FDI AND NATIONAL LABOR REGULATION

CASE STUDY OF THE AUTOMOTIVE INDUSTRY IN

HUNGARY AND THE SLOVAK REPUBLIC

By

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I, the undersigned Victor Rotari, hereby declare that I am the sole author of this thesis. To the best of my knowledge this thesis contains no material previously published by any other person except where due acknowledgement has been made. This thesis contains no material which has been accepted as part of the requirements of any other academic degree or non-degree program, in English or in any other language.

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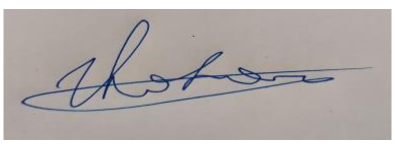
Signature: 

ABSTRACT

This thesis explores the different ways in which Slovakia and Hungary managed their public policies in response to the need to attract foreign direct investment. It uses data from various labor protection databases quantifying leximetric indicators to compare the outcomes for the protection of workers in both countries. It also showcases the German automotive giant Volkswagen, to see if or how their investments influenced or were influenced by changes in the national legislation regarding labor standards and regulations in Hungary and the Slovak Republic. It focuses on the paths and approaches taken in Post-Socialist period as means to explain the diversity in outcomes. Although very similar in many regards, the two Visegrad countries have responded differently to the pressures of the corporation's interests in the never-ending race to the bottom of attracting investments, generating growth and creating jobs. The paper uses focused comparison to see the way the two countries arrived at different outcomes for their citizens, while being courted by similar investors and having all other circumstances in high similarity.

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Table of contents

List of Figures, Tables or Illustrations

List of Abbreviations

CEE – Central and Eastern Europe

EU – European Union

FDI - Foreign Direct Investment

OECD – Organization for Economic Co-Operation and Development

ILO – International Labor Organization

Introduction

Central and Eastern European countries, after the fall of the Iron Curtain have had a diverse and tumultuous economic and social development. All countries adopted a varied array of public policies to respond to the need of economic growth and promoting their citizens' well-being. Both Hungary and Slovakia started from positions that were in many ways similar, such as the need for liberalization, foreign debt, loss of traditional markets, uncompetitive industrial complex, highly skilled human capital and favorable geographic positions. At the same time the two examined Visegrad countries had also a large number of differences, like the fact that Hungary used to have a relatively more free economic system even in the socialist period, while the Slovak economy, at the time part of Chzecoslovakia, was deeply rigid and with a planned structure. The existing differences seemed to favor Hungary in the initial period, the country exhibiting better economic outcomes and more success in attracting foreign investments at start of the 1990ties, but as we show further, currently Slovakia is ahead of Hungary in important indicators such as median wages for workers and levels of inequality. It has been long argued in the literature the extent to which public policies influence the outcomes for the population of the activities of the markets and the influence of the presence of foreign direct investments on the wages in the country and other indicators of interest. In the following chapters we try to take a look into the power and extent of foreign investments in shaping national public policy, and the importance of the way governments handle this important tool in finding the right balance between economic growth and the well-being of the population.

Having a clearer picture of the abovementioned relationship is of high importance in this time of never-ending race to the bottom of governments to provide incentives and attract multinational corporations. The need for growth and job creation cannot be neglected or disproved, and it is certainly not the scope of this paper. At the same time it raises the question of the importance public policies that strike the balance between being friendly to business but at the same time ensuring the protection of the interest of the larger population. It is especially important now, as the disruptive effects of technology start to be more and more visible and create the possibility of uncontrolled and unparalleled levels of inequalities due to the increasing returns from capital and decreasing returns from labor, and all these can only be kept in check by the wise intervention of the governments. The wise part is finding the right balance between being friendly to investors and incentivizing them to invest, but at the same time creating clear and just rules that ensure growth is sustainable and favors everyone, or at least most of the population.

The thesis starts with a literature review in the Chapter 1, outlining the debates in the relevant literature over the years on the impacts of Foreign Direct Investment in different country contexts. It looks at subjects such as FDI and public policy and FDI and inequality. This chapter also offers some introductory information about the two countries examined in this thesis and the evolution of the automotive industry both jurisdictions. The second chapter outlines the methods used for this research, the justification of selecting these particular country cases focused on their preexisting similarities and differences and also the possible limitations of the used methods. Chapter 3 presents the comparison of the two contexts using the selected indicators from several international databases and through the prism of the interests of the German automotive giant Volkswagen and the extent of its investments in the two countries. The las part of this work is the conclusion, which draws on the information analyzed in the previous chapters to illustrate the findings.

Chapter 1 – Literature Review

This chapter outlines the major debates in the relevant literature over the years on the impacts of Foreign Direct Investment on different country contexts. It examines at subjects such as FDI, public policy, inequality and their interconnectedness. This chapter also offers some introductory information about the contexts in two countries after the fall of the Iron Curtain and their similar but also very different path to build free and competitive markets. The chapter concludes by looking at the evolution of the automotive industry both Hungary and Slovakia after the fall of the socialist regimes.

1.1 FDI and Public Policy

Public policy is the most important tool in ensuring equitable outcomes for all members of society. It is also of crucial importance in preventing or handling the potential adverse effects of globalization on income inequality in today's societies. This relation, described by Stiglitz in chapter three of The price of Inequality, 2013 is also relevant in judging other effects of foreign direct investment. While warning against the perils of growing inequalities, he highlighted the role of the government in correcting market failures that can lead to it. He argued that economic growth does not necessarily have to be accompanied by extreme inequalities. Wise public policies can prevent outcomes that are beneficial for a limited number of individuals, while at the same time being detrimental for large portions of the countries' population and hindering growth in the long run (Stiglitz 2013). Similar views were expressed by Thomas Piketty in Capital in the Twenty-First Century, 2014. History proved again and again how extreme outcomes can be prevented by the right interventions from governments. The uninspired policies around the globe, tied with never before seen technological progress and connectivity are currently creating a world of unprecedented levels of inequality. As Piketty argued, "economic trends are not acts of God" governments previously have acted in ways that efficiently controlled extreme inequality, and can and should aim to do it again (Piketty 2014).

Foreign direct investment has long been regarded as a key ingredient in promoting growth for host countries, especially in the developing ones. Governments all over the world compete to lure investors to bring their funds to developing economies, armed with the conviction that it is the silver bullet for ensuring growth, creating jobs and developing the country(Abbes et al. 2015). In some regards they are right, previous studies show that foreign direct investment can be an efficient tool for transferring technology, with a higher contribution to growth than domestic investment. At the same time, the increased productivity effect appears only when the receiving economy already has a base stock of human capital. In this way, foreign direct investment contributes to the economic development of the host only in the presence in the latter of enough capacities to absorb and integrate the advanced technologies provided by the investing companies (Borensztein et al. 1998). Although, foreign direct investment can undoubtedly provide significant benefits for the host country, it should not be pursued as an end in itself. There are proven side effects of this remedy for growth. Studies have shown, that besides promoting growth and stimulating the economy FDI can potentially have adverse effects on the host country. For example, Taylor and Driffield, in their 2005 paper, have gathered evidence from UK panel data to see the role played by multinationals on inequality. Their findings proved that FDI has had significantly impacted wage inequality, even after including controls such as technology and trade. The authors disproved, or at least showed the smaller positive spillover effects of FDI on national markets when it comes to productivity and wages(Taylor and Driffield 2005). The same question, of the impacts of FDI on wage inequality, this time in the context of China’s economy, was examined by Chen, Ge and Lai in their 2010 paper. Their analysis showed similar effects. The authors also concluded that given the importance states put on growth, and their relentless race to attract foreign investments should be done while considering the possible negative spillover effects (Chen, Ge, and Lai 2011). In this regard, the unending race to the bottom of governments trying to attract investors to their countries, at any cost, should be examined critically, to ensure that the results for the general population are beneficial, rather than negative, and that all things considered, everybody is better off.

The intersection of foreign direct investment, labor regulation growth and socio-economic development presents and interesting subject in itself. Previous academic research into the subject of the reciprocal relation between regulation and long-run development has shown that labor regulation is a decisive element in the pattern of manufacturing development. Evidence from India showed that pro-worker regulation resulted in a decrease in the levels of investment, number of jobs and productivity of industries. It was also shown to encourage the growth of the informal economy. Besley and Burgess' paper found little evidence that regulations marked as pro-worker have in fact improved outcomes for workers, but instead that such regulation has in fact stunned growth and prevented decrease in poverty. The important aspect of these findings is the degree to which labor market institutions in India have had an impact on the industrial advancement of the country. Although the results might seem unexpected, the paradox of regulations aimed at protecting workers, actually having a negative impact on the population, should be an additional argument for the careful consideration of public policies, especially regarding rules and regulations and manufacturing development. Growth that is shared by most of the population and is beneficial to the bulk of the population can only come as a result of improved regulatory policies. The right balance between helpful and harmful regulation can only be found after careful consideration of each country's specific context, because there are various factors that potentially influence the outcomes in this regard(Besley and Burgess 2002). At the same time if the price of attracting investment is the security and wellbeing of workers, is it not a too high price to pay for growth?

1.2 Background information about Hungary and Slovakia post 1990

Countries in the region have undergone significant transformations in the recent decades. The speeds and intensity of the changes were not the same across the different countries for multiple reasons. The economic development of the CEE countries, and specifically Hungary and Slovakia, has been covered by many authors to date. Substantial analytical work has been done by Dotothee Bohle and Bela Greskovits in Capitalist Diversity on Europe's Periphery. The authors examined the diverse evolution of the capitalist institutions in the post socialist countries, their transformations to adopt free markets and their path of European Integration. The most important insight from this book for the current thesis is the diverse models adopted by the countries in the region on their paths to prosperity, as well as the factors that influenced the ways in which actors walked the line of building market economies with elements of neoliberalism while at the same time maintaining social cohesion and principles of welfare capitalism. Another key aspect is the extent to which national governments went in the race of attracting foreign investors to create generate growth and create jobs(Bohle and Greskovits 2012).

Although very similar in many regards, Hungary and the Slovak Republic have had different approaches to the adaptation and implementation of industrial policies. The two countries, that can be both classified as embedded neoliberal economies, have pursued different paths in managing their economic development and attracting foreign investments. Hungary initially opted for a gradual but comprehensive and vertical industrial policy, aimed at supporting small and medium enterprises, with non-negligible engagement from the state, especially in education and industrial policy. On the other hand, Slovakia's governments adopted a more liberal approach and went for the regulatory role in most areas, especially in the first decade after the fall of socialism(Duman and Kureková 2012). The approach of the Hungarian government in this regard shifted during Victor Orban's second term as prime-minister. The new policy was increasing the economic output at all costs and was based primarily on incentivizing German car manufacturers to invest heavily in their Hungarian plants as part of a general push toward increasing the creation of jobs and overall increase of the national GDP. The incentive package included changes in taxation, deregulation and overall liberalization of the economy, accompanied by increased state control in other areas, decreasing political diversity and freedom of speech.

It can be said that Hungary and Slovakia have explored the notion and form of foreign direct investment in quite different ways. Foreign investment was inexistent before 1989, but had seen exponential growth in the region, to various degrees and speeds in different countries. The initial movement into the region was not significant, but it has subsequently bloomed, which led to a noticeable portion of their outputs, taking into consideration the size of these transition economies. Investment has grown exponentially in many cases. As shown by Nina Bandelj in From Communists to Foreign Capitalists: the social foundations of foreign direct investment in post socialist Europe : "Since 1995 average FDI stock as a percentage of GDP for Central and Eastern Europe has been higher than the world average; by 2004, it was almost twice as high"(Bandelj 2008)p. 31).

1.3 The evolution of the car-manufacturing sector in Slovakia and Hungary

The evolution of the automotive industry in the region has been extensively studied over the years. This is due to the huge importance that this particular industry has played on the post socialist evolution of CEE countries, but also the high interest of major car manufacturing concerns in the region, due to its low labor costs and regulation(compared to “richer” European countries), highly skilled labor force and to a certain degree, developed industrial infrastructure. Another important advantage these countries provided was their geographical closeness to Western European markets, supply chains and transport nodes. Werner’s 2004 paper, examined the various foreign investment in the auto industries of Visegrad countries after the decades after the fall of Communism while analyzing de factors that influenced the investors to choose the specific countries or regions to invest (Werner 2003). Pavlinek, has examined the effects of foreign direct investment on the transformation of the passenger car industry. The author looked at the various levels of embeddedness of manufacturers into the host economies, and the diverse resulting outcomes. He has shown how automotive industry, fueled by foreign investment, helped the emerging economies of the region to integrate into the larger European industrial and commercial network (Pavlinek 2002). The World Bank’s Commission on Growth and Development working paper No. 29, also examined the investments made in the automotive industry in the CEE region, focusing on the Slovak Republic. It examined the effects of these investments on the country’s productivity and output growth, the Slovak case being a good example of an unbelievable leap to one of the region’s fastest growing economies as a result of strong commitment to reforms combined with efficient efforts in attracting foreign investments. The paper offers a comprehensive analysis of the incentives provided by the Slovak government for international car manufacturing giants, while ensuring sufficient social protection for its workers to prevent external migration(Jakubiak et al. 2008).

Hungary and the Slovak Republic, along with other countries in the Central and Eastern European region have a long tradition when it comes to car manufacturing. According to Hungary’s Investment and Trade Agency the Hungarian automotive industry began more than a century ago, in 1905(HITA 2012). A couple of decades later, the Czech manufacturer Skoda was established as the first local company to develop its own passenger car design.

The industry in both countries developed in the socialist era servicing the needs of the socialist planned economy, mostly as dictated by Moscow. It had low efficiency and produced cars that could not compete on the international market. In the 1980ties the industry started implementing improved technologies shifting to Western markets. However, by the end of the communist era, the entire region's factories produced only about 5.8% of the world's passenger cars(Pavlinek 2002). After 1990, both countries, similar to the entire region, tried to incentivize foreign capital to invest in this branch of the economy. The freshly liberalized countries used the end of the Communist era as their way back into Western Europe. Several factors had a positive impacts on those efforts. First of all, the industrial tradition in the car manufacturing sector as well as in related heavy industry sectors. Another attractive detail, the developed human capital, with skilled workers and high quality technical education. At the same time, investors were attracted by the opportunities provided by the emerging CEE markets and their proximity to the well-developed Western markets(Jakubiak et al. 2008). In addition to the cheap, but very skilled labor, the examined countries also provided an additional advantage. The labor legislation, covering work hours, compensation and vacation policies were somewhat more relaxed compared to other European Union countries.

Most important foreign investments in the automotive sector in Hungary and Slovakia include:

GM Opel – initiated their investment in Hungary by establishing a subsidiary in cooperation with the Hungarian Rába company in 1990. Before that, Raba was a state-owned company. Their plant in Szentgotthárd manufactured trucks, diesel engines and axles (Jagodzinski et al. 2006).

Suzuki – in 1991 the Suzuki Motor Corporation established the Magyar Suzuki Corporation, with the participation of the World Bank, and subsequently, in 1992 launched a factory in Esztergom, a town in the West of Hungary. The company invested more than $400 million in the next years, increasing the production to a 280,000 units in 2008(HITA 2012). The Suzuki investment in Hungary is an example of a greenfield investment that was quick to become intertwined with the host country's economy, by being mostly serviced by local suppliers(68% in 1998) (Pavlinek 2002).

PSA Peugeot Citroen – in 2003, after a long process of choosing from all Visegrad countries, the company chose the Slovak town of Trnava as a site for its next plant, a greenfield investment, that was launched in 2006, producing its 100,000th vehicle by 2007(Jakubiak et al. 2008).

Volkswagen – in 1991 Volkswagen acquired the Czech manufacturer Skoda. In the same year they bought a 80% share in the Slovak company BAZ, modernizing and expanding the production in the plant located near Bratislava. In 1998 the company became a full subsidiary of the Volkswagen Group, being renamed Volkswagen Slovakia, a. s. in 1999. The factory in Bratislava was an instrument for Volkswagen to cut their costs by transferring the assembly of certain parts from Germany and by this to significantly boost their competitiveness in their global markets(Pavlinek 2002). Later with the unexpectedly high productivity of the plant and after investments of up to $1.5 billion, the plant became one of the most prized in the group's portfolio(Jakubiak et al. 2008). According to the company's website : "Volkswagen Slovakia ranks among the pillars of Slovak export and since the company's establishment it has invested more than 4.35 billion euros in Slovakia" (www.visit-volkswagen.sk 2019).

In Hungary another part of the Volkswagen group, **Audi,** opened a factory in Gyor in 1992. With investments of up to €700 million in a decade, the plant manufactures engines, being the biggest maker of Audi engines in the world(Jakubiak et al. 2008). In 1998 the company initiated the assembly line of automobiles, surpassing the mark of 100,000 vehicles in 2014 .

A somewhat more nuanced perspective was adopted by looking at industrial relations and the flexibility policies adopted by the automotive giants and their subsidiaries in the region. Diverse labor legislation and institutions in the countries in the region prompted corporations to adapt to different contexts. Variations regarding work time flexibility, pay, including for overtime, were also results of the internal corporate cultures of the origin countries of the corporations. The mentioned elements dictated the investing companies' approach, regarding three major directions: the extent to which they recognize and accept national legal provisions, or attempt to change or simply ignore them; how much value the companies put into the negotiations with the labor representatives; and to what extent they apply their own employee relations and management systems from the origin country contexts(Drahokoupil, Myant, and Domonkos 2015).

Chapter 2 – Methodology

This chapter outlines the methods used for this research and explains their utility in this context, it also presents the reasons for of selecting these particular country cases and the possible limitations of the used methods in attaining the pursued goal of the research.

2.1 Research Method

This thesis aimed to examine the differences in outcomes for two similar countries that were both competing to attract investors to their economies, and to incentivize them to invest more once they were there.

To achieve that goal the method of focused comparison was used. In order to see the differences in the outcomes for the selected countries, a vast array of quantitative legislative indicators were gathered from several databases. Using these data we look at evolution in time of the legal labor protection in Hungary and Slovakia and at the differences in the indicators after the fall of the socialist system. Given the similarity in the sizes of the investments from one particular car manufacturer, Volkswagen, which occupies a huge segment of both countries' economic output and employs large a large enough number of workers to be influential, we look at how the two states had responded in the area of labor regulation, which as we know is one of the key factors taken into account by firms before investing in particular countries. The use of this method allows to peer into the generative mechanism of the drivers of foreign direct investment and national public policy. We try to see to what extent one influences the other, and which way does the causality actually run? We aim to focus on the illustrative independent and dependent variables and try to see if the prediction of the influencing factors on the particular outcomes in the country. We also examine other socio-economic indicators to establish a clearer picture of the examined country cases. This will allow to see the extent of interaction between national public policies and their direct and indirect effects on the population.

2.2 Case selection

The two country cases selected for this analysis are Hungary and the Slovak Republic after the fall of the socialist system at the beginning of the 1990ties. There are several reasons for choosing these particular cases to compare.

The firs reason to choose these particular two countries is the on the one hand the high similarity of circumstances influencing the countries at the time of the fall of the socialist system. Similarities are also salient when looking at the high reliance on foreign direct investment in the transformative period after the fall of the Iron Curtain, when both countries were trying hard to establish a market economy and compete between themselves and with other, more developing Wester European countries. Another similarity that was a reason for choosing Hungary and Slovakia was the interest of the same automotive giants in establishing production in these countries. In particular we look at Volkswagen who acquired a controlling, 80 share in the Slovak BAZ in 1990, and then purchased Skoda entirely and established Slovakia as its production ground for many of its world renown models. The concern's subsidiary, Audi initiated its investment in Hungary by purchasing an old manufacturing plant in Gyor and over the years invested several billions of euro in its development, making it the biggest maker of Audi engines in the world. Both countries were attractive to investors for similar reasons, cheap but highly qualified workforce, relatively well-established industrial infrastructure, geographical proximity to European transportation nodes and governments that were more than happy to offer attractive incentives and pose for pictures on new plants demonstrating their ability to create jobs in their countries. The last similar aspect determining the choice of these two countries is the extent to which the car manufacturing business forms the bulk of both countries' GDP and share of export. In Hungary the share of the automotive industry in the GDP is around 10% and 20% in the total of goods exported from the country in 2014(CTC 2014). In Slovakia, those numbers are 13% and 35 % respectively in 2015(Liptakova 2015).

Another reason for selecting these two country cases was in fact the differences existing between them. The relatively different political systems, various levels of openness in the first years after the fall of socialism could serve as important indicators of the variations of the indicators presented in the analysis part. Despite the mentioned similarities, the two countries also had relatively different economic systems in the pre 1990ties era. Hungary started earlier on its liberalization path, while Slovakia, having been part of Czechoslovakia, started in the aftermath of a very strict planned economy.

2.3 Limitations

The limitations of this research are given by the very high complexity of the phenomena examined. The economies and legal systems of both countries are part of the international system and are influenced both by internal and external factors. Establishing an exact causality relation between the flow of foreign direct investments and the national legislation is at best a brave undertaking. We have no way of guaranteeing absolute truths in this research, and it is by no means the goal. The goal is to peer into the complicated generative mechanism related to the researched topic and shedding some light on previously unexamined aspects of the issues of labor protection and foreign direct investment .

Chapter 3 – Analysis

This chapter starts by presenting information and comparison of several socio-economic indicators attained by Slovakia and Hungary since the fall of the socialist regimes, it briefly looks at the diversity of public policies adopted by the governments and some of the resulting circumstances. The next part of the chapter presents the evolution of Volkswagen's and its subsidiary Audi in Slovakia and Hungary, the most important milestones and turning points since the initiation of the investments. The last part of the chapter presents the comparative analysis of the evolution of leximetric indicators of labor regulation in the two countries according to several legal index databases.

3.1 Socio-economic indicators in Hungary and Slovakia in the period from the 1990 to today

Both countries, along with their neighboring Check Republic and Poland deeply transformed their economies and social policies to integrate into the European Union's single market. The region quickly became one of the biggest clusters of high-value industrial production and export. They did that by attracting foreign investors with generous inventive packages, extensive infrastructural investments. At the same time, they kept, to various degrees social protection systems that could be qualified as generous. The countries pursued relatively different paths in reaching their current statuses. The differences were shaped by various factors, such as different contexts in the past, political actors in control of the power, pressures from external forces or even various degrees of interest from investors within the countries. All these processes were also shaped by the rivalries between the neighboring countries for investor's attention and for markets for their products. It can be said that the most important drivers of these changes has been the drive of the governments to incentivize the largest car manufacturers in Europe and in the world to bring their production to their countries. In addition to the cheaper work force compared to other European countries the level of human capital was also an attracting factor(Bohle and Greskovits 2012). Hungary and Slovakia were also geographically convenient, in terms of the proximity to the main industrial networks of the continent(Pavlinek 2002). But these advantages would not have been enough of an attraction point for investors such as Volkswagen, GE or PSA. The host countries also needed to be accommodating in terms of amending their legislations to fit the needs of the investors.

From the outset, Hungary differed from the Slovak Republic in the fact that in its socialist past, the Hungarian economy was already showing signs of liberalization. At the same time the Slovak one, being still part of Czechoslovak state was subjected to a very strict planned economy, and had to start liberalizing it from the roots. The early start should have been an advantage for the Hungarian Economy, but as statistics show, it was not a factor that prevented the Slovak Republic to be ahead of Hungary according to many indicators(Bohle and Greskovits 2012). Initially Hungary tried to combine the pro-business approach and pro-market regulation with a still generous social welfare system, which almost brought the country on the brink of default, those policies were later replaced by drastic fiscal conservativism under the Orban government.

Public policies implemented in recent years in Slovakia were directed at decreasing the level of unemployment, improve the business climate and generate new jobs. The most significant changes were adopted in the early 2000s restructured the fiscal system, the national healthcare and the social security system, including pensions and the welfare system. Several of the reforms impacted the income redistribution and others attempted to improve the business environment(Kahanec et al. 2012). Many of the mentioned reforms will be seen and described in more detail in the following subchapters.

According to OECD's[1] latest data, inequality is higher in Hungary than in the Slovak Republic. The GINI coefficient is for 0.24 for Slovakia, having significantly decreased in the last years, from 0.28 that is was in 2004. In Hungary the current GINI coefficient is 0.29, having steadily increasing from 0.27 in 2006. According to a 2013 GINI report: "Hungary has one of the highest market-income inequalities, but one of the lowest disposable-income inequalities. This means that the tax/benefit system has a significant role in shaping income inequality of the population" (Kopasz et al. 2013, p 110) these levels of inequality have been the result of uninspired public policies, aimed at attracting investments at any costs, without regard for the wellbeing of the Hungarian people, combined with a tax system that is regressive in nature.

Although the two countries started from positions that were slightly different, Hungary demonstrating indicators that were better compared to Slovakia, in the last years the positions have changed for the better in t the latter. According to OECD's 2017 publication, measuring the well-being of member countries, Hungary has a mixed performance across the different well-being dimensions. It has one of the lowest levels of household net adjusted disposable income in the OECD, as well as one of the lowest levels of average earnings. In the Slovak Republic, the same indicator is higher, the household adjusted disposable income being about two-thirds of the OECD average level in 2015. Another important indicator, long-term unemployment rate was 5.5% in 2016 in Slovakia, triple the OECD average. At the same time the employment rate in 2016 was 65%, or 7 percent over its level in 2005. Real earnings have increased steadily over the last ten years, attaining a growth rate of 28 percent. While Hungary has one of the highest levels of job strain in the OECD, but the long-term unemployment rate, labor market insecurity and the employment rate are all close to the OECD average. After attaining a low in 2009-2010, the employment rate has started increasing, currently being

[1] OECD (2019), Income inequality (indicator). doi: 10.1787/459aa7f1-en (Accessed on 09 June 2019)

almost 10 percent higher than in 2006. Earnings fell from 2008 to 2014, improving only slightly since 2015 – and they are now a par with previous 2005 levels. Labor market insecurity peaked at 11% in 2012, and despite falling since then, it remains one point higher than in 2007. Long-term unemployment made a comparatively swift recovery from the crisis, and (at around 2%) it is now below its 2005 level. Job strain has also improved in the past 10 years, with the share of employees affected falling from 57% in 2005 to 52% in 2015 (OECD 2017). Bellow, figure 1 illustrates the evolution of the real minimum wages in Hungary and Slovakia and figure 2 shows the evolution of the ratio of minimum relative to median wages of full-time workers in Hungary and Slovakia.

The institution of the minimum wage in Slovakia was instituted by law starting in 1991. Initially it was defined at 40 % of the national median wage. In 2000, it has been changed to 35 %, only to be recently set at back 40% of the average wage. Political debates regarding minimum wage in the Slovak Republic have been going on for decades. The national legislation stipulates that is should be subject to indexation every year, but there is no clear legal mechanism regarding the procedure. As a result, it is a subject of negotiations between the government, business and trade unions. Some of the actors, illustrate it as an efficient tool for combating inequalities, especially because of the phenomenon of in-work poverty such as the unions and center-left parties, while employers and center-right parties portrait it as an impediment to the generation of growth and new jobs(Kahanec et al. 2012). Recent amendments to Slovakia's Labor Code, in 1 May 2018, introduced higher wage supplements for night work, which amounted to 30% of the hourly rate of the minimum wage – previously 20% – and for working during public holidays, which amounted to 100% of the employee's average wage – previously 50%. Changes to the same law also created supplements for work done on weekends, set at 25% and 50% of the hourly minimum wage respectively. The hourly minimum wage in 2018 was €2.759. Wage supplements were due to increase further from 1 May 2019(Cziria et al. 2019).

In Hungary, the minimum wage is decided by the Government following multipartite consultations with national civil dialogue institution, the National Economic and Social Council (Nemzeti Gazdasági és Társadalmi Tanács, NGTT). As stipulated by the Labor Code this multipartite civil dialogue body included a wide range of organizations, including churches and chambers of commerce. Before deciding the rate of the minimum wage, the Government takes into consideration the views the social partners of the private sector within the national tripartite body, the Permanent Consultative Forum of the Private Sector and the Government (VKF). This in fact is the terrain of negotiations regarding minimum wages, partly as a result of previous practices, changed by the new Labor Code, when the civil dialogue body had a co-determination right in setting the minimum wage. So in essence the minimum wage is set by the Hungarian government, and in 2001 and 2002, the minimum wage in the country was doubled. This affected average wages in the country, they also increased, the relative level of the minimum wage increased from 0.29 to 0.41 within this short period and remaining stable since then(Kopasz et al. 2013).

Hungary also has the highest implicit tax rate on consumption, being on the increase starting in 2007. The portion of consumption taxes in the total expenditures for consumption of Hungarian households was 28.1% in 2012, which represented a value 11.4 % more the similar proportion in the Slovak Households. Starting in 2004, the Slovak Republic is the only country in the region with an implicit tax rate on consumption that is lower than the average in the European Union (Moździerz 2015).

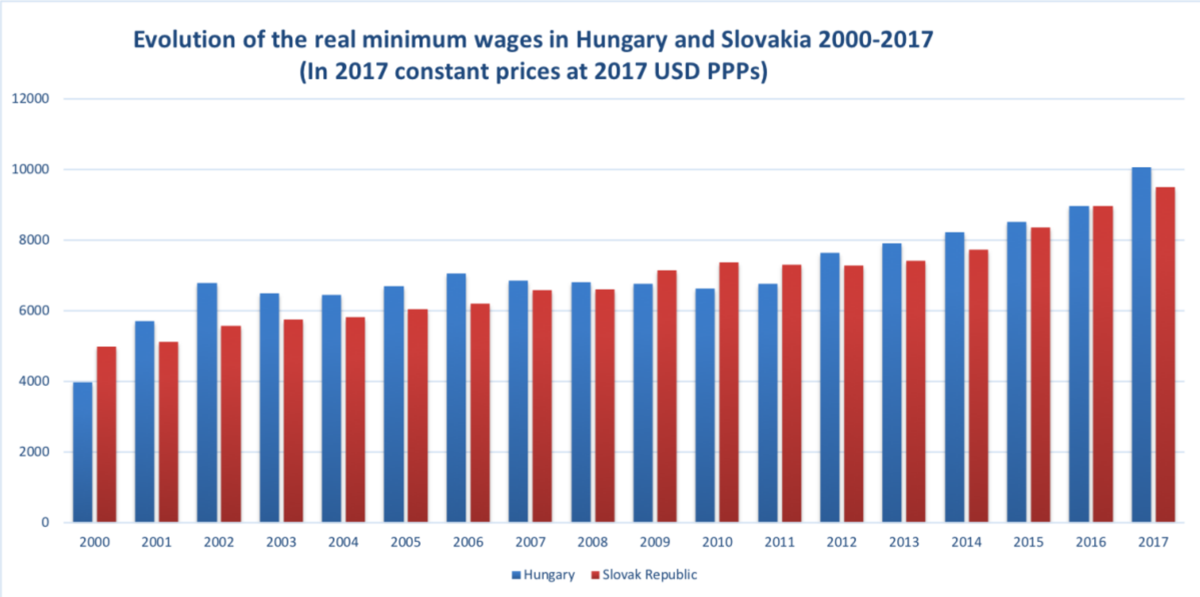

Figure 1 Evolution of the real minimum wages in Hungary and Slovakia, 2000-2017, Data source: ("OECD.Stat" 2019)

Figure 1 illustrates the comparative evolution of the real minimum wages in Hungary and Slovakia since 2000 to 2017. As can be seen in the figure, in 2000 the real wage in Hungary was lower than in Slovakia. The balance tipped the other way in 2001 to 2007 when for several years minimum real wages in Slovakia were slightly higher. In recent years however the real minimum wage, although steadily increasing in both countries, has been higher for Hungarian workers.

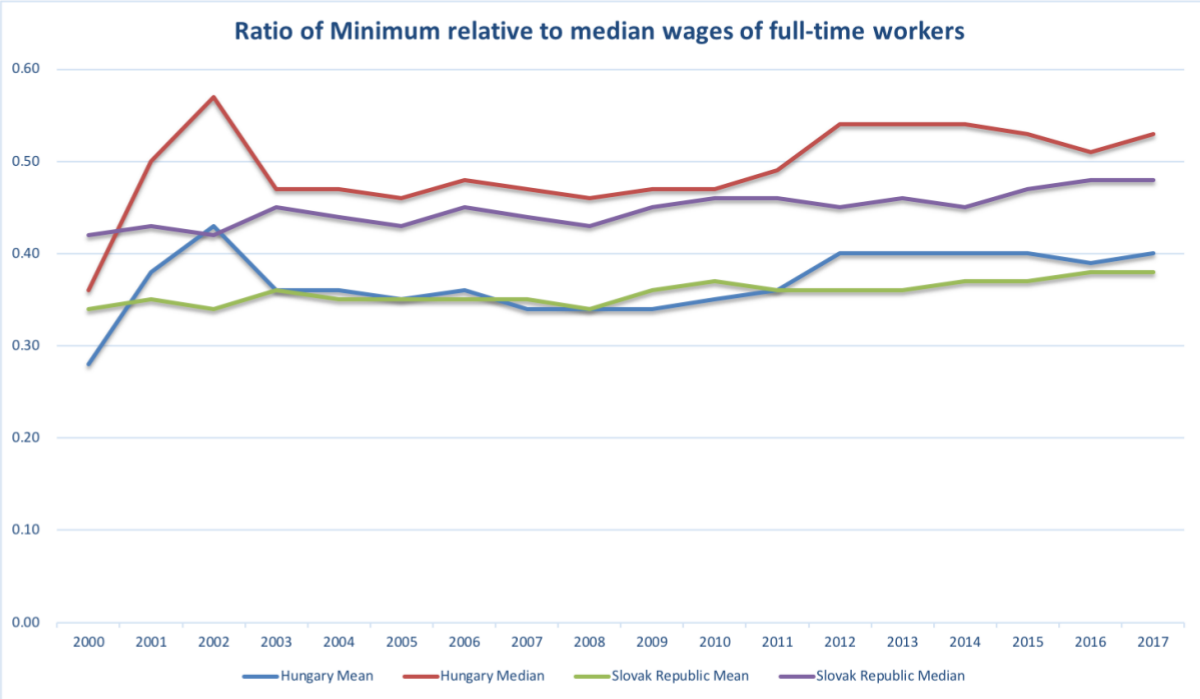

Figure 2 Evolution of the Ratio of Minimum relative to median wages of full-time workers in Hungary and Slovakia, 2000-2017Data source: ,("OECD.Stat" 2019)

According to the European Foundation for the Improvement of Living and Working Conditions country profile on Hungary, since the reshaping of the institutions in 2011, the government's policy actions affecting working life had mostly been decided outside of the interest reconciliation forums, and consultations did not influence the decision in major ways. At the same time, by the end of 2018, vehement levels of indignation from the citizens came as a response to the government's increasing disregard for the positions of social partners. Protest also referred to the changes regarding overtime, and the entire mechanism in which the law was implemented without democratic discussions in the Parliament with democratic debate or regard for the trade unions' willingness to participate in the discussions. The overtime law was met with indignation by employees and led to mass demonstrations. The adoption of the law coincided with other unilateral government decisions affecting, among other areas, education and academic freedom, and also with the elimination of the non-wage subsidy that had been provided by the cafeteria package. The demonstrations combined with political anxiety and intermittent strikes were the population's response to the actions of the government(Hárs

2019). The proposed far-reaching change to the Labor Code, specified increasing the maximum time over which hours of work could be gathered, from 12 months to 36 months, as regulated in the collective agreement. At the same time, the most controversial and change was in the number of hours of overtime work which could be ordered in a given calendar year. That number was increased from 250 hours to 400 hours. Even though the bill regulating overtime came as response to the problem of labor shortage, instead of improving the situation, the amendment was another move from the government to relax the already-flexible working time regulations of the Labor Code to be favorable for employers, more flexible at the expense of the rights of the workers (Kiss et al. 2018).

One of the most important taxation reform in Slovakia took place in 2004, with the implementation of the flat income tax rate. At the same time changes were made in the structure of the value added and capital taxes. A flat tax was introduced replacing the progressive scheme, accompanied by a system of deductions. Prior to this reform, a progressive framework was applied to taxation of income. Here were five brackets of incomes starting at 10% and up to 38%. The corporate tax rate was 25 per cent and basic VAT was 20 per cent and reduced VAT was 14 per cent. In 2004, all those tax rates changed to 19 per cent exclusively. When it comes to taxes related to labor, contributions to social security remained at 48.6 % of the value of gross income, structured as follows: 13.2 % from workers and 35.4 % respectively paid by the companies. The social security payments were collected from all employee's incomes, including those with very low incomes. The government designed the tax reform with the intention for it to be income neutral for the state budget, as a result the results were on income redistribution(Kahanec et al. 2012). The tax policy implemented in both Hungary and the Slovak Republic in the last decade was criticized for several reasons. The first reason is the fact that said policy had adverse effects on income inequality. At the same time, it had the effect of decreasing tax revenues while the spending on social needs was high. In 2003, cash benefits were at a lower level than the entire amount of tax revenue in both studied economies. The relationship between these categories was 80.1% in Slovakia and 65.8% in Hungary. Subsequently in 2012, tax revenues in Hungary covered cash benefits (69.2%) . In Slovakia the changes had effects so detrimental that social spending outweighed the tax revenues by 20.7% as a result of the country's experience with the flat income tax. Hungary reformed its taxation system in an attempt to mitigate the effects of the crisis, introducing several new taxes and fees and noticeable reshaping existing ones. Sudden and controversial changes in the tax structure gave Hungary tools to maintain a grip on its public finances. This in turn resulted in the move by the Council of the EU to lift the excessive deficit procedure in 2013. But unfortunately, the price for that was paid by the Hungarian households who had to face an increased risk of poverty and social exclusion(Moździerz 2015).

3.2 Evolution of Volkswagen's investment in Hungary and Slovakia

Figures 3 and 4 present the visualization of the most important milestones of Volkswagen's manufacturing plants in Bratislava, Slovakia and Gyor, Hungary. The information for compiling the timeline was collected from several sources related to the company's activity in the region. The information about the Audi plant in Gyor was mostly extracted from the Audi MediaCenter" 2019,(audi-mediacenter.com 2019) and the Volkswagen history webpage, https://www.volkswagenag.com/en/group/history.html# .

The information on the history of the plant in Bratislava was mainly collected from the Volkswagen webpage (Volkswagen 2019), the general history of the group (Rodriguez 2014) and (" Bratislava Motor City" 2019).

As can be seen below, in the evolutions of the legislative changes regarding labor protection in Hungary and Slovakia, the major changes, in 1993, 2001-2003, and 2011-2012, coincided with the milestone investments done by Volkswagen in the Audi Gyor plant in Hungary and the Volkswagen Bratislava plant in Slovakia. This does not mean one necessarily caused the other, it is actually difficult to determine the direction of causality in this regard. The investments might have been prompted by more relaxed labor regulations or the governments might have responded to increasing investments by creating even more incentives.

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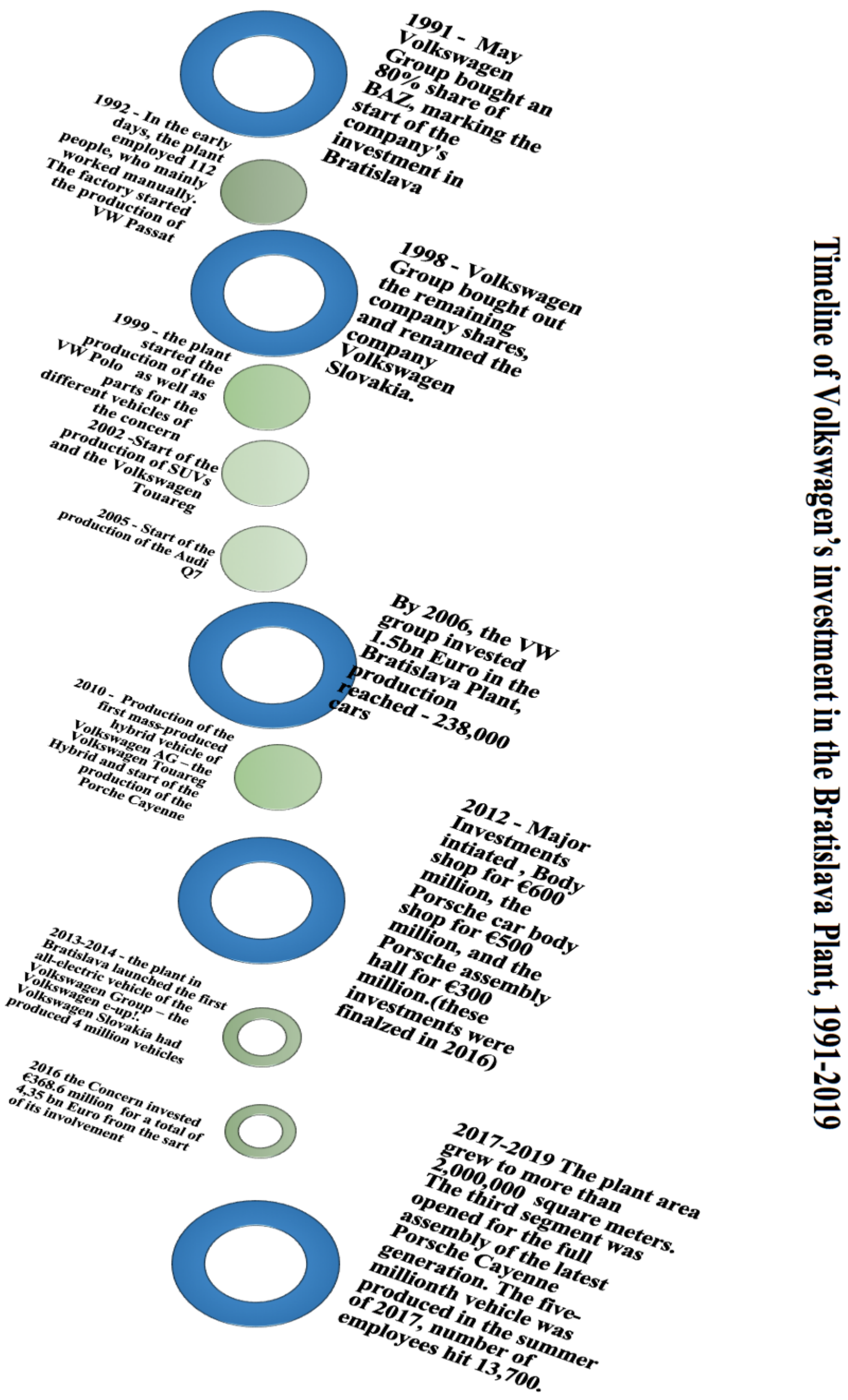


Figure 3 Timeline of WV's investment in the Bratislava plant, 1991-2019

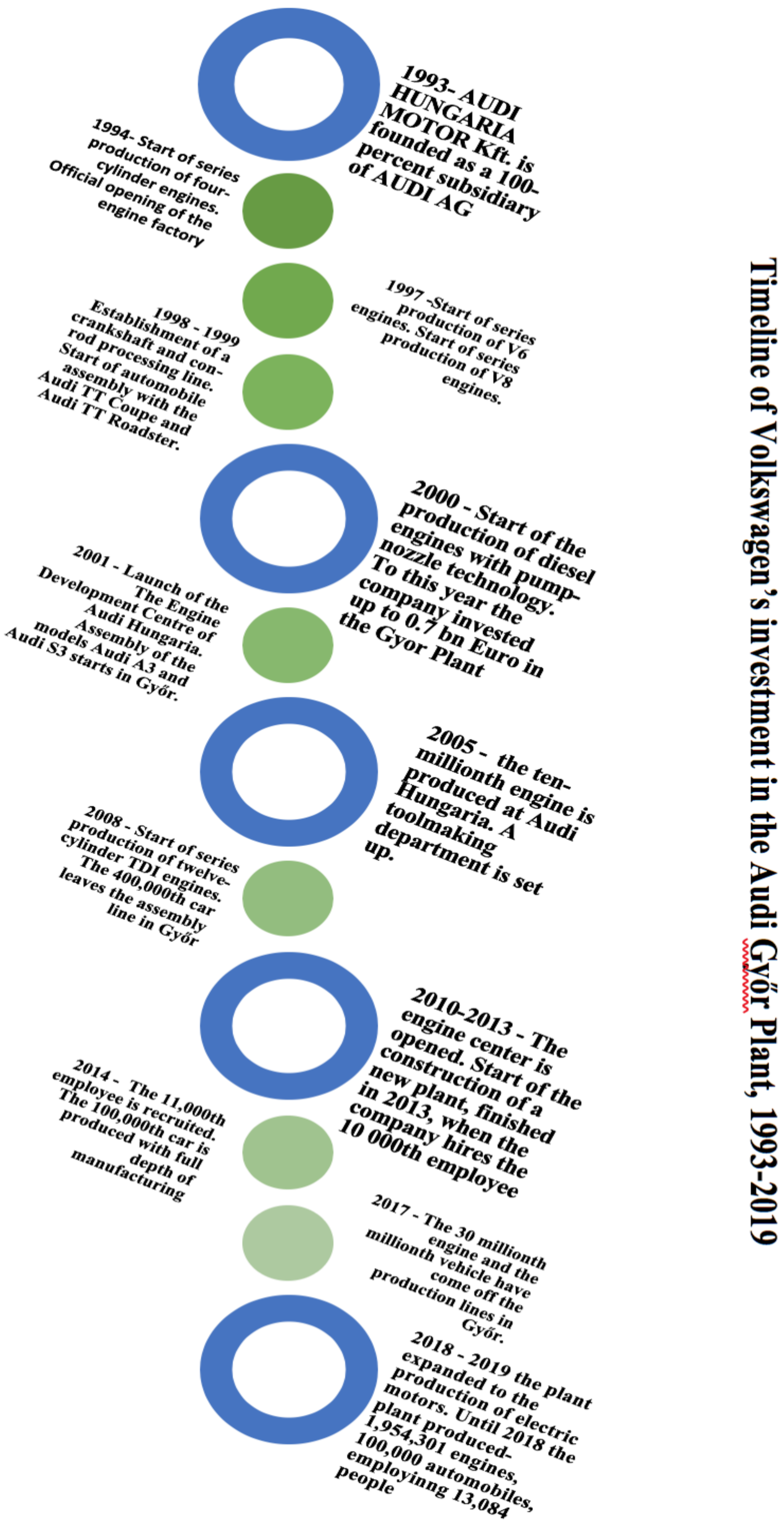


Figure 4 Timeline of VW's Investment in the Audi Gyor Plant, 1993-2019

3.3 analysis of the labor protection regulatory framework in Hungary and Slovakia from the 1990ties to today

The following subchapters will present a synthesis of indicators quantifying legal information included in several international databases. The use of indicators from these databases allows us to see and compare the evolution of the legal provisions regulating labor protection in Hungary and Slovakia.

3.3.1 ILO Employment protection Legislation Index

The data used for this this comparison was extracted from the International Labor Organization's EPLex database. It provides 50 quantitative indicators carefully collected and calculated from 95 countries in different regions of the world in the period 2009 to 2013. They cover the employment protection legislation and in most cases does not include references to case law or collective agreements. This was done to avoid spatial concerns and is not a relevant impediment for the countries examined in this paper. The ILO EPLex database systematizes the approaches that are similar in various country contexts. It also captures the specific regulations regarding termination of individual and collective work contracts. One of the missions of the database is to generate a comprehensive view of the laws and regulations that frame the employment contracts and the legislation governing the protection of employees against accidents and/or abuses from the employers. At the same time, another important feature of the database is that it presents a standardized way to view the legal information so that is can be used in research purposes by lawyers and economists. The key feature of this database, a standardized way to use legal information that can reflect the specifics and the diversities of different jurisdictions, by building on ILO's comparative expertise in the area of labor law(ILO 2015).

The areas included in Figure 5 to compare the employment protection legislation in Hungary and Slovakia in 2010 are: Valid grounds for dismissals(Area_1); Prohibited grounds for dismissals(Area1_2); Maximum probationary (trial) period(Area_2); Procedural requirements for dismissals(Area3_1); Notice periods(Area3_2); Severance pay(Area4_1), Redundancy pay(Area4_2); Redress(Area5) and the composite indicator of Employment protection legislation governing regular contracts, individual dismissals(EPLEX).

As we can see clearly from the comparison, in 2010 Slovakia had a higher level of protection of employees than did Hungary. Except for the maximum probationary (trial) period, where the indicators are equal, on all the rest Slovakia scored higher in terms of legislation protecting the workers from arbitrary employment termination, disproportionate notice period, and redress. In terms of regulations regarding redundancy and severance pay, both countries had low protection for workers, but Slovakia's was still at a higher level.

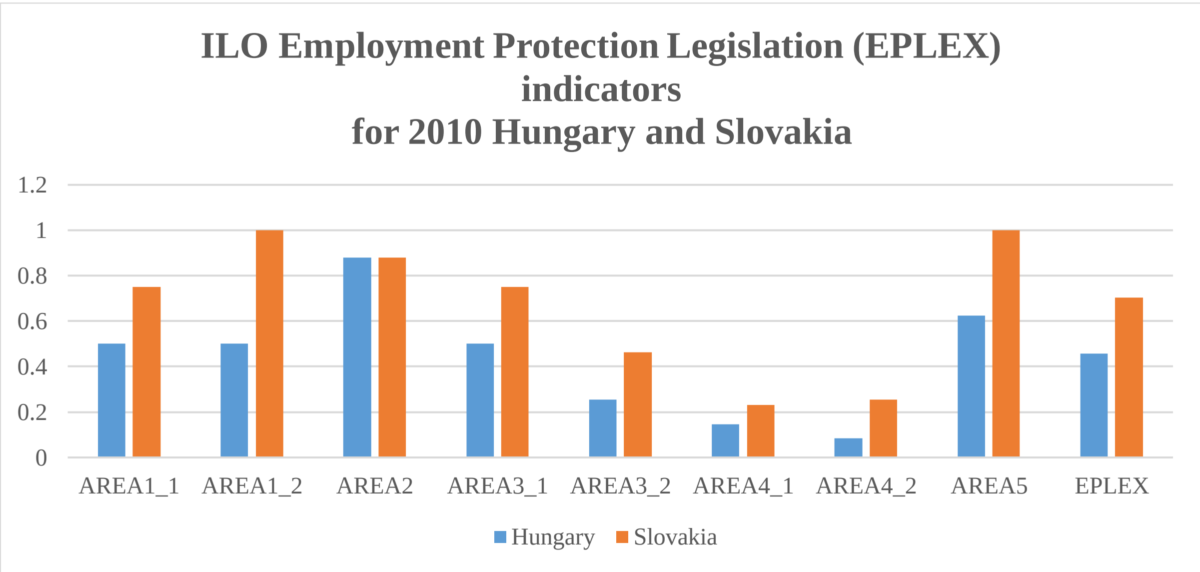
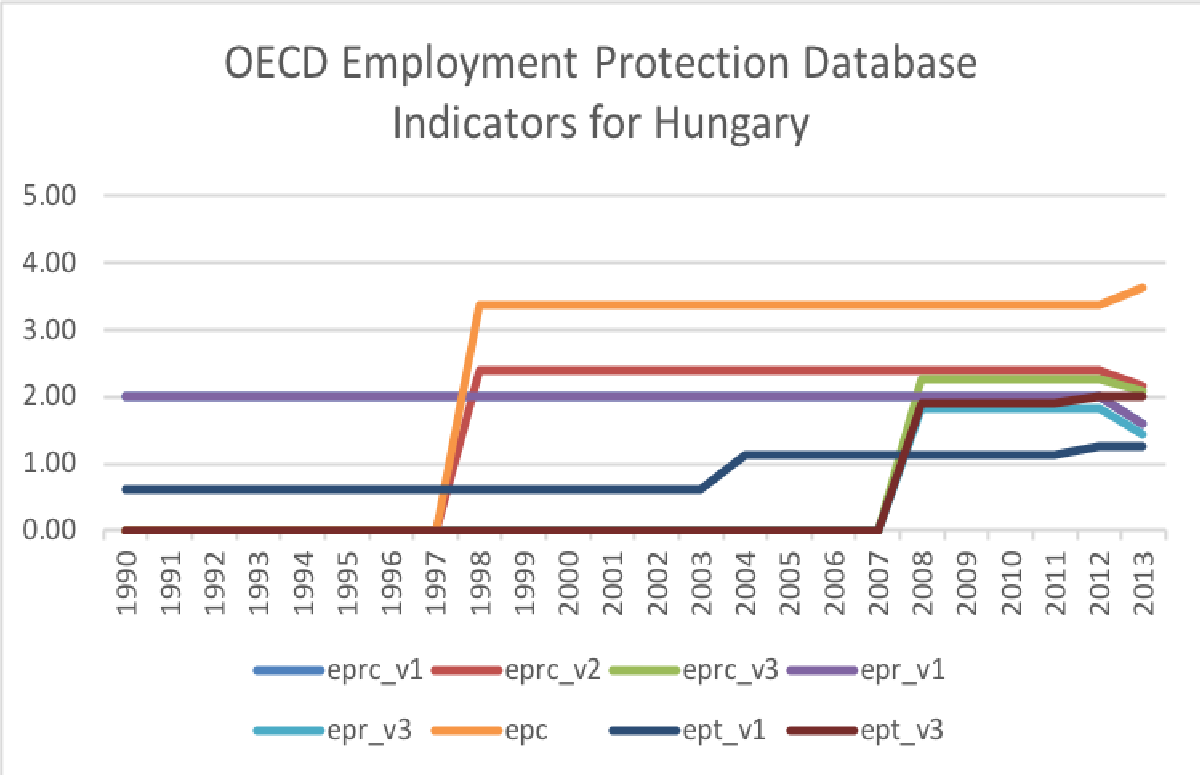


Figure 5 Comparison between the values of the indicators for Hungary and Slovakia of the ILO Employment Protection Legislation for 2010, Data source:(ILO 2015)

3.3.2 OECD Employment Protection Indicators



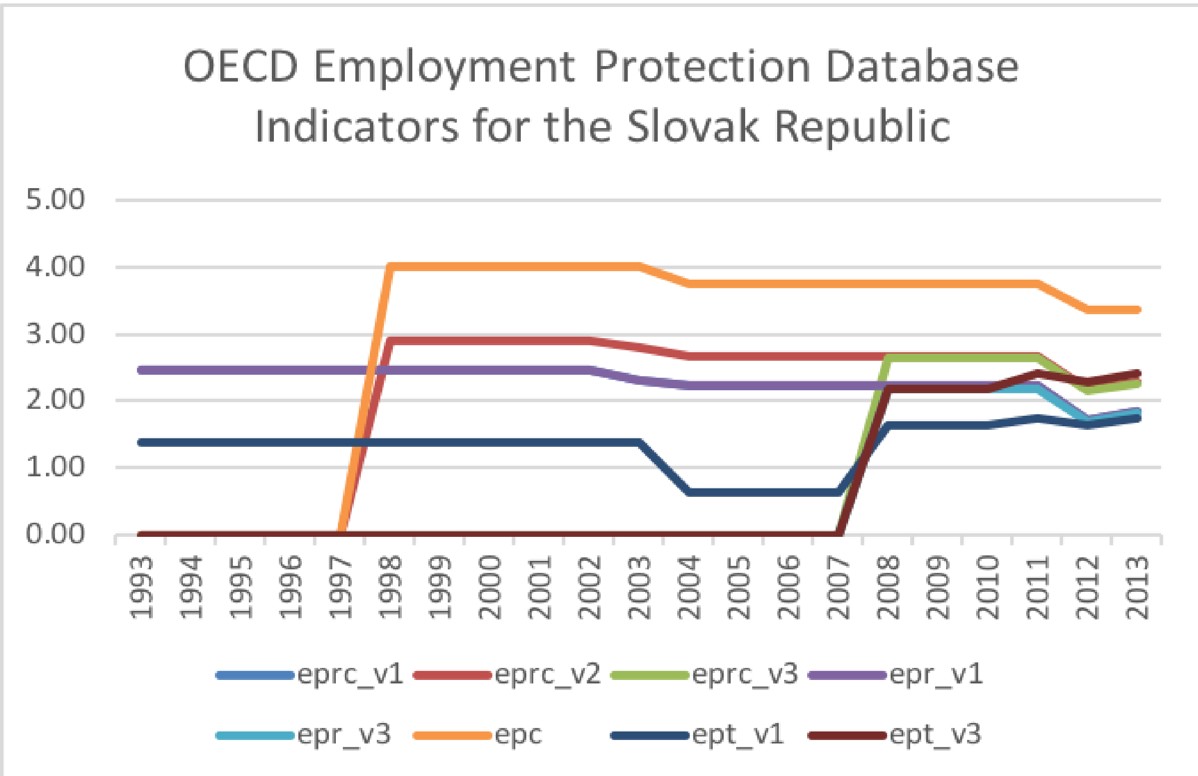


Figure 6 Comparison of values of selected indicators for Hungary and Slovakia from the OECD Employment Protection Database, Data Source:("OECD.Stat" 2019)

Figure 6 presents a comparison of the evolution over the period 1990(Hungary) 1993(Slovakia) to 2013 of the indicators of employment protection synthesized by the OECD. These indicators reflect the strictness of legal provision regarding dismissals and the use of temporary contracts. The indicators cover three different aspects of regulations regarding employment in the form they produced legal effects at the beginning of each year. In compiling these indicators experts from OECD used their reading of statutory laws, case law, social dialog agreements and inputs from OECD member countries experts and officials. The authors of the database note the importance of keeping in mind that employment protection only reflects one of the elements of the multifaceted issue of labor market flexibility(OECD 2015).

The synthesized indicators refer to the following topics: strictness of employment protection – individual and collective dismissals (regular contracts)(eprcv1,2,3); strictness of employment protection – individual dismissals (regular contracts)(epr_v1,3); Strictness of employment protection – collective dismissals (additional provisions)(epc); Strictness of employment protection – temporary employment(eptv1,3). According to the data, Slovakia's legislation was favoring workers slightly more than Hungary in terms of protection in case of collective dismissals of employees, but after interventions in the labor regulation, starting in 2012, when the new Hungarian Labor Code was adopted, both countries had the same level of legal protection in this area. In all the other indicators both countries had significant progress in 2007, Slovakia being slightly more generous to workers, but in 2012 the paths diverged, Slovakia slightly increasing the level of protection for the workers while Hungary decreased it by the same amount.

Figure 7 shows the evolution of the OECD indicators of employment protection in Hungary and Slovakia for the period 1993 to 2013. They are synthetic indicators reflecting the strictness of laws regulating dismissals and the conditions for the usage of temporary contracts. The indicators reflect laws acting from the beginning of the respective year. For a better illustration, this figure also includes the variable OECD countries. It represents the unweighted average for the 34 OECD members 2013(OECD 2015). Not surprisingly these indicators show a similar picture to the ILO indicators described above in that Slovakia had stricter regulation regarding employment protection, even slightly higher than the OECD average, until 2011when an amendment to the Labor Code reduced the legally mandated notice period from two to one month. The score also reflects the fact that in 2013 another amendment brought back the 2 months' notice in certain circumstances.

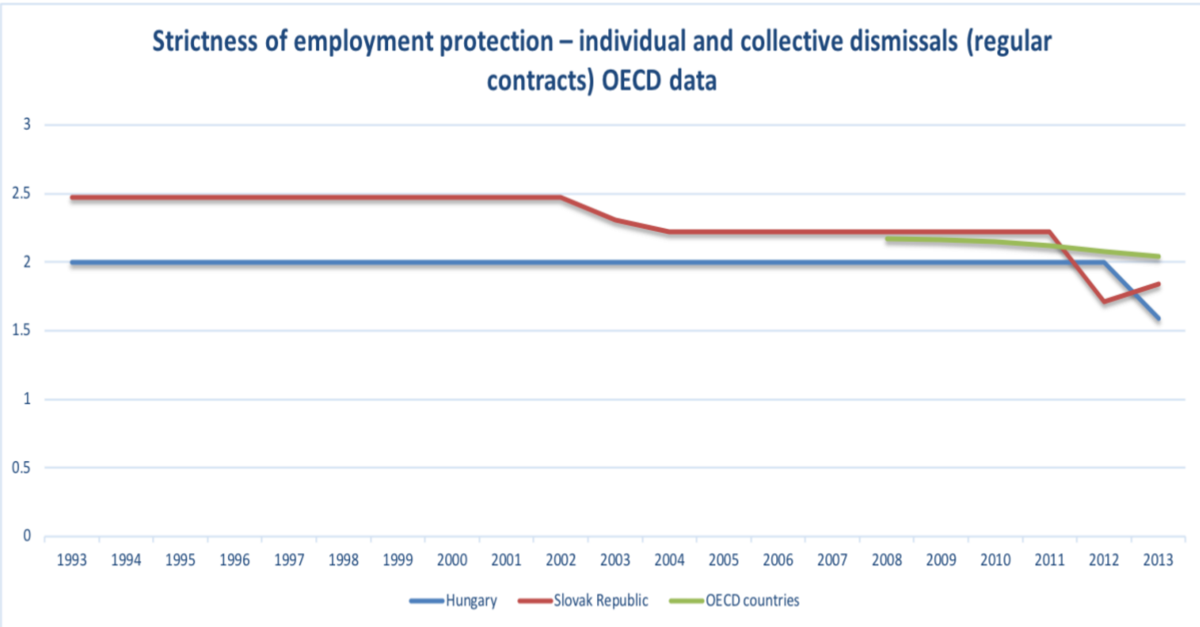


Figure 7 Comparison of OECD indicators for strictness of employment protection in individual and collective dismissals, Data source:("OECD.Stat" 2019)

Figure 8 illustrates the evolution of the OECD indicator of the strictness of employment protection when it comes to temporary contracts. The same as in the previous figure the comparison is between Hungary, Slovakia and the average for the OECD countries for the period 1993 to 2013. The figure illustrates the fact that in Hungary, according to the OECD database on employment protection legislation, had legal provisions setting a limit on the duration of fixed term contracts since 1992. The index rises in 2003, when the labor legislation introduced the principle of equal treatment for workers on a fixed term contract. On the other hand, Slovakia had a significant higher degree of protection for employees on temporary contracts, until 2003, the country had a maximum duration for temporary contracts, and a reduced amount of activities it could be applied for. The index for Slovakia drops in 2003, after amendments to the legislation broadened the areas where the temporary employment contracts could be used. The situation changed in 2007, and then in 2011 when new limitations were implemented for the protection of employees, the fixed term contracts could be used only with a small number of permissible reasons.

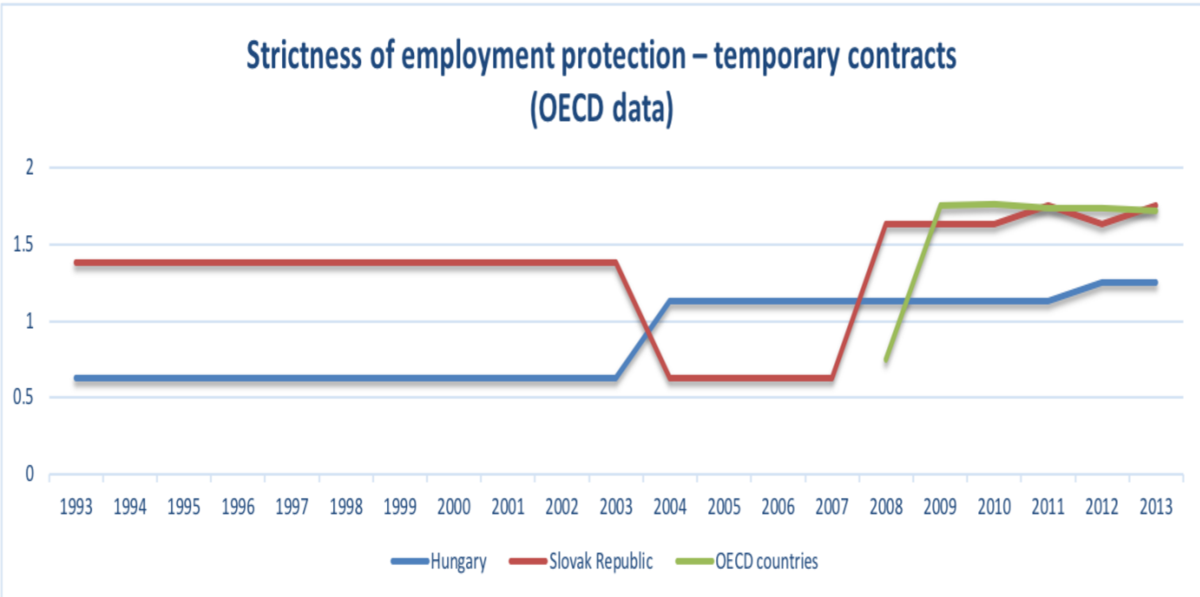


Figure 8 Comparison of OECD indicators for strictness of employment protection temporary contracts, Data source:(“OECD.Stat” 2019)

3.3.3 CBR Labor Regulation Index

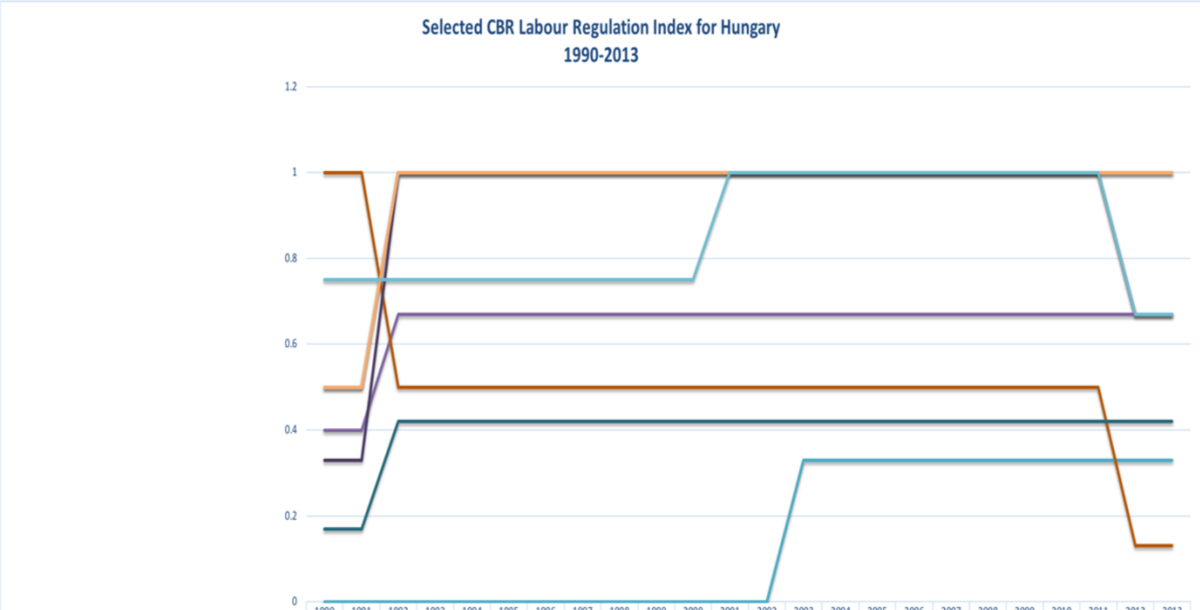
The following Figures 9 and 10 present an visual instrument to compare Hungary and Slovakia’s national labor legislation in terms of several areas of interest for the period after the fall of the socialist regime 1990(Hungary) and after independence 1993(Slovakia) to 2013. The data for the graphs was extracted from University of Cambridge’s, Center for Business

Research (CBR) Labor Regulation Index Dataset. The dataset contains quantitative indices for regulation regarding working conditions, security, and protection from 117 countries, using the leximetric methodology that allows to quantify legal provisions for analysis. This information allows to see period following the emergence the market economy and the evolution of the legal provisions accompanying it(Adams, Bishop, and Deakin 2016). The database compares 40 different indicators, but in the interest of this research, 8 of them were selected to be used to compare Hungary and Slovakia. The selected indicators are: provisions regarding annual leave; legal limits on overtime work; legal determination of the workers' status; provisions regarding the leave notice, level of permission and regulation of fixed term contract, legal obligation for employers to notify dismissed workers, codetermination and information/consultation of workers; and legislation regarding extensions of collective agreements.

As can be seen from the figures, both countries had similarly high levels of protection regarding the social dialogue and the extension of collective agreements, but Slovakia in 2004 introduced the possibility of a collective agreement being binding even for non-members, the amendment was removed in 2007, only to be reinstated in 2010.

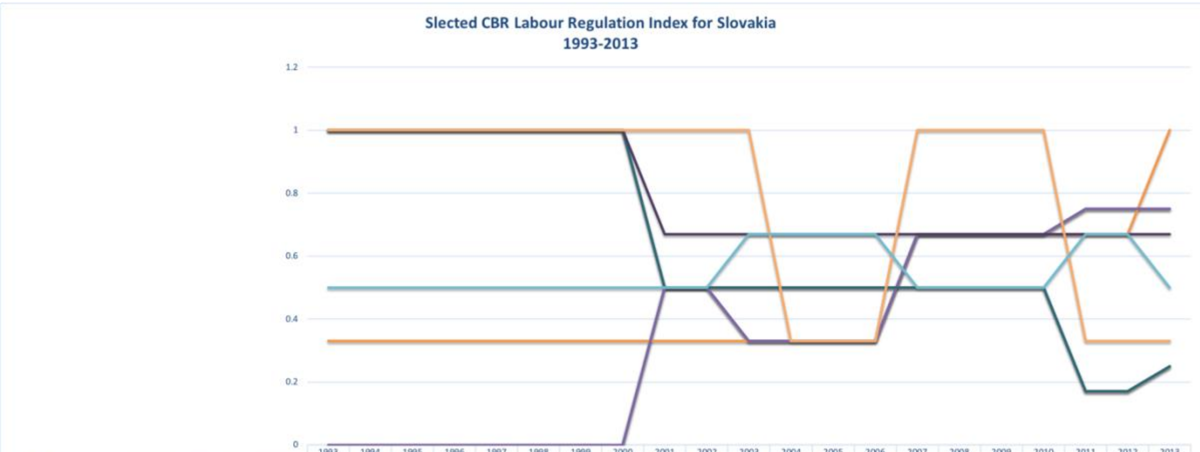
In terms of having legal provisions regulating the status of the workers, as opposed to the employment contract, Hungary had stricter rules protecting the workers starting in 1990, and strengthened it in 1992. In Slovakia, the Labor Code offered increased legal protection in 2007, and in 2013 strengthened to the highest level. The evolution of the regulation of fixed term contracts in the two countries for the same period was described above, using the OECD indicators.

Slovakia's labor legislation was more generous to workers regarding the annual leave, starting in 1993, when the labor code entitled workers to two weeks of leave annually and in 2001 it was doubled. While in Hungary 1992 Labor Code stipulated 20 days of paid leave, with increasing leaves for more experienced workers.



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
The law determines the legal status of the workers	0.5	0.5	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
fixed term contracts are allowed only for work of limited duration	0	0	0	0	0	0	0	0	0	0	0	0	0	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33
Anual leave provisions	0.4	0.4	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67
Limits on overtime work	1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.13	0.13
legally mandated notice period	0.17	0.17	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42	0.42
Notification of dismissal	0.33	0.33	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	0.67	0.67
Extension of collective agreements	0.5	0.5	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
codetermination and information/ consultation of workers	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1	1	1	1	1	1	1	1	1	1	1	0.67	0.67

Figure 9 Evolution of selected CBR Labor Regulation indicators for Hungary 1990-2013, Data Source: (CBR 2016)



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
The law determines the legal status of the workers	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.67	0.67	0.67	0.67	0.67	0.67	1
fixed term contracts are allowed only for work of limited duration	0	0	0	0	0	0	0	0	0.5	0.5	0.33	0.33	0.33	0.33	0.67	0.67	0.67	0.67	0.75	0.75	0.75
Anual leave provisions	0	0	0	0	0	0	0	0	0.5	0.5	0.33	0.33	0.33	0.33	0.67	0.67	0.67	0.67	0.75	0.75	0.75
Limits on overtime work	1	1	1	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.17	0.17	0.25
legally mandated notice period	1	1	1	1	1	1	1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.17	0.17	0.25
Notification of dismissal	1	1	1	1	1	1	1	1	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67	0.67
Extension of collective agreements	1	1	1	1	1	1	1	1	1	1	1	0.33	0.33	0.33	1	1	1	1	0.33	0.33	0.33
codetermination and information/ consultation of workers	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.67	0.67	0.67	0.67	0.5	0.5	0.5	0.5	0.67	0.67	0.5

Figure 10 Evolution of selected CBR Labor Regulation indicators for Slovakia 1993-2013, Data Source: (CBR 2016)

Conclusion

The scope of this thesis was to see the different ways in which Slovakia and Hungary managed their public policies in response to the need to attract foreign direct investment. It attempted to do this by analyzing indicators quantifying legal information included in several international databases and comparing their values for both countries over time. The use of indicators from these databases allows us to see and compare the evolution of the legal provisions regulating labor protection in Hungary and Slovakia. The analysis showed that by many indicators, Slovakia has had a labor legislation that was more favorable for workers, and offered them more legal protection and bargaining power in relation to the employers, compared to Hungary's. This has not been an impediment for Volkswagen, along with other car manufacturing companies, to invest large amounts of money into its production plants in this country. The importance of researching this topic is especially relevant at the moment and will continue to grow in importance because we now know the extent to which regulatory actions by governments frame the development of societies. Levels of inequality are at dangerously high levels, while automation and disruptive technologies have the potential to further deepen these levels and create an even more unjust society with all the resulting negative consequences. Globalization and foreign direct investment are the main drivers of those changes and only efficient and well calculated public policies can bring them on a more just and equitable path. Foreign direct investment should not be pursued as an end in itself, disregarding all other effects it can potentially have on a country's economy and population. The analysis in this thesis has tried to show that given the similar circumstances but a stricter labor legislation, investors will still be willing to invest and increase production and create jobs and modernize. Governments should be aware of the dangers of the race to the bottom of deregulation and sacrificing worker security and well-being for the sake of attracting bigger and richer investors. This thesis by no means argue against efforts to attract investors, but only advocates for governments to put the wellbeing of their citizens above all considerations, and pursue growth in a sustainable and equitable way. Governments need public policies that promote growth in ways that benefit everyone, and we should never trade the citizen's wellbeing for pursuing increasing economic indicators just for their own sake.

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