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Central and Eastern European Countries: Determinants of Foreign Direct Investments in the Period of 1990s

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Abstract: **Foreign direct investments (FDI) played a major role in the economic transition and overall economic development of the Central and Eastern European (CEE) region. The extensive inflow of FDI, recorded in six CEE countries covered by this paper (Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia) during last two decades was achieved also thanks to new strategies and reforms, implemented to attract and positively stimulate FDI inflows. Nevertheless, an uneven development of both FDI policies implemented by the CEE countries and diverse patterns of FDI inflows into the region could have been observed between 1990 and 2002. With the aim to asses and understand the varying performance in FDI attraction of the CEE countries during the first years of transition, we investigated the FDI-related strategies introduced by respective countries. At the same time, the initial conditions at the outset of their transition process are also reviewed.**

Keywords: **foreign direct investment, investment promotion, FDI attraction, Central and Eastern Europe.**

1 1. INTRODUCTION

Ernst & Young's survey from 2012 examining the attractiveness of particular regions as an investment destination found out that Central and Eastern Europe (CEE) was regarded by investors as the third most attractive foreign investment destination after Western Europe and China. At the same time, the region scored as the second most favored place for investments in manufacturing industries (Ernst & Young, 2012). However, this "investment favorable image" has not came without an effort. It required wide range of economic reforms, linked to transition from centrally planned economies to regular market adjustment as well as introduction of FDI-friendly policies.

Nevertheless, the six CEE countries covered by this paper have begun their transition process from different "starting lines", i.e. reporting various initial conditions and moreover, the countries have developed under different regimes and at different paces. Based on a perception that this influenced the amounts of foreign capital invested in respective countries, the present paper takes the discussion on initial conditions of CEE countries at the outset of their transition as a starting point.

On the top of that, the overall economic development of the CEE countries in the early 1990 and respectively their investment climates have been considerably affected by implemented transition and privatization policies. As these policies varied from country to country, distinct approaches to foreign investment resulted in very uneven development of FDI inflows. This makes the CEE region a reasonable subject for comparative research evaluating the effects of transition policies on the level of FDI inflows. This paper briefly describes and illustrates the economic and political developments in the CEE region, focusing on the countries' approach towards foreign investors in particular, with the aim to shed a light on the diverse development patterns of FDI inflows into six CEE countries between the years 1990 and 2002.

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The remainder of the paper proceeds as follows. Section 2 discuss a range of selected structural and macroeconomic indicators as well as the assessment of the initial transition conditions as measured by European Bank for Reconstruction and Development (EBRD). Section 3 deals with FDI development in more detail, with the aim of to review the implications of individual national transition and privatization policies on foreign-investment. Firstly, we examine the overall FDI inflows in CEE region during the last 25 years. As the uneven development of both FDI policies implemented by the countries and patterns of FDI flows into the region could have been observed in different periods, we decided to divide the section and analyze the development in two distinct phases. While the first years of transition (1990-1994) were marked by relatively low level of investors' interest in CEE region, the second phase of the regional transition (1995-2002) reports significant take off of FDI. We present our conclusions in section 4.

2 2. INITIAL CONDITIONS

In order to accurately assess and understand the development patterns of FDI into six countries covered by this paper, the initial conditions at the outset of their transition process need to be considered. In what follows, we will focus on those country-specific features and economic indicators, which we consider as likely to have played an important role in the overall transition and could have an influence on the eventual perception of the respective country by foreign investors.

Table 1 below presents a range of selected indicators and measures illustrating initial conditions of the six CEE countries, i.e. for the year 1990 (alternatively 1991 or 1992 (in case of data for 1990 was not available).

Table 1: Initial pre-transformation conditions of selected CEE countries, 1990: Regional comparison of structural indicators and EBRD transformation subindices

	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Structural Indicators						
Population (in millions)	8.6	10.3	10.3	38.3	23.2	5.3
GDP (USD, current prices and current exch. rates, p.c.)	872	2,467	3,230	2,037	1,245	2,052
GDP growth rate	-11.7	-11.5	-11.9	-7.0	-12.9	-14.6
Share of industry in GDP (percent)	37.4	40.2	26.7	40.2	37.9	37.9
Share of agriculture in GDP (percent)	14.3	6.0	7.8	6.8	18.9	6.2
Private sector as a share of GDP (percent)	10.0	10.0	25.0	30.0	15.0	10.0
Share of trade in GDP (percent)	24.1	19.3	27.4	15.7	14.6	117.0
Share of industry and construction in total employment (percent)	44.8	45.4	36.4	36.3	38.1	44.9
Investment rate (percent)	21.3	26.3	30.4	21.0	19.8	31.3
EBRD Transition Subindices						
EBRD index of small-scale privatization	1	3	1	3	1	3
EBRD index of large-scale privatization	1	1	2	2	1.7	1
EBRD Index of price liberalization	3	3	3	3	2	3
EBRD Index of forex and trade liberalization	3	3	4	3	1	3
EBRD index of enterprise reform	1	2	2	2	1	2
EBRD Index of competition policy	2	2	2	2	1	2

Sources: Structural Indicators - EBRD, 1999. Data for 1990, alternatively 1991 or 1992 (in case of data for 1990 was not available); EBRD Transition Subindices - EBRD, 2000. Data for 1991.

Before analyzing regional FDI trends in CEE in more detail, it is worthwhile to outline the most important features that could have been observed in CEE region with respect to the initial conditions at the beginning of their transition process and respectively in their investment climates:

- Six CEE countries covered by this paper have begun their transition process from different "starting points", with different initial conditions. The countries have also developed at different paces over the last two decades. This, on the one hand, affected the composition of FDI inflows in terms of the type of the investment from the sectoral point of view as well as the amounts of capital invested, on the other hand. For example, investors motivated by the availability of cheap and extensive labor pool are generally drawn to less developed countries, whereas market-seeking investors and companies in search of specific labor competencies or skill sets prefer economies in later stages of development. At the same time, labour-driven investment projects are less capital intensive than the projects that are rather stimulated by the availability of the skills and competencies of the local population, which is usually the case of more developed countries. Since 1991, the two countries reporting the lowest level of GDP per capita (in current prices) in CEE region are Bulgaria and Romania (UNCTAD, 2016b).

- The physical characteristics of the countries in the region vary distinctly. The largest country in terms of population is Poland (with almost 39 million inhabitants). This is often cited as a factor helping to attract market and wide labor pool seeking investors. At the other end of the scale is Slovakia which, with its population of 5.4 million people, is almost eight times less populated than Poland.

- The reviewed countries implemented different overall transition policies and thus different privatization approaches as well as different to FDI policies at the beginning of the transition. This resulted in distinct investment development paths. Several of studies claim that transition-specific factors play an important role in the process of investment decision making of multinational companies and that the slow transition progress could have impeded FDI inflows, even in the economies with the lowest labor costs or another favorable FDI determinants (Carstensen & Toubal, 2003). This argument will be more elaborated in the succeeding part of the paper, nevertheless, the divergences in the transition progress among CEE countries are still present even today. The evidence for this argument is, for example, the Transition index elaborated by EBRD, which measures country-specific progress in the transition from 1994. Practically, it summarizes progress with transition reform in different areas of the economy on a scale of 1-4.3 (the last value corresponding to a fully functioning market economy). Observing the overall country rankings, we find out that Romania and Bulgaria are still lagging behind their Central European (CE) peers – notably, when it comes to Governance and enterprise restructuring indicator. In 2014, the CE countries reported the score 3.7, while Romania and Bulgaria distinctly less ahead with the score 2.7 (EBRD, 2016).

3 3. THE DEVELOPMENT OF FDI IN CEE REGION

For the most part, the six CEE countries covered by this paper had not been recipients of FDI to any important degree before 1990. Most of these countries did not report any inward FDI at the time at all, and the size of the FDI stock with respect to the size of the economy of the ones that did (Czechoslovakia, Hungary, and Poland) was far below the average recorded in other European economies. Total CEE stock of FDI in 1990 was 2.32 bn. USD equating 0.26 percent of the FDI stock in EU15[1] countries (881.84 bn. USD) in the same year (UNCTAD, 2016a).

In spite of that, during the last 25 years, the CEE countries have managed to transfer its economic structures from centrally planned to market-based systems and experienced an impressive surge of inward FDI and increasing presence of foreign-led companies. However, this process was rather complex and far from what could be described as homogeneous. Consequently, both the stock and growth of FDI differed across the time in these countries.

[1] EU15, as reported in UNCTAD statistics comprises the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom

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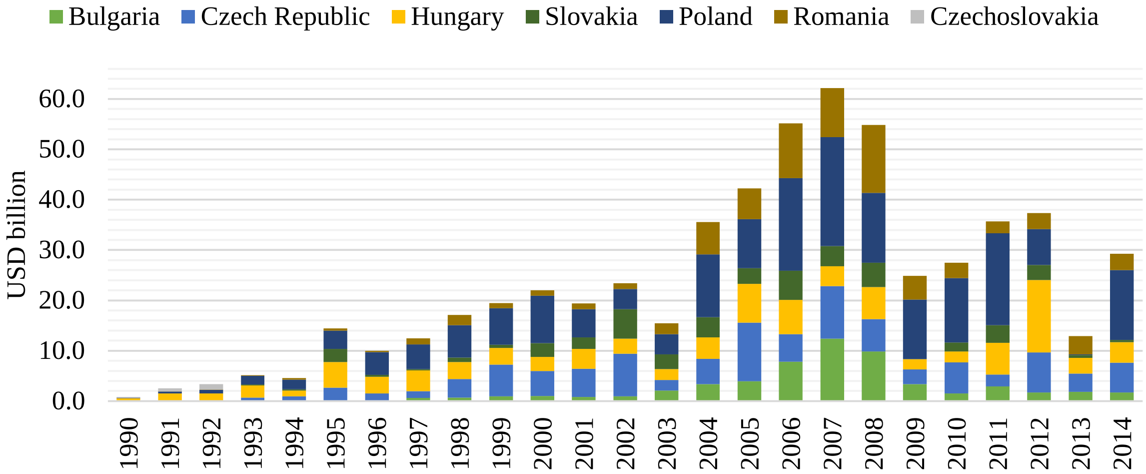
Graph 1: FDI inflows into selected CEE countries, 1990-2014



Source: UNCTAD, 2016a

In what follows, we describe the FDI development in CEE region during the period between 1990 and 2002. As we have observed the uneven development of both FDI policies implemented by the countries and patterns of FDI inflows into the region in different periods, we decided to divide the analysis into two distinct phases.

3.1. The first years of transition: 1990-1994:

The decade of the 1990s was the period of change for the six CEE countries. It involved opening up and the region-wide transition process from centrally administered to market-based economic systems. This post-1990 period was characteristic by the beginning of the integration of CEE countries into the world economy and, what is for the present analysis the most important, it introduced the initial surge of FDI inflows as well. This is not surprising considering the fact that the fall of the “east block” and subsequent opening up of the CEE countries has created a new particularly attractive and favorable area for international expansion of multinational corporations. At the same time, the period of the late eighties and early nineties saw an unprecedented wave of FDI. Examining data for selected global FDI indicators, we find out that between 1986 and 1990, the average annual growth rate of FDI outflow accounted for 28.3 percent and the stock of outward FDI grew at an annual rate of 19.8 percent (UNCTAD, 1995). In addition, the international organizations, as well as western liberal economists, repeatedly suggested that a successful transition to the market-based system of the transition economies could only be achieved with large inflows of FDI (Pavlínek, 2004). The US Ambassador to Hungary, Donald Blinken, has indeed stated that foreign private investment was ‘a new Marshall Plan to help Central and Eastern Europe’ and these opinions were also promoted by western advisers to local policy makers who flooded the region (Drahokoupil, 2008). FDI was also attributed a crucial role in the economic development of CEE region among academics and experts as the foreign-led companies were often viewed as a ‘vehicle for economic modernization’ and an important tool for catching up with the western European states. It was believed that a successful transition in the region would depend on FDI inflows for starting up the successful economic restructuring and development (e.g. Hunya, 2000).

With this in mind, one would expect that the promotion of FDI will play a major role in CEE transformation process and that it will be one of the top priorities of local politicians and policy-makers resulting in a dramatic inflow of direct foreign capital. However, contrary to the expectations, in the early 1990s, this was not the case. As can be seen on the Graph 1 below, although annual FDI inflows into six CEE countries covered by this paper have begun to increase after the year 1990, the growth of FDI was still very low.

The Table 2 below shows us the CEE FDI data in the broader perspective, the cumulative annual FDI inflows to CEE in the early 1990s were low not only in the global context but from the European perspective as well. CEE attracted 16.43 billion USD between 1990 and 1994 or 1.6 percent of the global FDI inflows, compared to 430.84 billion USD invested in Europe and 390.71 billion USD invested in EU15 (CEE accounted for 3.8 percent of FDI inflows in Europe and 4.2

percent of FDI inflows in EU15 respectively). However, FDI inflows to CEE in the early 1990s were not so low in the comparison with their transition peers. The cumulative annual FDI inflows of six CEE countries are more than two times higher than the cumulative data for 17 transition countries[2].

Table 2: CEE annual FDI inflows (USD billion), 1990-1994: Global and regional comparison

	1990	1991	1992	1993	1994	Total inflow 1990-1994	CEE inflows as a share 1990-1994
World	204.90	154.14	163.01	220.15	254.91	**997.09**	*1.6%*
Europe	102.75	81.94	75.91	80.68	89.55	**430.84**	*3.8%*
EU15	94.59	76.05	70.79	72.38	76.90	**390.71**	*4.2%*
Transition economies	0.08	0.20	1.65	3.03	1.94	**6.89**	*238.4%*
CEE countries	**0.81**	**2.53**	**3.38**	**5.12**	**4.59**	**16.43**	*100%*
							CEE = 100%
Bulgaria	0.00	0.06	0.04	0.04	0.11	**0,25**	*1.5%*
Czech Republic	-	-	-	0.65	0.87	**1.52**	*9.3%*
Hungary	0.55	1.47	1.48	2.44	1.14	**7.09**	*43.1%*
Poland	0.09	0.36	0.68	1.72	1.88	**4.72**	*28.7%*
Romania	0.00	0.04	0.08	0.09	0.34	**0.55**	*3.4%*
Slovakia	-	-	-	0.18	0.26	**0.43**	*2.6%*
Czechoslovakia	0.17	0.60	1.10	-	-	**1.87**	*11.4%*

Source: UNCTAD, 2016a

Based on the data shown in Table 2, it can be also stated that the FDI inflows within CEE were very uneven. Four CE countries (Czech Republic, Hungary, Poland, Slovakia, or more precisely Czechoslovakia until 1993) accounted for more than 95 percent of all FDI inflows in the region between 1990 and 1994 (15.63 billion USD out of 16.63 billion USD in total). The highest FDI stock as of 1994 was in Hungary (7.09 billion USD), followed by Czech Republic (4.55 billion USD) and Poland (3.79 billion USD). However, Slovakia was poorly performing as in the early 1990s, the FDI was, in fact, non-existent and Bulgaria together with Romania lag far behind as well.

Low levels of FDI, as well as the discrepancies in FDI inflow levels among CEE countries between 1990 and 1994, cannot be entirely explained by traditional FDI determinants, but rather by transition-specific factors (Carstensen & Toubal, 2003).

Firstly, it generally takes some time before the foreign investors became really active and operate. Location decision process within a company is not straightforward and is usually subject to due diligence investigation of the potential investment destination, realization of feasibility studies as well as evaluation of a target country in terms of risks, labour costs, infrastructure, political & economic stability, market size, geographic location and physical features, suppliers networks and many more. Generally speaking, this process contributes to informed location decision making, necessary for successful long-term business planning and is not finished in the short-run.

The second explanation is more transition-specific. As we have already noted, the overall transition policies in CEE countries differed and thus investment strategies aiming to promote and attract FDI in CEE region varied. On the top of that, the real investment attraction policies began to be implemented only around 2000. At the early nineties, all governments of the CEE region have been mostly focused on developing privatization programs and legislation in order to minimize the role of the state as the business owner, but only a few of them took foreign direct investors into account and incorporated FDI into these strategies. Diverse techniques of privatization, standard, less-standard and even non-conventional, have been shaped and already implemented in CEE region, varying one from another in each country.

As Drahokupil (2008) argues, most states in CEE practiced distinct national, inward-oriented frameworks, often explicitly avoiding FDI. The countries aimed at the creation of domestic ownership class and national capitalists, rather than focusing on creating foreign-investment-friendly environments and accommodating the business environment to the preferences of foreign investors.

Hungary was, however, the only exception in this regards, where the government set out the rather FDI-friendly policy in the early nineties onwards. On the top of that, together with Poland, Hungary benefited from partial reforms implemented by the communist governments during the 1980s and had therefore already a partially liberalized economy (Fidrmuc, 2002). This was also reflected in the transition progress evaluations of the international organizations at the time. When we compare the already mentioned EBRD's Transition index among CEE countries for the year 1994, we find out that Hungary achieved the best score (3.6 out of 4.3) and outperformed its CEE peers mostly when it comes to price liberalization and trade & foreign exchange system, reflecting the removal of quantitative and administrative import and export restrictions and current account convertibility (EBRD, 2016a). Additional evidence of Hungary's open policy towards FDI in the early nineties is provided by the FDI UNCTAD's statistics (see Table 2). Between 1990 and 1994, Hungary accounted for the largest share of FDI inflows in the CEE region and also reported the highest stock of FDI in 1994 equating to 42% of total FDI stock in CEE region (UNCTAD, 2016a).

Another important difference in initial conditions of Hungary in contrast to other CEE countries was the size of the private sector. Hungary, together with Poland, reported the relatively high share of private sector in GDP and employment while the real private entrepreneurial activity was de facto absent in former Czechoslovakia. Taking this into consideration, it would appear that Hungary and Poland had an initial advantage as they started transition progress with part of the domestic population having entrepreneurial skills and already acknowledged to the system of the market economy (Fidrmuc, 2002).

In the case of the Czech Republic and Slovakia, transition process was initiated while both countries were part of the former Czechoslovakia (until 1993). The national strategies relied heavily on inward-oriented strategies aimed at the formation of domestic accumulation of capital and the so-called voucher privatization method was implemented as a mean to transfer ownership of large state-owned enterprises. Nevertheless, the programs implemented by the government in charge at the time preferred privatization in favor of domestic investors rather than transnational ones and, what is more important, little emphasis was put on the integration of the local economic structures into transnational business networks (Fidrmuc, 2002). On the top of that, both countries largely utilized non-standard privatization methods, where foreign investments were technically excluded by default. One of such non-standard methods was restitution, although more implemented in the Czech Republic. This process consisted of the return of the properties confiscated by the previous regime to the original owners or their heirs, or by providing them financial compensation. On the top of that, after the break-up of Czechoslovakia, Slovakia gave up completely privatization in the form of vouchers and the overall process became much politicized. Privatization of most state-owned enterprises was characterized by the lack of transparency and frequent direct sales to a predetermined, mostly domestic buyers close or linked to leading party.

In contrast to Czechoslovakia in the early nineties, in Poland the attempts to attract foreign investors in the process of privatization could have been observed. However, in the early stages of transition, these attempts, as well as the results, were limited. All privatizations programs were open to foreigners but in reality, there was a preference for so-called 'insider privatization', where management and employees of the companies hold preferential treatment. The most prevailing method was a so-called liquidation, usually on the initiative by insiders (employees), under which the assets of a company were preferentially sold to employees and subsequently, the company was closed. This type of privatization was used as a means 'to buy off union opposition' and of restructuring labor relations by eliminating the dominant workers' councils (Williams & Balaz, 1999).

3.2. Gradual transformation intended to facilitate EU entry: 1995-2003:

Foreign investment began to take off significantly for the most part in 1995 and this period can be also marked as the beginning of the second phase of the regional transition. FDI inflows rose from 4.59 billion USD in 1994 to 17.09 billion USD in 1997 and 23.43 billion USD in 2002 (see Table 3). As a result, the stock of FDI inflows in CEE countries rose by an unprecedented 758% over the period 1994 and 2003 (UNCTAD, 2016a). This growing amount of FDI flows into the region was a reaction to the development of CEE countries in regard to their gradual economic liberalization, democratic political processes, progress in market-oriented reforms and their successive integration into the world economy. In addition to those issues, far-reaching policy reforms, as part of the transition process, resulted in the modification of legislation, business climate regulation as well as a twist in countries' approach related to FDI attraction, facilitating FDI, joint-ventures, mergers and acquisitions and foreign trade (Michael Faust, Voskamp, & Wittke, 2004).

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Table 3: CEE annual FDI inflows (USD billion), 1995-2002: Global and regional comparison

	1995	1996	1997	1998	1999	2000	2001	2002	**Total inflow 1995-2002**	**CEE inflows as a share 1995-2002**
World	341.5	388.7	481.2	692.3	1076.3	1363.2	684.1	591.4	**5618.8**	2%
Europe	138.1	134.2	162.6	302.8	529.8	717.4	262.2	296.6	**2543.8**	5%
EU15	115.3	112.5	129.8	265.1	482.6	661.3	223.8	256.1	**2246.4**	6%
Transition economies	4.0	5.3	9.8	7.2	7.2	5.8	7.8	10.1	**57.1**	242%
CEE countries	**14.42**	**9.97**	**12.47**	**17.09**	**19.49**	**21.99**	**19.40**	**23.43**	**138.25**	100%
										CEE = 100%
Bulgaria	0.09	0.11	0.65	0.68	0.92	1.02	0.81	0.92	**5.19**	*4%*
Czech Republic	2.56	1.43	1.30	3.72	6.33	4.99	5.64	8.48	**34.45**	*25%*
Hungary	5.10	3.30	4.17	3.34	3.31	2.76	3.94	2.99	**28.91**	*21%*
Poland	3.66	4.50	4.91	6.40	7.27	9.45	5.58	4.03	**45.79**	*33%*
Romania	0.42	0.26	1.22	2.03	1.03	1.06	1.16	1.14	**8.31**	*6%*
Slovakia	2.59	0.37	0.23	0.93	0.63	2.72	2.28	5.87	**15.60**	*11%*

Source: UNCTAD, 2016a

Before we move to a detailed analysis of the carriers and mechanisms that lay the foundations for this development, it is important to understand the factors that positively influenced inflows of FDI to the region and how the transformation of the countries' economic strategies towards internationalization actually took place. Therefore, in what follows, we will analyze standard FDI determinants in CEE region for the observed period as well as policy-specific determinants, mainly linked to the improvement in governance. These changes were primarily stimulated by the reforms designed to facilitate or permit European Union (EU) accession but may have had the secondary effect of encouraging and attracting inward FDI.

Some of the positive variation in FDI inflows patterns in CEE region between 1995 and 2002 can be partly explained by improving economic and development indicators matched with low wages compared to other European countries. As a result, multinational companies have started to increasingly use eastern European based production facilities and comparatively cheap and skilled local labour force with the aim to restructure their production models, and hence improve their competitiveness (Michael Faust et al., 2004). This progress, still linked to the privatization of the national economies was reflected in the scale of changes in the ownership of formerly state-owned enterprises. On the top of that, some of the most relevant reforms have included liberalization of markets and trade, improving public administration and gradual creation of a more favorable business environment. Additionally, progress in banking reforms and the building of financial institutions could also have been observed. All these positive trends in the region were mirrored in improving transition index scores for all of the CEE countries.

Table 4: Average EBRD's Transition Indices scores for selected CEE countries; number of banks and share of foreign-owned banks, 1995 vs. 2002

	EBRD's Transition Index[2]		Number of banks		Share of foreign-owned banks	
	1995	**2002**	**1995**	**2002**	**1995**	**2002**
Bulgaria	2.6	3.4	41	7.3%	34	76.5%
Czech Republic	3.6	3.8	55	41.8%	37	70.3%
Hungary	3.7	3.9	43	48.8%	38	71.1%
Poland	3.4	3.8	81	22.2%	59	76.3%
Romania	2.6	3.3	24	33.3%	31	77.4%
Slovakia	3.5	3.9	33	54.5%	18	83.3%

Source: EBRD, 2003

[2] Average score for 6 TI subindices: large scale privatization, small scale privatization, governance and enterprise restructuring, price liberalization, trade & foreign exchange system and competition policy

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As the Table 3 above shows, all of the CEE countries managed to improve their overall transition score. As measured by the EBRD, this index reflects the countries' progress in 6 distinctive areas linked to transition processes: large-scale privatization, small-scale privatization, governance and enterprise restructuring, price liberalization, trade & foreign exchange system and competition policy. The greatest improvements could have been observed in the case of Bulgaria, where transition score increased by 0.83 points and Romania, where the score increased by 0.72 points between 1995 and 2002. The average score increase in Visegrad 4 countries were 0.27 points (however, the better performance of Bulgaria and Romania may be questioned and this interpretation may be misleading as we have to take into account the effect of a lower initial score of both countries). The improving privatization and transition indices were also coupled with progressing restructure and reform of the banking sector. One could expect, that the number of banks in the region would increase very rapidly, however, in reality, several acquisitions and joint ventures were accomplished in the banking sector and as a consequence, the absolute number of banks decreased. Nevertheless, from the point of our analysis, the most important trend is that share of those banks which were foreign-owned was rising, year-by-year. While in 1995, the average share of foreign-owned banks in CEE region accounted for 34.7%, this proportion raised to 75.8% by the end of 2002. The largest growth of the share of foreign-led banks was recorded in Bulgaria, rising from 7.3% in 1995 to 76.5% in 2002, more than tenfold increase.

Consequently, foreign companies investing in the region began to play a crucial role in the abovementioned economic restructuring and transition. Since the mid-1990s, FDI in CEE region has taken off and the leading export sectors began to be operated almost exclusively by foreign firms. Moreover, not only finance but also strategic services like telecommunications started to predominantly fall under foreign owners (Bohle, 2006). Several authors agree that these multinational corporations acted as one of the catalysts for the economic changes, as local capital markets alone would not have been able of providing the funds needed for the large-scale modernization and consolidation of the private sector (e.g. Walkenhorst, 2004). However, the role of foreign-led companies at the time was not just to bridge the gap of insufficient domestic funds to finance the private sector transition process. Alongside with the long-term capital, the foreign companies have also been the carriers of new technologies, managerial and organizational know-how and skills assisting the reforming CEE economies in their transition efforts.

It could be therefore understood that from the governance perspective, a lot of prominence and special attention have been given to the crucial role of foreign investors in CEE region. In the second half of the 1990s, but mainly in the early 2000s, most of the countries implemented governance reforms and introduced changes in the private sector related policies in the expectation of attracting more FDI. For example, the Czech Republic's economic agenda drafted by Social Democratic party which took power in 1998, explicitly included the aim of attracting foreign investments as a central strategy for economic growth and introduced a package of generous investment incentives. As Drahokupil (2008) argues, this stimulated start of the competition for greenfield investments in the region, mainly in the countries of the Visegrad group. Consequently, the late 1990s marked the introduction of investment promotion schemes by other CE countries: Slovakia followed the example and emulated the scheme implemented in Czech Republic in 1998, Hungary introduced anew incentives scheme in 2003 and Poland came out with a similar program in 2005. That said, the discussions on how to make the business environment more attractive and the business operations easier for foreign investors started to be more and more common among politicians and local governments[3]. One illustrative example is the statement of former Slovak Deputy Prime Minister for the Economy, Ivan Mikloš, who indeed declared that „the expansion of production of Volkswagen, not only in its Bratislava plant but in other locations throughout Slovakia, is a matter of public interest.“[4] This position reflected the new spirit that inspired and motivated FDI oriented policy-making in the CEE region. At the same time, establishing professional organizations that promote FDI become a very popular institutional strategy across the whole CEE region. These entities are known as investment promotion agencies (so-called IPAs) and usually operates as a separate governmental entities reporting to respective state authority, in most cases the Ministry of Economy. Its aim is to promote country as a destination for FDI as well as support the needs of foreign investors, provide consultancy services and help them to deal with administrative and legal procedures linked to the implementation of investment projects. Hence, the fact that CEE countries established such agencies on which grounds they legitimized practice of FDI

[3] For reference, see: http://www.vlada.gov.sk/vlada/zasadnutia/1999/sk_tlacovka19990309_21.shtml

[4] In the public interest: government's support for VW Slovakia (*Vo verejnom zaujme: podpora vlady VW Slovakia*), Daily Pravda, 19 January 1999

promotion would signal the presence of states' commitment to improve the FDI environment and promote inward FDI (Bandelj, 2008).

Table 5: Investment Promotion Agencies in selected CEE countries

Country	Name of the agency	Operational
Bulgaria	InvestBulgaria Agency	1995-present
Czech Republic	CzechInvest	1992-present
Hungary	Hungarian Investment and Trade Development Agency (IDT, now HIPA)	1993-present
Poland	Polish Agency for Foreign Investment (PAIZ)	1992-present
Romania	The Romanian Centre for Trade and Investment / Romanian Agency for Foreign Investment	1997-present
Slovakia	Slovak National Agency for Foreign Investment and Development (SNAZIR)	1994-2000
	Slovak Investment and Trade Development Agency (SARIO)	2001-present

Source: Bandelj, 2008. Adjusted based on information from respective IPAs websites, general sources and informal documents

The first two IPAs in CEE region were established in Czech Republic and Poland, soon after the start of transition process – CzechInvest and Polish Agency for Foreign Investment (PAIZ) in 1992. Slovakia and Hungary followed in the next two years – Hungarian Investment and Trade Development Agency in 1993 and Slovak National Agency for Foreign Investment and Development (SNAZIR) in 1994. However, it has to be stressed that SNAZIR, as an agency existing in a political environment governed by Vladimír Mečiar, paid only little attention to attracting FDI and recorded very poor performance. The evidence is the abovementioned fact that during the years 1993-1999 Slovakia was lagging behind its V4 counterparts in terms of FDI attraction and was unable to reach comparable levels of investment inflow (see Graph 1). SNAZIR, operating in an environment that promoted national accumulation of capital, had in fact no impact on changing the FDI promotion strategy of the country. Even though, it should be highlighted that the Mečiar government introduced incentives in the form of tax reliefs for foreign investors in June 1998, only three months before the elections brought into force a new coalition, ready and willing to open the country to foreign capital.

Nevertheless, it has to be noted that inward FDI into the region between 1995 and 2002 was stimulated by a broader economic context. The important point is that all of these countries applied for EU membership between 1994 and 1996 (Hungary and Poland in 1994, Bulgaria, Romania and Slovakia in 1995, the Czech Republic in 1996). This is interpreted to mean that it was not only the FDI's potential and capacity for structural economic changes but also the potential membership of CEE countries in the European Union (EU) and consequently the prospects of removing the barriers of the free movement of goods and capital that helped to stimulate foreign investors' interest. At the same time, regulatory framework that had to be implemented in order to qualify for the EU accession also effectively forced the states to set strategies and adapt policies within the foreign-investment-friendly direction.

4. CONCLUSION

Since 1990, CEE countries became home to number of multinational companies which have made decisions to invest in expansion or relocate their business into foreign country. Mainly in the early 2000s, the region was perceived as the future success story with its solid growth predictions, promising an affordable and skilled labor force with an advantageous location on the periphery of Europe and the promise of soon EU accession.

Nevertheless, all CEE countries underwent large-scale transformation since the beginning of their transition in 1990 from a centrally planned to a market economy. This process included implementation of numerous reforms, mostly linked with privatization, market liberalization, restructuralization of business and financial sector and changes in governance. The evidence presented in this study suggests that these processes varied from country to country, which naturally resulted in individual approaches to foreign investment and subsequently, in very uneven development of FDI inflows.

The period covering the years from 1990 to 1994 was characteristic by the beginning of transition process and privatization programs as well as the initial surge of FDI inflows. Nevertheless, the FDI in CEE recorded in the early

1990s were very low and uneven at the same time as a consequence of various transition-specific factors. Firstly, it generally takes some time before the foreign investors became really active. Secondly, in majority of CEE countries the promotion of foreign direct investments was not the top priority of local politicians and policy-makers at the time and begun to be implemented only around 2000. At the early nineties, all governments have been mostly focused on minimization of the state as the business owner, rarely taking foreign investors into account and sometimes explicitly avoiding them. However, Hungary does not fit into this category, as this was the only country that implemented set out the rather FDI-friendly policy right at the outset of its transition process. This is reflected in country's favorable scores in EBRD's transition indicators as well as higher FDI inflows and stocks recorded, in comparison with its CEE counterparts. On the contrary, Czech Republic and Slovakia implemented rather non-standard privatization methods, which preferred domestic investors rather than foreign ones. On the top of that, both countries utilized methods, where FDI were excluded by default (e.g. non-eligibility of foreign investors etc.). In the case of Poland, the attempts to attract foreign investors were very limited, as a result of so called 'insider privatization' method, where management and employees of the local companies were preferentially chosen for buy offs of assets.

Nevertheless, it has to be noted that despite inward oriented investment strategies that were in place in Czechoslovakia and partly in Poland at the early 1990s, few important FDI deals were concluded and almost all of them were part of the automotive industry. The first example is the Volkswagen's acquisition of Czech Republic based car manufacturer Škoda in 1991. The second case was the investment of Italian carmaker Fiat in the Polish city of Tychy (by the takeover of the Polish FSM - *Fabryka Samochodów Małolitrażowych*). Third 'success story' included Volkswagen's 80% acquisition of Slovak BAZ (*Bratislavské Automobilové Závody*) in 1991. On the top of that, there was also the case of greenfield investment in 1990, after Suzuki invested into the establishment of new assembly factory in Hungary. However, these are just a few bright and exceptional cases and up until 1995 investors' interest in CEE region remained low. To attract larger volumes of FDI inflows position themselves within waves of multinational capital, the CEE countries needed to review their policies towards foreign capital owners and develop proper institutional and policy frameworks.

Following the period of national regimes between 1990 and 1994 (with the exception of Hungary), the CEE countries undertook a profound reorientation in relation to FDI. The countries gradually revised their approach and began to prioritize the role of foreign investment attraction in their agendas and in the mid the 1990s. As a result, FDI inflows begun to steadily increase as a response to this transformation. This growing amount of FDI flows into the region was also a reaction to the development of CEE countries in regard to their gradual economic liberalization, political processes, progress in market-oriented reforms and their successive integration into the world economy.

Policy reforms implemented as part of the transition process resulted in the modification of legislation, business climate regulation and, as already mentioned, twist in countries' approach related to FDI promotion. The countries have adopted fairly open FDI regimes, introduced a package of generous investment incentives and establishing state bodies dedicated to promote FDI (so-called IPAs) become a very popular institutional strategy across the whole CEE region. All these efforts paved the way for the increased surge of FDI inflows in CEE countries in the latter part of the 1990s subsequent strong growth of FDI inflows in the 2000s, additionally boosted by the EU accession.

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