing the magnitude of the impact of a given element on FDI (Götz, 2016). We apply both the simple quantitative method and qualitative ones based on a critical review of selected literature.

The aim of this article is firstly to determine whether the latest parliamentary elections in Poland and Hungary have changed the perception of the institutional stability of those countries. Secondly, we try to investigate whether the policy changes, or rather their perception, influenced the FDI inflow. The first part of the article is devoted to an overview of the most commonly researched FDI determinants. We observe how regional specificity influences the FDI location and whether the political changes received their due attention in previous studies of the CEE countries. Further, we examine FDI flows in Europe during and after the global economic crisis, i.e. in the 2010-2016 period. Lastly, we concentrate on Poland and Hungary specifically, not only to explore the FDI inflow but also to investigate current global reports which constitute a potential source of information for investors. We put emphasis on the period 2010-2016 since it refers to the latest parliamentary elections in Hungary (2010) and in Poland (2015) which were won by conservative parties. However, to create a broader picture, we present data on FDI inflow and two indices usually used to evaluate the competitiveness of economies in terms of their institutional environment for the period 2000-2016.

LITERATURE REVIEW AND THEORY DEVELOPMENT

Determinants of FDI Inflow in Central and Eastern European Countries

FDI is said to be one of the most desirable ways to attract foreign capital. Unlike short-term investment, FDI is not subject to sudden reversal and therefore, is more crisis-resilient (Busse & Hefeker, 2005). FDI is positively associated with employment growth, technology transfers, and therefore, indirectly with the overall economic growth (Goswami & Haider,

2014), though mixed effects can be also found in the empirical literature (Iwasaki & Tokunaga, 2014). Since the benefits of such investments are usually quite easily observable, policy-makers try to boost the quality of the socio-economic and political environment. FDI inflow is believed to be determined by the competitiveness of the host country and its regions, as well as sectors and firms. Attractiveness understood as the ability to pull foreign capital to given locations constitutes one of the dimensions of competitiveness. Research on FDI determinants groups the factors into two main categories – traditional and environmental ones (Popovici, 2016). Traditional factors include market potential, labour structure and economic growth. Environmental factors focus on infrastructure and political framework. The strength of the impact of particular factors depends on the ‘type’ of the host country and goals of the investor. The horizontal (market-seeking) FDI is used to explore the market potential of the host country and the vertical (efficiency-seeking) FDI exploits their low-cost inputs (Alam & Shah, 2013; Shatz & Venables, 2000). Traditionally, less developed countries were said to attract more vertical investments, whilst the developed ones accommodated the horizontal FDI. Recently, however, this proves to be less true as firms seek not only to reduce their production costs but also to create market opportunities by penetrating it. Institutions play an important role in this respect (Acemoglu & Johnson, 2005; Child & Rodrigues, 2011; Jackson & Degg, 2008). Research has shown that the geographical dispersion of FDI flows is caused by different factors. Studies of the CEE countries have proved that both traditional and environmental factors are of significance in attracting FDI (Table 1). Due to the fact that those economies were not as developed as their Western counterparts, numerous studies concentrated on the labour market as major pull-factor attracting investors with low wages and relatively high productivity. With time and oversaturation of their home markets, investors turned to the CEE countries in search for a new target group. However, researchers also emphasise that in the case of those transition economies regional-specific factors should also be taken into consideration while exploring FDI determinants. They highlight potential significance of the political environment and membership in regional organisations, i.e. the EU membership. Some studies covered the role of agglomerations and clusters for attracting foreign capital to Poland (Ciešlik, 2004).

Hosseini (2005) argues that any study of FDI should combine the behavioural economic perspective with historical approach. He claims that full rationality assumption should be abandoned and the complexity of investing foreign markets needs to be considered. Political uncertainty, economic instability and cultural distance hinder venturing abroad by imperfectly rational decision makers. Given the natural barriers such as the information asymmetry causing higher transaction costs, it is impossible to make perfect investment decisions as presumed by the neoclassical approach.

Surprisingly, not much attention is paid to political risk or broader, to the quality of institutions (Busse & Hefeker, 2005). It is mostly taken for granted that FDI flows are higher if the host country exhibits political stability (e.g. Brunetti & Weder, 1998; Lee & Mansfield, 1996; Wei, 2000). However, to understand fully what stands behind political stability, one should first take a closer look at institutions. North (1991, p. 97) defines institutions as ‘humanly devised constraints that structure political, economic and social interactions’. The institutional environment, therefore, can be understood very broadly. It involves normative, cultural and regulatory aspects (Grosse & Trevino, 2005). The normative aspect covers the establishment and functioning of institutions as well as the

interdependencies between the actors of the system. The cultural aspect reflects the specificity of internal processes and rules which characterise a given community. Finally, the regulatory aspect involves the establishment of specific rules and legislation framework, as well as sanctions provided for the violation of those rules.

Table 1. FDI determinants in CEE studies

Group of factors	Exemplary measures	Exemplary research
Traditional factors		
Macroeconomic stability	inflation rate, GDP growth rate	Kersan-Skabic & Orlic (2007), Stawicka (2014), Chidlow, Salciuviene, & Young (2009), Gauselmann, Knell, & Stephan (2011), Cem (2013)
Labour market	labour cost, labour productivity, labour market structure	Paul, Popovici, & Calin (2014), Kersan-Skabic & Orlic (2007), Stawicka (2014), Chidlow, Salciuviene, & Young (2009), Brahim & Dupuch (2016), Gauselmann, Knell, & Stephan (2011), Cem (2013)
Environmental factors		
Infrastructure	per capita data on ICT, transportation as well as production and transmission facilities	Paul, Popovici, & Calin (2014), Kersan-Skabic & Orlic (2007), Chidlow, Salciuviene, & Young (2009)
Institutions	property rights protection, contract enforcement, number of legal changes per year	Paul, Popovici, & Calin (2014), Gauselmann, Knell, & Stephan (2011), Cem (2013)
Taxation	corporate income tax, VAT, social security contribution	Paul, Popovici, & Calin (2014), Kersan-Skabic, & Orlic (2007), Brahim & Dupuch (2016)
Region-specific factors		
Market-openness	exports and imports value, EU membership	Stawicka (2014), Brahim & Dupuch (2016), Cem (2013)

Source: own study.

Institutions are said to create the conceptual base for political change. The institutional environment is perceived as relatively stable if changes happen during a given time interval and are not radical. Institutions should ensure the fairness of any changes and safeguard the values of the society. If they fail to uphold the integrity of the system, the perceived political risk increases. Those processes might be reflected in various economic measures, including FDI inflow. If institutions do not fulfil their task of uncertainty reduction (e.g. they fail to guarantee property rights, contract enforcement, etc.) investors might turn to destinations of higher predictability (Shi, Sun, Yan & Zhu, 2017).

Evidence of such dependency was found by Jensen (2003), Harms and Ursprung (2002), and Busse (2004) who claim that investments are more likely to be located in countries of full democracy. Investors use various global reports to obtain data on institutional change. For instance, the Democracy Index created by The Economist Intelligence Unit reflects on the 'electoral process and pluralism, civil liberties, functioning of government, political participation, and political culture' (Democracy, 2017). The Index of Economic Freedom by Heritage Foundation also includes institutional elements, such as property

rights, government integrity, judicial effectiveness, government spending, tax burden, fiscal health, business, labour, monetary, trade, investment and financial freedom (Miller & Kim, 2017). The growing uncertainty in the institutional environment of economies is reflected in their ranking placement which in turn might undermine the investor's decision making process. The significance of both indices is even greater when one takes into account the growing debate on populism in the era of globalisation (Rodrik, 2017). Therefore, in the remaining part of the article we are guided by the following research question: did the recent parliamentary change in Poland and Hungary, as well as a visible turn towards new nationalism provoke an increase in institutional uncertainty? Furthermore, we investigate whether those events had impact on FDI inflow.

MATERIAL AND METHODS

In our study, we try to check if the latest parliamentary elections in Poland and Hungary have changed the perception of the institutional stability of those countries. This kind of message is often highlighted in different media. But we need facts and figures to be able to conclude about any changes and its implications. Thus, we try to investigate whether the policy changes, or rather their perception, influenced the FDI inflow.

Based on statistical data we apply a cross-country analysis to verify whether the perceived higher investment risk truly undermined the choices of firms. We draw on the available databases of UNCTAD and explore the FDI inflow in years 2000-2016 for the four Visegrad countries, Europe as such, EU 28 and world as total with emphasis on Poland and Hungary. We confront the results with the overall FDI patterns to see whether Poland and Hungary constituted an exception from the global trend or followed it.

As a background, to present current situation with democracy level in Poland and Hungary we use the *Democracy Index* – prepared by the Economist Intelligence Unit. Unfortunately, the data on Democracy Index are available from 2006 and not from 2000, and in the first years the results were presented every two years. The index is based on five detailed categories: *electoral process and pluralism*, *civil liberties*, *functioning of government*, *political participation* and *political culture*. Based on their scores on a range of indicators within these categories, each country is then itself classified as one of four types of regime: 'full democracy', 'flawed democracy', 'hybrid regime' and 'authoritarian regime'. Another measure which we use as a proxy of changes in the political situation in Hungary and Poland, is the *Index of Economic Freedom*, or even more connected with investors' sentiments – one of the components – *Business Freedom*. Economic freedom seems to be the centre of individual autonomy, concerned with the freedom of choice in acquiring and using economic resources. The basic assumption behind the creation of *Economic Freedom Index*¹ is that individuals know their needs and desires better than the government or technocratic elite. We present the dynamics of FDI inflow against the dynamics of the three proxies for institutional changes, in particular, political ones in Poland and Hungary. We apply a qualitative analysis and critical discussion drawing on the available reports and dossiers.

¹ The *Index of Economic Freedom* takes 12 different factors, some of them are concerned with a country's interactions with the rest of the world, most, however, focus on policies within a country, evaluating the level of individuals' liberty to use their labour and finance without restraint or government interference.

RESULTS AND DISCUSSION

FDI Inflow – the Global and European Perspective – Figures in Brief

The eruption of the Global Financial Crisis created many challenges to firms, in particular, to those eager to expand abroad with the most ambitious and risky mode – FDI. The consequences of the financial and further economic turbulences reshaped the context for investors and impacted FDI flows in the next years. In our article, we do not intend to focus on the crisis implications for investors but rather on institutional factors which determine the smooth flow of FDI. We aim to examine the cases of Poland and Hungary, which are EU members and at the same time two out of four Visegrad countries. Thus, for the purpose of our analysis, it is worth having a closer look at the world and European context. The share of Europe in FDI inflow in the period 2000-2016 fluctuated from more than 53% (in 2005 the highest value) to around 27% (in 2014), while the V4 possessed the ratio at the level from 0.62% (in 2015) to 3.65% (Table 2).

Table 2. FDI inflow – total value in USD real prices (millions of USD) and percentage of total world

Year	Europe		EU28		V4	
	Value	%	Value	%	Value	%
2000	689 699.5	53.08	658 183.8	50.65	18 886.57	1.45
2001	338 394.5	45.31	323 028.4	43.25	16 463.92	2.20
2002	286 368.1	49.77	274 178.3	47.65	20 558.92	3.57
2003	268 093.3	49.86	236 938	44.06	10 737.37	2.00
2004	225 977.6	34.04	202 702.2	30.53	24 219.35	3.65
2005	489 742.8	53.93	460 168.9	50.67	29 669.21	3.27
2006	636 295.1	47.53	530 648.8	39.64	31 407.83	2.35
2007	922 922.3	51.00	800 917.8	44.25	37 026.14	2.05
2008	419 716.5	30.20	296 157.9	21.31	28 944.87	2.08
2009	471 958.1	40.64	384 228	33.09	14 449.28	1.24
2010	471 358.3	35.40	381 148.8	28.62	22 525.1	1.69
2011	524 356.2	35.38	417 902.8	28.20	27 157.1	1.83
2012	518 051.7	35.48	438 861.7	30.06	36 931.1	2.53
2013	383 182.1	27.43	315 089.9	22.56	9 925.7	0.71
2014	339 154.9	27.11	289 466.1	23.13	24 912.7	1.99
2015	518 129.6	29.92	435 365.6	25.14	10 680.8	0.62
2016	528 711.4	30.81	561 684.4	32.73	12 408.5	0.72

Source: authors' compilation on the basis of the UNCTAD data.

Since we aim to focus more on the period 2010-2016, we looked closer at the global FDI inflow in that period. Looking at the value of the global FDI inflow in 2010, we should mention the crisis realm since the FDI flows were at that time still at about 75% of their peak level of 2008. In that particular year, FDI inflows rose modestly after the previous two years of decline (in 2008 and 2009). They amounted to USD 1.33 trillion in 2010 and they were higher than in 2009. The visible growth was experienced particularly by developing countries. More than half of FDI flows were targeted at developing countries as well as at the transition economies. The reasons underlying such location choices were two-fold: a relatively fast recovery of these economies combined with strong pressure on cost-

effectiveness and efficient global value chains development among multinational enterprises (MNEs). In 2010 Europe was perceived as a sub-region very much shaken by the crisis turbulences, which was reflected in FDI inflow which fell most sharply. Nevertheless, the distribution of negative trends in FDI inflow was not equal throughout the whole Europe. The uncertainties about the worsening sovereign debt crisis were not very strong as far as Poland and Hungary were concerned. Already 2011 compared with 2010 brought the growth of FDI inflow by 11% (Table 2). The key absorbers of the increase were the developing and transition economies attracting a lot of greenfield investments. However, in Europe in general (where FDI inflow grew by 11%) there was a visible domination of large cross-border M&A (Table 2). As far as the European Union (the EU 28) is concerned, the growth oscillated around 10% but the Visegrad countries were characterised by the 21% growth of FDI inflow, which manifests their relatively high attractiveness for FDI compared to the other EU members (Table 2; Figure 1).

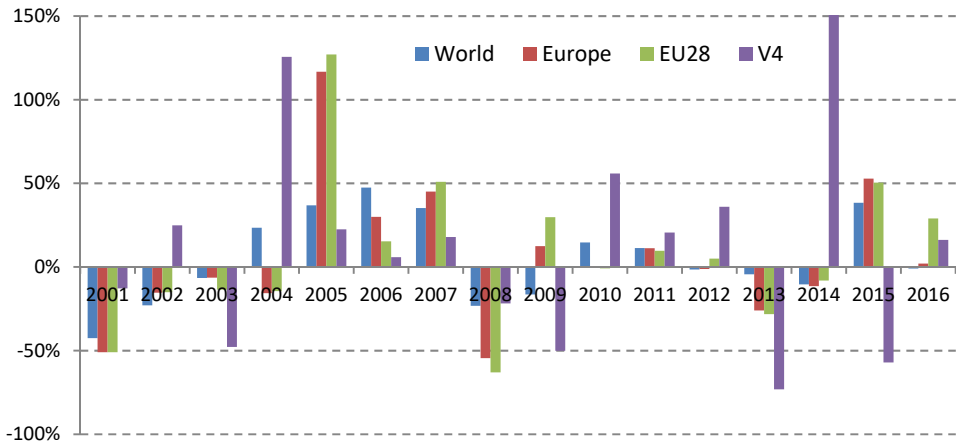


Figure 1. Dynamics of FDI inflow – percentage change (year-to-year)
 Source: authors’ compilation on the basis of the UNCTAD data.

The analysis of the dynamics of FDI inflows does not allow us to formulate any decisive conclusions. The percentage change measured on the year-to-year basis was negative globally in the period 2001-2003. Afterwards, the worldwide economic crisis, i.e. years 2008 and 2009, was fully reflected in the dynamics of FDI inflows. The next two years brought some improvement though only temporarily, as global FDI inflows diminished again in 2012. The value of FDI inflow in that year decreased by 1% when compared to 2011. The negative trend was visible in Europe with a similar decline of 1%. However, the whole EU 28 experienced the growth by 5% and the Visegrad countries exposed their attractiveness attracting even more foreign capital. However, decreases were observable in the next year. FDI inflow globally decreased in 2013 by 4%, whilst Europe and the EU 28 experienced a significant reduction by 26% and 28%, respectively. The position of V4 was even worse since the fall reached the level of 73%. 2014 was the continuation of the trends from 2013 as far as the world, Europe and the EU 28 are concerned (Table 2). Within each regional category there was a reduction. Surprisingly, the V4 region grew a lot when compared to 2013. The ‘trend reversal’ emerged in 2015 when the world, Europe and the

EU28, among others, experienced strong FDI inflow. The FDI global inflow grew by 38% and in Europe by 53%. But on the other hand, the V4 countries faced a decline by 57% when compared to the previous year (Figure 1). The year 2016 brought a decrease in FDI flows by 1% to USD 1.716 billion. According to UNCTAD, the value of cross-border M&As grew by approximately 18%, which was the highest level since 2007. In the studied period, the global share of FDI inflow in GDP oscillated between 1.44 to 4.06%. The same ratio for the EU 28 and Europe was more volatile than for the world since it reached more than 7% in 2000, decreased to the level of around 1.6 % in 2014 (Table 3).

Table 3. FDI inflow as the percentage of GDP

Year	World	EU28	Europe	Czech Republic	Hungary	Poland	Slovakia
2000	4.06	7.67	7.36	8.11	5.85	5.50	13.15
2001	2.32	3.72	3.56	8.37	7.33	2.93	10.64
2002	1.72	2.88	2.74	10.38	4.43	2.03	23.67
2003	1.44	2.04	2.10	2.12	2.51	1.83	8.77
2004	1.59	1.51	1.53	4.18	4.11	4.76	9.36
2005	2.02	3.27	3.12	8.57	6.85	2.68	6.35
2006	2.74	3.55	3.76	3.52	5.94	4.23	10.17
2007	3.29	4.64	4.68	5.53	2.84	4.62	5.22
2008	2.36	1.60	1.93	2.74	4.02	2.30	5.04
2009	1.97	2.29	2.44	1.42	1.54	2.28	-0.01
2010	2.22	2.27	2.40	2.97	1.69	2.67	1.98
2011	2.25	2.32	2.42	1.02	4.50	3.01	3.57
2012	2.15	2.59	2.53	3.87	11.33	2.48	3.20
2013	2.05	1.78	1.79	1.75	2.53	0.69	-0.62
2014	1.74	1.58	1.57	2.68	5.41	2.30	-0.33
2015	2.46	2.74	2.80	0.68	1.07	1.60	0.93

Source: authors' compilation on the basis of the UNCTAD data.

As far as the V4 countries as a group are concerned, FDI inflow expressed as the ratio of GDP varied from even -2.33% to more than 8% in particular years. However, a more detailed breakdown revealed differences among the V4 countries and in some cases showed even a negative ratio implying the withdrawal of capital (Slovakia in 2009, 2013 and 2014 – Table 3).

Although *in absolute terms* the inflow of FDI to Poland is remarkable as compared to other countries in the region, there are still areas where improvement can be made – labour costs reduction; simplification and stability of legal and tax systems; development of transport and logistics infrastructure, further upgrading of the education of skilled workers (Ślusarczyk & Kot, 2012). This is also why in terms of FDI/GDP, the results are no longer so striking.

Hungary and Poland – Political Changes Versus FDI Patterns

'Most of the Eastern member states and particularly the economies of the Visegrad countries have become dependent on foreign investment: their growth is to a great extent based on exports by foreign-owned companies' (Medve-Bálint, 2014). Since Hungary and Poland – the countries being analyzed in this article – are perceived to be democratic economies, changes in the political system – either positive or negative, can be easily observed

in the progress or regress in democracy level. The starting point should be an answer to the question: how to measure the democracy level in a country? Free and fair election and civil liberties are conditions sine qua non for democracy, but these two are not the complete picture of democracy level and they do not seem to be sufficient for a full democracy. Obviously, it should be accompanied by other important features: transparent and efficient government, high enough level of political participation, as well as democratic political culture, which should support mechanisms and institutions of democracy. Even in traditionally and long-established democratic system, one might observe the mechanism of corrosion, if the system is not protected or permanently supported.

The general parliamentary elections in Hungary and Poland in the period 2010-2016 are often seen as major shakeup for the political stability even in the region. In Hungary, in the first round of the elections in 2010, the conservative party Fidesz won the absolute majority of seats, which was enough to form a government on its own. In the second round, the candidates of Fidesz-Christian Democratic People's Party (KDNP) were able to achieve a two-thirds majority, which was required to modify the major laws, including the country's constitution. Likewise, the result of the 2014 Hungarian parliamentary election was a two-thirds majority victory for the Fidesz-KDNP Alliance, allowing Viktor Orbán to remain the Prime Minister. For the first time since the transition of Hungary's to democracy, the election had a single round (Mueller, 2014). As argued by the observers of the political scene, the April 2010 general elections did not just sweep away the ruling post-communist government but caused an earthquake on the political scene (Sardi, 2010). Whereas in Poland in 2011 general election the ruling Civic Platform won a historic victory promising further stable, favourable economic and political conditions and the pro-European course (Sardi, 2010), the 2015 elections brought major reshuffling on the political scene with the victory of Poland's opposition Law and Justice party – clearly conservative and visibly Eurosceptic (Poland, 2015).

To refer to the institutional changes in Poland and Hungary, we used the *Democracy Index* – prepared by the Economist Intelligence Unit. The value and the rank among 165 countries of democracy level for two countries – Hungary and Poland – in 2006-2016 are presented in Figure 2. Although the index provides just a snapshot of the state of democracy at the end of each year, some tendencies could be easily identified. In case of Hungary, the whole analysed period is as well the period of a negative trend in the level of democracy. Less significant drop is observed between 2006 and 2008 and, since winning with a two thirds parliamentary majority in the 2010, the centre-right party has systematically been taking over the country's independent institutions: the state audit office, the presidency, the media council and even partly the central bank.

In the case of Poland, one might divide the whole period into four shorter ones: 2006-2008 as a period of the stagnation of democracy, but on a relatively high level, 2010-2013 as a period of the stagnation of democracy on moderate level, 2013-2014 – a one year period of a significant improvement in democracy level and since 2015 we might observe a decline². Since 2015 – the year of the parliamentary elections won with a significant majority by Law & Justice party – the level of democracy seems to be adversely affected by political decisions and movements of the new government and president, which are very similar to those implemented in Hungary since 2010 (higher score indicates a decline in the level of democracy).

² We exclude 2009 as no data were available for that period.

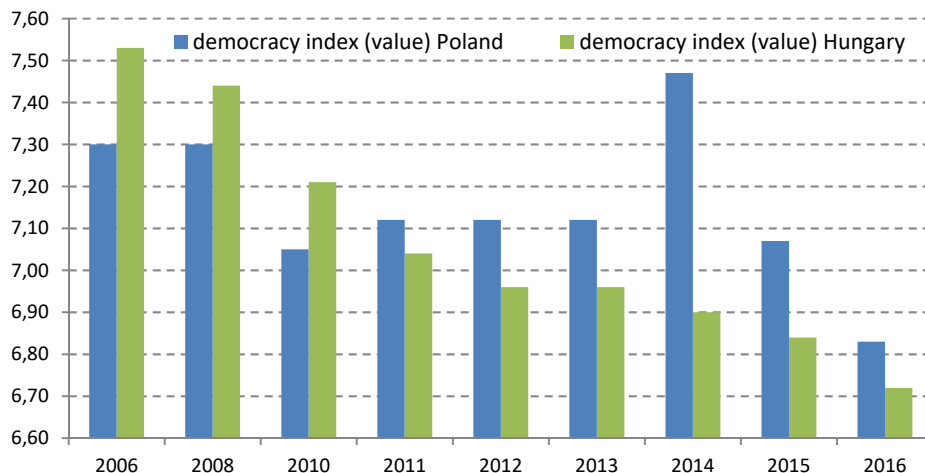


Figure 2. Democracy Index for Poland and Hungary (values, 2006-2016)

Source: authors' compilation on the basis of the Economist Intelligence Unit data.

Additionally, we used the *Index of Economic Freedom* and (*Figure 3*) *Business Freedom Index* (*Figure 4*) as proxies for the institutional, in particular, the political changes in both countries.

The tendencies in the level of *Economic Freedom Index* are presented in *Figure 3* and *Figure 4*. There are substantial discrepancies between the two analysed countries regarding the starting point as well as changes over time. In 2000 Hungary recorded a higher value of index (around 65% of the max value) compared with Poland (around 63% of the max value). Looking at the tendency, it is visible that in the period 2000-2016 the index fluctuated – at first, in 2000, the tendency was negative, then since 2004 the tendency was positive for both countries. Since 2013 one might observe gradual deterioration of the index value in the case of Hungary. Similar tendencies appeared in the case of Poland two years later, in 2015.

Backsliding in the *Economic Freedom Index* value for Hungary since 2013 was accompanied by the same tendency for the *Business Freedom Index* (cf. *Figure 3* and *4*). Between 2000 and 2006, there was stagnation in business freedom in Hungary. In 2007 there was a slight decline and in the next years till 2013 once again stagnation but on quite a high level. Since 2014 there was a dramatic regression in the case of the Hungarian level of business freedom. Poland followed the path of stagnation in the period of 2000-2004, then in 2005 it recorded a drastic decrease and the regression is visible till 2009. Bearing in mind the significance of the period 2010-2016 for the study, it is useful to have a closer look at those years. The period 2010-2016 offers a little different picture for both countries. In 2010 Poland started from a lower level of business freedom than Hungary (61.4 for Poland compared with 76.5 for Hungary) (cf. *Figure 4*), then the value of index for Poland was gradually, but substantially increasing till 2013. Following the top level in 2013 (70.1), there was a minor deterioration in 2014 and 2016.

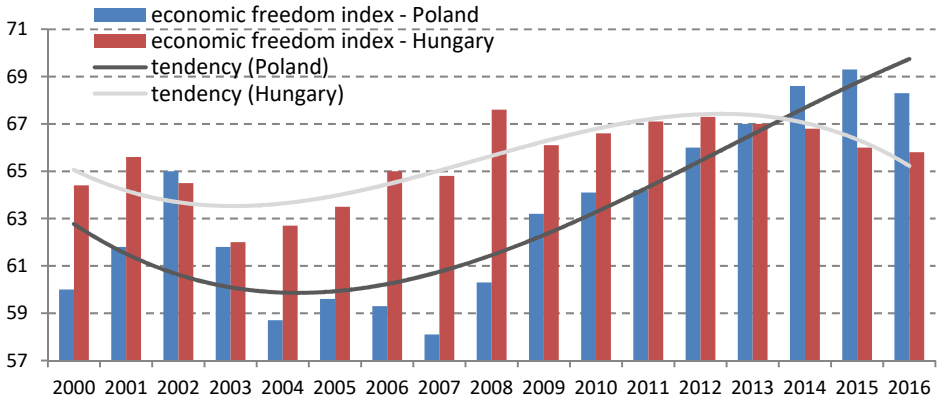


Figure 3. Economic Freedom Index value for Poland and Hungary, 2000-2016
 Source: authors' compilation on the basis of the Heritage Foundation data.

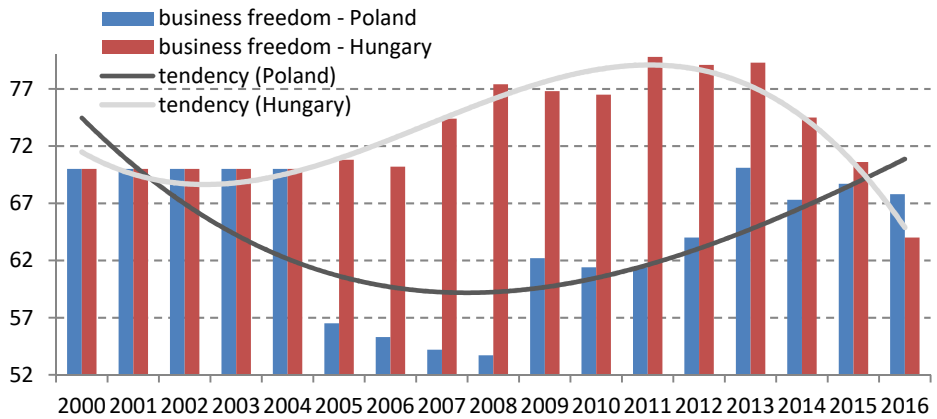


Figure 4. Business Freedom Index value for Poland and Hungary, 2000-2016
 Source: authors' compilation on the basis of the Heritage Foundation data.

The two proxies of political changes in Hungary and Poland described above (i.e. *Democracy Index* and *Business Freedom Index*), were applied in the next step, in which we took an attempt to identify any relations between the political (parliamentary) changes and FDI inflow in these two countries. FDI inflow in real prices contrasted against the moments of parliamentary elections for Poland and Hungary are presented in Figure 5 and 6, respectively. In the period 2000-2016 we can indicate two moments both for Poland and Hungary when the parliamentary elections were won by conservative parties. In Poland it was 2005 and then 2015. In Hungary similar trends emerged in 2010 and 2014. We can notice that for 2005 and 2010, respectively for Poland and Hungary, the FDI inflow grew. Thus, the entry of conservative parties was accompanied by an increase in the foreign capital inflow. And for 2014 and 2015 respectively for Hungary and Poland the situation was different – conservative parties won and foreign investors decreased their engagement in both markets. It confirms that the institutional factors matter a lot and determine

attractiveness for FDI, though they should be always analysed in a broader context. Such irregularities as the one identified in our study (the index deteriorates, whereas FDI continue to flow) require a broader context-embedded interpretation of institutional settings.

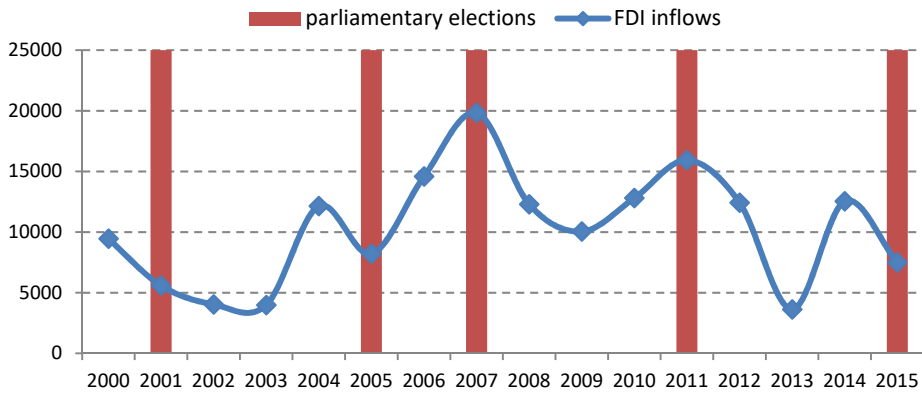


Figure 5. FDI inflow and parliamentary elections in Poland (FDI value in millions of USD, 2000-2016)

Source: authors' compilation on the basis of UNCTAD data.

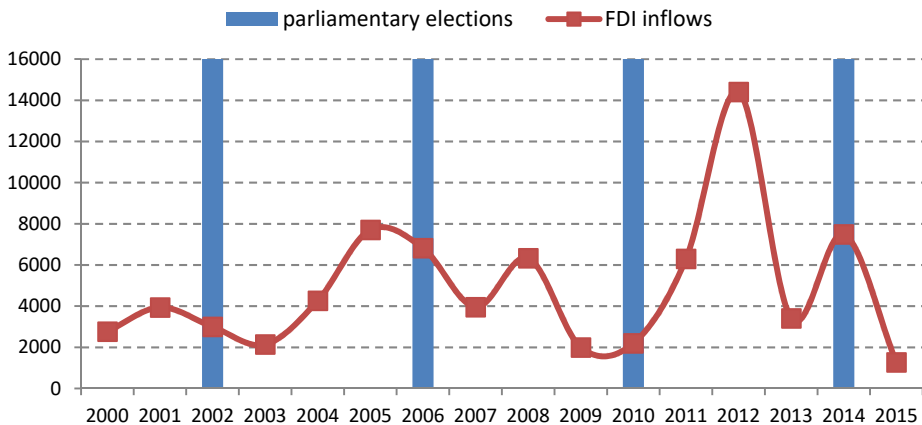


Figure 6. FDI inflow and parliamentary elections in Hungary (FDI value in millions of USD, 2000-2016)

Source: authors' compilation on the basis of UNCTAD data.

Bearing in mind the moments of the latest parliamentary elections in both countries, the lack of data on Democracy Index for the years before 2006, we focused a lot on the period 2010-2016, which is a relatively short period and thus we applied the qualitative methods. The results of the qualitative analysis for Hungary and Poland are presented in Tables 4 and 5. Since FDI is a forward-looking activity based on investors' expectation towards economic, political, legal, etc. conditions on a particular market, but we believe these expectations are shaped by the observation and assessment of current situation, we decided to apply a one year lag between changes in the political situation and FDI inflow

(t+1). In both cases (Hungary and Poland), in at least half of the cases there is a link between deterioration or improvement in democracy level or business freedom level and accompanying changes in the FDI inflow patterns (shaded cells in Tables 4 and 5).

Table 4. FDI patterns versus changes in the political system – the case of Hungary

Year	Democracy Index	Business Freedom Index	FDI as % of GDP		FDI value in million USD (real values)		FDI value in million USD per capita (real values)	
			t	t+1	t	t+1	t	t+1
2010	↓	→	↑		↑		↑	
2011	↓	↑	↑↑	↑	↑↑	↑	↑↑	↑
2012	↓	→	↑↑	↑↑	↑↑	↑↑	↑↑	↑↑
2013	→	↑	↓↓	↑↑	↓↓	↑↑	↓↓	↑↑
2014	↓	↓	↑↑	↓↓	↑↑	↓↓	↑↑	↓↓
2015	↓	↓	↓↓	↑↑	↓↓	↑↑	↓↓	↑↑
2016	↓	↓		↓↓		↓↓		↓↓

Notes: → no change in value; ↑ increase; ↑↑ significant increase (i.e. increase higher than 100% on year-to-year basis); ↓ decrease; ↓↓ significant decrease (i.e. decrease higher than 100% on year-to-year basis)

Source: own study.

Table 5. FDI patterns versus changes in the political system – the case of Poland

Year	Democracy Index	Business Freedom Index	FDI as % of GDP		FDI value in million USD (real values)		FDI value in million USD per capita (real values)	
			t	t+1	t	t+1	t	t+1
2010	↓	↓	↑		↑		↑	
2011	→	→	↑	↑	↑	↑	↑	↑
2012	→	↑	↓	↑	↓	↑	↓	↑
2013	→	↑	↓↓	↓	↓↓	↓	↓↓	↓
2014	↑	↓	↑↑	↓↓	↑↑	↓↓	↑↑	↓↓
2015	↓	→	↓	↑↑	↓	↑↑	↓	↑↑
2016	↓	↓		↓		↓		↓

Notes: the same as for Table 4.

Source: own study.

Obviously, on the basis of the simple qualitative analysis we cannot declare the political or parliamentary changes as an explanatory variable for FDI inflow. Thus, we treat the results presented in this article as a starting point for much deeper and more complex analysis of investors' sensitivity to parliamentary and political changes.

Recent studies by independent international organisations such as the UNCTAD Report revealed that significant changes of FDI flows might be simply explained by the corporate reconfiguration, reshuffling, revaluation, and not necessarily reflect the alteration of FDI volumes in a strict sense.

The comparison of FDI patterns in Hungary, Poland, the Visegrad Group (V4) versus the European Union 28 (Figure 7) for the period 2010-2016 shed also some light on the results of our analysis. There was a clear discrepancy in 2013-2015 between the two countries and tendencies for the whole EU. The decreasing trend of FDI flows in 2016 followed the growth in 2015. New 2017 UNCTAD Report finds that USA, Great Britain and China remain the leaders attracting most FDI. In general, the decline of the value of M&A to the tune of 18% was

accompanied by an increase in greenfield projects by 12%. Interestingly, the share of developed countries as recipients of FDI increased to unprecedented 59% (highest share since 2007). Among the largest host countries attracting a lot of foreign capital there are transition economies, such as the former Soviet Republics. In Europe, 19 out of 32 countries recorded a decrease in FDI flows, though the value of M&A increased to the highest level since 2007. The CEE countries suffered some decline in the inflow, and Poland, the largest recipient in this group, was no exception. The decline of inflow can be, however, as argued, attributed to corporate reconfigurations, to disinvestment process and deteriorating exchange rate. Examples of disinvestments in Poland and Hungary include in Hungary the purchase of MKB Bank from German BayernLB and other shares in public utility companies and media, whereas in Poland the transactions of repolonisation, including the acquisition by Alior Bank, the shares of GE Capital and the purchase of the shares of Bank Pekao from UniCredit by PZU and PFR consortium. Even though the inflow of FDI to Poland decreased from 14.3 bln USD in 2014, to 13.5 in 2015 and 11.4 in 2016, these figures are satisfactory, given the problems of the economic situation in many traditional home countries of FDI in Western Europe. As the scale of foreign engagement by MNE originating in the EU is still below the pre-crisis level, the sluggish investments are seen among others in the CEE.

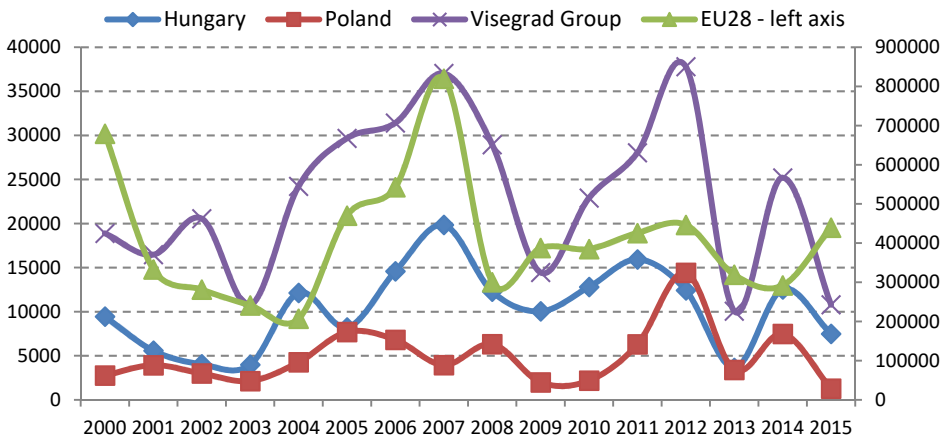


Figure 7. FDI inflow for Hungary, Poland versus V4 and EU28 (value in millions of USD, 2000-2016)

Source: authors' compilation on the basis of the UNCTAD data.

Since the transition process, the CEE countries are regarded as being heavily dependent on the inflow of foreign capital, FDI in particular. Except for Poland, the FDI stock represents more than 50% of GDP everywhere (Éltető & Antalóczy, 2017). This dependency is present both from the macroeconomic point of view (see 'dependent economy model' by Nölke & Vliegenthart, 2009), and also on the regional, local level (see 'nested dependent city regions' by Jacobs, 2017).

As noted by Éltető and Antalóczy (2017), attractiveness for foreign investors is increased in the case of a host country's predictability of regulatory and tax policies and well-functioning institutions, and deteriorates with corruption, lack of transparency leading to inefficiency in the allocation of financial resources. Findings by Éltető and Antalóczy (2017, p. 23) re-

vealed that the EU Country Report warns on legal uncertainty in Poland. The Polish tax system (including VAT, CIT, excise duties and others) underwent many rapid changes in 2016, leading to higher uncertainty undermining the stability and credibility of the Polish tax system, as amendments tend to be often introduced quickly and without broader consultations. In 2016, policy instability became the third (before it was the 10th) most important factor hampering doing business. Yet, despite these processes, the ease of doing business in Poland has been gradually improving. This may be attributed to the implementation of the new insolvency law, faster procedures for property registration, and amendments to the construction law. The government plans further to streamline certain business procedures with a range of proposals put forward within the 'Strategy for Responsible Development'.

In Hungary since 2010 international indicators point to a low and deteriorating quality of institutions, and policy uncertainty is quoted as one of the most important barriers to doing business in Hungary. As stressed by Éltető and Antalóczy (2017) for government initiated proposals, consultations tend to be limited to very short time periods, around 4.5 days in the last three years. Transition periods enabling adequate preparation for policy implementation tend to be insufficient. Additionally, public procurement consistently suffers from limited competition and Hungary's score in Transparency International corruption perception index (CPI) has continued to deteriorate over the past few years (Éltető & Antalóczy, 2017). The same study revealed that over a few last years the legal, regulatory environment in Poland poses the systemic threat to the rule of law and creates legal uncertainty, whereas in Hungary legal uncertainty, changing taxes, deteriorating institutions, corruption are problems (Éltető & Antalóczy, 2017, p. 26). Yet, in 2012 the Hungarian government introduced the system of 'strategic agreements' which has been signed with a number of foreign companies. The aim was to encourage the activity of only selected, preferred multinational firms with the declaration of partnership. Up till May 2017, the number of signed strategic agreements was 74, out of which 65 partners were foreign-owned companies. The partners are concentrated mainly in electronics, automotive and pharmaceutical industries. The agreements were initiated mostly by the government and their content was rather uniform, stating the intention of general cooperation in job creation, training and education, R&D, local supplier network development. According to Transparency International Hungary (2014), foreign firms hoped that this new agreement would ease communication with the Hungarian government, despite its often unfriendly rhetoric. Hence, as argued by some experts, it is not that FDI overall is not welcome any more in Hungary. It is mainly the horizontal type which is discriminated against.

Paradoxes and Limitations

Bearing in mind the role of the state in internal and international affairs, we ventured to pre-examine the dependencies between public policies and FDI inflow. Unfortunately, no decisive conclusions can be drawn, most probably due to two reasons. Firstly, the timeline of the analysis is insufficient – the time elapsed between the electoral change and today is yet too short to indisputably draw a link between the two phenomena. Secondly, if the dependency is to be seen, it will probably happen with a time-lag and so it will only further push for a more extensive dataset. Therefore, a visible limitation to our study is the insurmountable barrier of time. However, with this in mind, we would like our study to serve as a starting point for future discussion.

Of course, to assess accurately the role of policy as a factor influencing foreign investor decision, more robust econometric analysis would be required. Yet, based on this kind of reports, one may suppose that the newly elected, apparently conservative and FDI unfriendly governments in Poland and Hungary have not shaken the inflow of foreign capital as presumed. The explanations can vary. One is the corporate long term strategy and inertia of this kind of process, another is the relative perception of investment conditions, though perhaps worse than it used to be, but business environment in these two countries is probably still much better than in unstable Russia, inward-looking USA or unpredictable Great Britain outside the EU.

The necessity of discussion is even stronger bearing in mind the recent business media and reports by consultancy firms released in 2017. The not overly optimistic picture arising from the UNCTAD Report may be contrasted with E&Y Report (Szadkowski, 2017) which claims that Poland remains the fifth best location for foreign capital and the value of transaction in 2016 increased by 74%. Not only has the number of projects and the value of invested money increased recently, but investors, when asked about their opinion, are reported to expect an improvement in Poland's attractiveness. The figures are optimistic and seem to deny the popular opinion of a negative effect of the unfriendly policy of the new government, deterring the investor. The interpretation here is the following – it is not the policy as such but rather the intrinsic features of long term investing that explain the inertia of FDI inflow. The commitment of assets and resources, corporate strategy and a long-time perspective make investors not abandon their plans once the government changes in a host country. Such rhetoric seems to stress and attach more importance to real conditions, hard data than political consideration, party manifestos or other ideological declarations. Another approach broadens the perspective and sees the Polish and Hungarian complications and seemingly the departure from neoliberal mindset against the background of much deeper, profound and radical processes taking place worldwide, such as the victory and presidency of conservative Donald Trump, Brexit and the return of protectionism across advanced economies.

CONCLUSIONS

There are common fears that the Global Financial Crisis brought back the economic patriotism or even protectionism. Financial turbulences, trade imbalances, instability of fiscal policies and problems on labour market have justified intervention of the state. Various measures have been launched and policies altered. The concern of protectionism has been directed also towards the CEE as right-wing parties have come to prevail in Hungary and Poland, seemingly posing a serious challenge to neo-liberal regime. The change of government and reorientation of general policy does not have to imply the simultaneous change of a particular type of policy, namely the one pursued towards FDI. It should be mentioned that the government changes in these two countries were not due to crisis-induced, unpopular austerity measures forcing many European governments to step down. In the case of Poland and Hungary the new governments come from regular election. Regardless of the origins, scholars and experts point to the risks attached to these new inward-looking policies. The change may unintentionally answer the question of too lax and too liberal previously pursued policies of inviting foreign investors. We should remember that the observed tendencies might result also from other developments and reflect changes of other than

policy factors. One more aspect we should bear in mind are investors who might perceive, contrary to the majority and the common wisdom, the more unstable and volatile environment and political instability as an advantage enabling reaping extra benefits. Hence, we cannot exclude the situation when the unpredicted, apparently less friendly environment is perceived by some groups of foreign investors as an actual advantage, opportunity to extract extra profits, to outdo competition, do a pre-emptive strike.

Following the financial turbulence of 2008 and the economic crisis which ensued, adjustments have been made in major fiscal and monetary policies. Relatively little appears to be known about possible modifications to policies in other secondary areas of governmental activity, such as foreign direct investment. Not only thanks to the convenient macroeconomic conditions, but also due to the pursued policies, have the CEE countries hosted a large number of affiliates of multinational enterprises (MNEs). The transition processes towards full market economies, further economic development and the EU membership have created an evolving context for pursuing the FDI policies. The Great Recession and emerging 'departure from neoliberalism' or the feared 'return to protectionism' might suggest certain reorientation in the approach towards FDI adopted by the CEE countries. The proportion between a country's outward and inward FDI is intrinsically related to the country's economic development as laid out by Dunning's Investment Development Path, nevertheless, it depends also on the policy being pursued (Götz, 2016). Such policy usually changes over time from aiming at the reduction of market failures towards promoting better integration between domestic and foreign firms and stimulating home companies to venture abroad (Fonseca, Mendonca, & Passos, 2007). An important finding is that during the recent crisis, there was a tendency towards less integration, which manifested itself in the resurgence of domestic rather than foreign sourcing.

Public intervention in market economy comes in many forms. The state is far more than a rule setter. Governments can act as goal-oriented strategists, through public policies and mechanisms ranging from firm ownership to more indirect intervention designed to promote internationalisation (Colli, Mariotti, & Piscitello, 2014). The outcome of the interaction hinges on the country's form of capitalism – rooted in historical and cultural behavioural models and subject to path-dependent institutional changes. Even seemingly similar economies such as the V4 countries differ in the character of change and the role of key actors.

The CEE countries with Hungary and Poland being notable examples have been building their development model of attracting foreign capital for a long time. This high dependence combined with deteriorating business conditions, more nationalistic policy and the overall worse global sentiment make governments of these countries resort to other, more selective targeted measures to attract foreign capital. Applying them somehow contradictory to the general line of policy making in these states can paradoxically help improve the policymakers' image and in case of successful investment be used as a success story. Hence, the government can be credited with winning an important investor. Nevertheless, cases of the reorientation of the policy towards incoming FDI (reversing or slowing privatisation processes or seeking alternative sources of growth) can be found in recent literature (Szanyi, 2016).

As revealed by Éltető and Antalóczy (2017), legal stability has shaken in Hungary and Poland, yet these countries still compete for large investments, by making grants for foreign firms (narrow incentives) of growing importance. However, this can be true in the

short run, but cannot endlessly compensate for the mentioned worsening business climate, that is promotion in a broad sense (Éltető & Antalóczy, 2017). The clash between perceived deteriorating friendliness of Poland and Hungary towards foreign capital due to more conservative policy reorientation and yet good FDI performance might be also explained by the peculiarities of investment processes. The decision is usually a two-stage or even multi-stage process and targeted promotional efforts will be meaningless for attracting FDI if macroeconomic fundamentals are flawed (Éltető & Antalóczy, 2017). Hard data and facts are crucial for investors to decide about location of their investment but.

Thus, bearing in mind the ambiguity of the situation and having conducted a qualitative not a quantitative analysis, we attempt to propose a hypothesis for further research. We argue that *in the long term, the perception of democracy and freedom in the post-transition CEE economy, traditionally highly dependent on FDI, influences the FDI inflow to the country, but the analysis of the role of institutional and political changes need to be context-embedded*. With the snapshot of the current economic and political situation, we feel that there is enough evidence to investigate this matter with quantitative means, once enough time has passed. Some contradictory tendencies as revealed by our qualitative study and the quoted reports may be explained and interpreted by taking a broader perspective and accounting for the peculiarities of foreign investment and the CEE countries dependency on FDI. We would see our study as making the case for more subtle analysis of the institutional dimension of a country's attractiveness for FDI. Our findings seem to highlight the necessity of including a more nuanced and broader context-embedded analysis of the role of institutional changes on FDI flows. It also stresses that the actual change on the political scene and even the resulting possible shifts in the perceived transparency or quality of institutions do not have to translate into actual changes in the inflow of foreign investments. In this article, we have tried to show the idiosyncrasy of the relationship – institutional election-induced changes in the political landscape and the subsequent modification of attractiveness sentiment leading presumably to changes in the actual FDI flows. We argue that there is a need for more nuanced analysis of such linkages, as they prove to play an important role, though very much context-embedded and subject to broader settings.

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