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Multinational enterprise strategy, foreign direct investment and economic development: the case of the Hungarian banking industry

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Abstract

This paper examines foreign direct investment (FDI) in the Hungarian economy in the period of post-Communist transition since 1989. Hungary took a quite aggressive approach in welcoming foreign investment during this period and as a result had the highest per capita FDI in the region as of 2001. We discuss the impact of FDI in terms of strategic intent, i.e., market serving and resource seeking FDI. The effect of these two kinds of FDI is contrasted by examining the impact of resource seeking FDI in manufacturing sectors and market serving FDI in service industries. In the case of transition economies, we argue that due to the strategic intent, resource seeking FDI can imply a short-term impact on economic development whereas market serving FDI strategically implies a long-term presence with increased benefits for the economic development of a transition economy. Our focus is that of market serving FDI in the Hungarian banking sector, which has brought improved service and products to multinational and Hungarian firms. This has been accompanied by the introduction of innovative financial products to the Hungarian consumer, in particular consumer credit including mortgage financing. However, the latter remains an underserved segment with much growth potential. For public policy in Hungary and other transition economies, we conclude that policymakers should consider the strategic intent of FDI in order to maximize its benefits in their economies.

1. Introduction

It is claimed in the literature (Dunning, 1993; Porter, 1990; Vernon, 1966) that foreign direct investment (FDI) and multinational enterprise (MNE) activity contribute to the economic development of an emerging economy through numerous channels. These include employment creation (and associated rising incomes), technology transfer and general upgrading of industrial standards to world levels. Furthermore, it is possible to draw a contrast between FDI that is fundamentally resource seeking and FDI in services which is market serving (Birkinshaw & Hood, 1998). This allows us to focus on the strategic intent of FDI.

The dramatic changes that occurred in 1989 in central and eastern Europe (CEE) created an ideal setting for an empirical appraisal of these claims. With the collapse of state socialism, there was a desperate need to move towards a market-led enterprise economy. One of the most frequent policy prescriptions

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for transition economies was to liberalize their industrial sectors by encouraging FDI and foreign ownership. Among the CEE economies, Hungary has led the way in adopting this development strategy. At the same time as the 1989 changes, increasing economic integration at a global and regional level has significantly strengthened the role of MNEs in the economic development of countries in general.

The first few years of the arrival of FDI in Hungary were heralded as a significant step forward in the modernization of the Hungarian economy. Old, obsolete capital was replaced with new, efficient plant and machinery. New business practices were introduced with a commercial, market focus. Those areas of excellence in Hungary that were regarded as world class have been supported by injections of new capital. Above all, unemployment caused by the collapse of the state socialist planned economy has been partially solved by employment created by MNEs. In international organizations and governments around the world, Hungary has been lauded for undertaking the necessary liberalization of its economy. Today, over 50% of Hungarian GDP is produced by MNEs and a staggering 80% of Hungary's exports is produced by MNEs. Most modern western European economies were based on the activities of small national firms created in an era of closed economies and which would later grow and become multinationals through the course of the twentieth century. But in the globalized economy post-1989 this model of development via the creation of a national entrepreneurial structure was not available to the transition countries of Central and Eastern Europe (Inotai, 2000). Therefore, the MNEs have become the engine of economic development for this region.

As long as the Hungarian economy continues to grow, one can expect to see foreign companies remaining active, particularly in the emerging service sectors. The objective of this study is to trace the development and effects of foreign direct investment in Hungary, one of the leading transitional economies of Central Europe and which in 2004 will attain EU accession. Given the broad and extensive nature of this topic, we wish to pursue that branch of FDI known as *market serving* investment (as opposed to the export-driven or *resource seeking* variety), and concentrate on the role played by FDI in one key market serving sector in particular, that of banking, regarded as being central to the sound development of an economy. In doing so, we will attempt to determine if some of the claims made in the literature regarding the effects of FDI on transitional economies hold true in the case of the Hungarian banking sector during the post-Communist period.

The paper is organized as follows: Section 2 provides a conceptual framework for the impact of FDI in a transition economy. Section 3 gives an overview of FDI in Hungary. It presents aggregate data on FDI and presents a general picture of the state of MNE involvement in Hungary. Section 4 focuses on FDI in the Hungarian banking sector as a case study of the role of FDI in service industries. Section 5 is a concluding section.

2. Effect of FDI on transition economies

First of all, it is important to ''define'' our concept of transition economy by highlighting what we regard as key characteristics of this kind of economy. We impose the following restrictions on our ''definition.'' We are making claims about transition economies (TEs) based largely in Central and East Europe (CEE). In doing so, we are not examining the development of TEs in South East Asia such as Vietnam or the former Soviet Republics in Central Asia such as Kazakhstan. Second, we wish to take account of approximately one decade of economic reform and hence focus on TEs in CEE that are making strides to join the European Union in the coming decade. In this sense, we eliminate from our analysis TEs such as Russia, Ukraine and Belarus, which are highly unlikely to be considered EU candidates in the immediate term largely due to a relative inability to undertake substantial EU-compliant reforms in their economies. Third, we conceptualize CEE TEs as being relatively small in economic terms, i.e., GDP per capita. This has an important implication when we consider the strategic intent of FDI below. Fourth, with the exception of Slovenia, we ignore the former Yugoslavia given the unique situation caused by war during the break-up of the former federal republic. By imposing these restrictions, we are left with a raft of CEE economies. Even among these, we can see significant differences between larger TEs such as Poland and Romania and the small Baltic republics.