

Institutions, internationalization and FDI: the case of economies in transition

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The attempts in the literature to explain the uneven allocation of foreign direct investment in the economies in transition for the most part stress the role of the market as the most significant factor in the attraction of such investment. This article attempts to verify empirically the argument that institutional factors such as civil rights and internationalization of the national economy are critical in explaining the behaviour of foreign direct investment inflows in the economies in transition. It uses a panel data set for the economies in transition, which are to become member states of the European Union. The findings show that market size and degree of internationalization of the host economy explain a significant part of the cross-country variation of foreign direct investment. However, institutional factors related to investment decisions strengthen these location advantages and help a country become an attractive location for such investment.

Key words: foreign direct investment, transition economies, institutions, economic integration.

Introduction

The interlinkages of trade and foreign direct investment (FDI) influence the economic growth and welfare of countries in a global environment, which undergoes continuous change.

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In this sense, FDI inflows are viewed as a measure of the extent to which a country or a region is integrating into the world economy. Therefore, policies to attract FDI are included in the governmental agenda of many countries. Despite these policies, FDI growth is unevenly distributed among the economic regions of the world. Recent statistics (UNCTAD, 2001) show that 80% of total world FDI inflows are accounted for by the “*Triad*” (European Union-Japan-United States) which also hosts 90% of the world’s largest (in terms of foreign assets) transnational corporations (TNCs). In fact, the top 30 host countries account for 95% of the total world FDI inflows and 90% of the total stock of FDI.

Economies in transition in Central and Eastern Europe (CEE) attract a small share of the world’s FDI, a share that is moreover unevenly distributed in the region. Central Europe and the Baltic States have received more FDI per capita than South-Eastern Europe and the Commonwealth Independent States (Sengenberger, 2002).

The recent literature in the field has tried to explain this uneven allocation of FDI in the economies in transition. Most of the studies, whether descriptive (for example, Glaiser and Atanasova, 1998; Tuselmann, 1999; Pournarakis, 2001; Sengenberger, 2002; Barry, 2002), or empirical (Tondel, 2001; te Velde, 2001), stress the market as being the most significant factor for the attraction of FDI in the economies in transition, while institutions are hardly included in their analysis.

Economies in transition have only recently received the attention of researchers regarding the impact of institutional change on their economic performance. A. Brunetti, G. Kisunko and B. Weder (1997), using the findings of a survey, have verified that institutions are correlated with economic growth and foreign direct investment. To explain the cross-country variation in economic performance, C. Zinnes, Y. Eilat and J. Sachs (2001) have emphasized the deep privatization, while L. Grogan and L. Moers (2001) have emphasized the role of quality institutions.

This article aims to verify empirically whether the “deep determinants” (geography, integration and institutions) proposed by D. Rodrik and A. Subramanian (2003) explain the behaviour of FDI inflows in a sample of economies in transition, using a set of institutional variables that differ from the ones found in other studies. The article uses a panel data set for eleven countries of the region for the period 1997-2001. The first group of countries includes the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia, which have already been accepted to join the European Union (EU) by the year 2004. The second group of countries includes Bulgaria, Croatia and Romania, which may join the EU in the second enlargement phase of the Union. Finally, Albania is also included in the sample. The period 1997-2001 has been chosen as the reference period because, during the first half of the 1990s, most of the countries in our sample were subject to the turbulence of transition from the old planning regime to a market economy (war in Croatia, the political split of Czechoslovakia and political instability in Albania, Bulgaria and Romania). All the countries of our sample now enjoy vigorous democratic institutions. However, there are still substantial differences in their relative success in building quality institutions, especially those related to law enforcement.

This article is organized as follows: in the second section, the theoretical framework is presented; the third section presents the data used in our empirical analysis; the fourth section presents the empirical results and related discussion; and, finally, the fifth section consists of concluding observations.

The theoretical framework

The flow of FDI is viewed as an integrating factor in the world economy. The economies in transition, having lagged behind in the race for FDI attraction, are called upon to agree on a more efficient investment regime. Among other things, this means the recognition and exploitation of their location advantages, while the progressive removal of their disadvantages should be incorporated more fully into their development

strategies. According to John H. Dunning (1993), the location advantages derive from the supply side (labour skills and costs, corporate taxation), the demand side (market size and growth) and the political and social infrastructure. To date the literature on FDI in economies in transition has focused on both the supply and demand side location advantages, but market size stands out as being the most significant factor in the attraction of FDI. There is a widespread argument that most CEE bound FDI has been market seeking (Sengenberger, 2002; Tuselmann, 1999; Tondel, 2001; Te Velde, 2001). In this respect the Balkan countries are in a disadvantageous position for various reasons. The region suffers from the syndrome of fragmentation rather than unification. Long-standing rivalry and instability have created distances among the countries of the area and thus make cross-border trade and FDI activity more difficult.

Of course, good market performance does not exclusively depend on market liberalization and privatization. The enabling market setting requires, among others, an appropriate kind and degree of regulation, effective law enforcement and qualitative public services (Sengenberger, 2002). Thus, excessive bureaucracies, delays in privatization, unclear and arbitrarily enforced rules, monopoly control of the real sector (Glaister and Atanasova, 1998), the lack of tripartite social dialogue, and unsatisfactory industrial relations (Sengenberger, 2002) could constitute strong investment barriers even for market-seeking TNCs (Ekholm and Markusen, 2002). Brunetti, Kisunko and Weder (1997) found that differences in the degree of predictability of the institutional framework might explain to a significant degree the differences in FDI across economies in transition. Zinnes, Eilat and Sachs (2001) present empirical evidence that the change of ownership resulting from privatization programmes was not an adequate explanation of the variation of economic performance. The firm's objective function (profit maximization), the severity of the budget constraints and the legal and institutional framework that enables a firm's agents to monitor and control enterprise managers, are also critical in explaining the variation in economic performance, as measured by economic growth and FDI inflows. Finally,

Grogan and Moers (2001), using different institutional measures, verify the previous findings that quality institutions are important for economic growth and FDI in economies in transition, for the period 1990-1998.

This article seeks to explain the cross-country variation of FDI inflows for the period 1997-2001 in those countries that will become full members of the EU in 2004. Rodrik and Subramanian (2002) proposed three fundamental factors influencing the economic performance of a country: geography, economic integration in the global economy and institutions. This article will test for the last two, integration and institutions, controlling for geography.

Integration in the global economy is proxied by two alternative variables, exports and international trade as a percentage of GDP. Countries that have become more integrated in the global economy – the level of their annual exports is higher – are expected to attract more FDI than countries with a lower degree of integration. Thus, the following hypothesis is posited:

H1: The more integrated a country is in the global economy the higher are FDI inflows.

Quality institutions, and the rules of the game in a country are defined in terms of the degree of property rights protection, the degree to which laws and regulations are fairly applied and the extent of corruption (IMF, 2003). Civil liberties, the freedom of expression, freedom of association and organization rights, and the rule of law and human rights, are all important influences on business decision-making. For example, the lack of free trade unions and collective bargaining is an important factor since feelings of job insecurity inevitably run high and FDI performance worsens in the host country. Empirical research, as noted by Sengenberger (2002), has shown that this feeling is present in the CEE countries. The independence of the judiciary system, the prevalence of the rule of law in civil and criminal matters, the treatment of population under law with equality, and other related issues such as corruption and the mafia, may

also significantly influence the decision of a TNC to enter a new market. As K.W. Glaister and M. Atanasova (1998) point out, even though Bulgaria has adopted a very liberal legal framework for FDI, the endemic nature of organized crime in business and the strength of the official bureaucracy have resulted in a “lagging behind” of Bulgaria when compared to other CEE countries in terms of FDI. Thus, the following hypothesis is posited:

H2: The higher the institutional quality that a country exhibits the higher FDI inflows.

The data

In the following section, the two hypotheses stated in the previous section are tested, using data from the aforementioned sample of economies in transition for the period 1997-2001. Recent studies (Mauro, 1995; Brunetti, Kisunko and Weder, 1997; Zinnes, Eilat and Sachs, 2001; Grogan and Moers, 2001) used information about the perceived quality of institutions trying to explain the cross-country variation of economic performance. Subjective institutional measures, as Grogan and Moers (2001) point out, could lead to more interesting conclusions about the mechanism at work and the policies needed. These subjective measures are constructed by commercial, international country-risk agencies using surveys of the opinions of economic agents who make investment relevant decisions, and for that reason are more relevant to FDI.

The first source of our data for institutional measures is Freedom House. Three indices are used to measure the quality of political institutions (Freedom House, 2002b). These indices are constructed using survey methodology. The first is an index of political rights. The index ranges from one to seven. In countries that receive a rating of one, elections are free and fair; those who are elected rule the country, the opposition plays a significant role in the political system and citizens enjoy self determination. The countries that receive a rating of two are

less free, and factors such as political corruption, political discrimination against minorities, or foreign or military influence may be present. In countries that receive a rating of three, four or five, the presence of military involvement, unfair elections, one party dominance and civil war are considered harmful to civilians' freedom.

The second index involves civil liberties. The index ranges from one to seven. Countries receiving a rating of one are distinguished by an equitable system of rule of law, are free of corruption and enjoy free economic activity. Countries that receive a rating of two exhibit some deficiencies in civil liberties but could still be characterized as free. Finally, countries receiving ratings of three, four or five present significant deficiencies in terms of free association and limitations in business activity imposed either by governmental institutions or non-governmental agents (that is, terrorists, mafia).

The third index is related to freedom of the press. The data reported in Freedom House (2000a) are used. They measure the degree to which each country of our sample permits the free flow of information. The free press is the sum of ratings for the news delivery system as functioning under country's laws and administrative decisions; the degree of political influence over the content of news media; and the economic influence on media content (that is, government funding, corruption). The free press index ranges from zero to one hundred, zero indicating a completely free press and one hundred a completely non-free press.

The second source of data for the institutional measure is derived from Transparency International. The Transparency International's Corruption Perception Index is used as a measure of corruption. This is a composite index based on international surveys of the perception that business people and country experts have regarding corruption in over fifty countries. The results of individual surveys are standardized, that is, they are expressed in standard deviations from the mean. The index is

the simple average of these standardized values and it is a continuous scale from 0 representing an absolutely corrupted state to 10 representing a completely clean one. The sample consists of data for the period 1998-2001, but the data are not available for the full range in all countries of the sample.

The degree of internationalization of an economy is captured by two measures, the share of exports in gross domestic product and the ratio of international trade to gross domestic product. The data are drawn from the World Bank Economic Indicators for the years 1997-2001.

The endogenous variable is FDI inflows per capita. The data for FDI inflows are published by UNCTAD for the period 1997-2001. The control variables that a priori may be expected to matter for the behaviour of FDI in economies in transition are drawn from the literature gathered in the field. A proxy for market size is per capita gross national income. Data are used (Atlas method in current dollars) as reported in World Bank Economic Indicators for the years 1997-2001. The annual inflation rate for a country as reported in World Bank Economic Indicators for the period 1997-2001 is used as a proxy for macroeconomic stability.

The cluster typology proposed and developed by Zinnes, Eilat and Sachs (2001) – who assign countries based on similarities in variables at the start of transition – is used to control for the initial conditions. This clustering exercise resulted in seven clusters of economies in transition, and four of them are used: Cluster 1: Albania; Cluster 2 (Baltic States): Estonia, Latvia, Lithuania; Cluster 3 (the “Balkans”): Bulgaria and Romania; and Cluster 4 (EU Border States): Croatia, Czech Republic, Hungary, Poland, Slovakia, Slovenia.

Empirical results and discussion

Based on the discussion of the previous section, equation (1) is set, which is the model to be estimated:

$$LFDIC_{ij} = a + b_1INST_{ij} + b_2INT_{ij} + b_3LGNII_{ij} + b_4INFL_{ij} + Cluster\ Dummies \quad (1)$$

where $LFDIC_{ij}$ is the logarithm of per capita FDI inflows for country i in year j , INT_{ij} the internationalization degree for country i and the year j , and $INST_{ij}$ stands for the institutional variables used in our paper to capture the impact on FDI. The CPI_{ij} , the corruption perception index, the $LPRESS_{ij}$, the logarithm of the press freedom index, the $POLIT_{ij}$, the index for the political rights, and the $CIVIL_{ij}$, the index for the civil rights, are used alternatively. In order to deal with macroeconomic stability, the annual inflation rate for the country i and the year j , $INFL_{ij}$ is used. Two alternative indices to capture the degree of internationalization, INT_{ij} , are used: first, the percentage of exports to gross domestic product in logarithms, denoted as $LEXP_{ij}$ in the data set; second, the percentage of international trade to gross domestic product in logarithms, denoted as $LINTR_{ij}$ in our data set.

In order to face the endogeneity problem between FDI and per capita gross national income (GNI) the log of the per capita GNI with one lag, $LGNII_{ij}$ in equation (1) is used. Considering that FDI takes one to two years to affect the national income of a host country, the use of per capita GNI with one lag solves the endogeneity problem satisfactorily (Griffiths, Hill and Judge, 1993).

The expected signs, according to the hypotheses set in the previous section and the literature, are: $b_2, b_3 > 0, b_4 < 0$. The signs of the institutional variable depend on the measurement scale. Thus, we expect positive sign for CPI and negative for $LPRESS$, $POLIT$ and $CIVIL$.

Table 1 presents the descriptive statistics and table 2 the correlation coefficients. Table 3 evaluates a series of pair-wise relationships between $LFDIC$ and the individual determinants. Individually, only $LGNII$ explains almost 45% of the overall variation of the $LFDIC$, while the individual contribution of the other determinants ranges between 11% and 27%. The individual estimated parameters of the institutional variables and

integration are statistically significant and have the expected signs. The *LFDIC* is correlated with lower corruption, more press freedom and better political and civil rights. Finally, the *LFDIC* is correlated with the degree of internationalization. However, as these are only univariate regressions, the conclusions must be viewed with caution.

Table 1. Descriptive statistics

Variable	Mean	Max	Min	s.d.
COR	3.95	6	2.30	1.035
PRESS	31.76	75	17	14.34
FDIC	143.29	614.22	12.12	128.17
CIVIL	2.45	5	2	.87
POLIT	1.62	4	1	1.01
GNI	3787.13	10070	750	2277.47
INFL	27.83	949	-1	122.75
EXP	48.79	95	9	19.20
INTR	104.73	192	41	35.41

Source: Authors' own calculation.

Table 2. Correlation matrix

Variable	COR	PRESS	FDIC	CIVIL	POLIT	GNI	INFL	EXP
COR								
PRESS	-.583**							
FDIC	.309	-.353**						
CIVIL	-.558**	.768**	-.282*					
POLIT	-.673**	.915**	-.238	.880**				
GNI	.706**	-.302*	.379**	-.553**	-.366**			
INFL	-.190	.140	-.136	.064	.074	-.193		
EXP	.541**	-.504**	.463**	-.493**	-.542**	.354**	.037	
INTR	.507**	-.479**	.443**	-.399**	-.492**	.323*	-.031	.983**

Source: Authors' own calculation.

* correlation is significant at the 0.05 level.

** correlation is significant at the 0.01 level.

Table 3. Single OLS estimations: dependent variable *LFDIC*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Constant</i>	2.404 (0.001)	7.340 (0.000)	0.761 (0.326)	-1.204 (0.364)	6.106 (0.000)	4.959 (0.000)	-2.864 (0.011)	4.736 (0.000)
<i>COR</i>	1.707 (0.001)							
<i>LPRESS</i>		-0.772 (0.006)						
<i>LEXP</i>			1.039 (0.000)					
<i>LINTR</i>				1.286 (0.000)				
<i>CIVIL</i>					-1.534 (0.001)			
<i>POLIT</i>						-0.739 (0.001)		
<i>LGNII</i>							0.944 (0.000)	
<i>INFL</i>								-0.0009 (0.332)
<i>R2-adj</i>	0.25	0.110	0.307	0.249	0.27	0.155	0.447	-0.001
<i>F-stat</i>	12.664**	2.256**	26.74**	20.27**	13.7**	11.78**	48.78**	0.959
<i>Observations</i>	35	59	58	58	59	59	59	59

Source: Authors' own calculation.

Note: p-values in parenthesis.

** statistically significant at the 0.01 level

Table 4 presents the estimates of the *LFDIC* equation. Eight different modes of equation (1) were estimated.¹ As a

¹ Heterogeneity between countries has been tested, that is whether equation (1) is the adequate one by assuming that all parameters are equal for the ten-cross-country units. If the assumption is correct, there are no behavioural differences across countries and the data can be treated as one sample of 58 observations. In order to test for common or different intercepts in individual countries the least squares dummy variable model (Griffiths, Hill and Judge, 1993) was applied. The estimated F-statistic suggests that the null hypothesis, the constant terms of the individual countries are equal, could not be rejected at p=0.01. Thus the constant term is the same across countries and it was possible to proceed by considering the data set as one sample.

control variable, the *LGNI*, *INFL* and the cluster dummies were used, and tested for the overall significance of the institutional variables and internationalization. The conclusions that can be inferred from these regressions are two. First, the *LGNI*, *LEXP*, and *LINTR* are statistically significant in all regressions (with the exception only of *LINTR* with *COR* and *CIVIL* as regressors). Second, for all specifications institutional variables have a statistically insignificant effect on FDI inflows, even though the estimated coefficients have the expected signs (with the exception of *LPRESS* with *LEXP* as regressor). Thus, the results verify the previous findings in the literature that market size, as captured by *LGDI*, and internationalization, as captured either by *LEXP* or *LINTR*, are very important factors influencing the decision of TNCs to enter the host countries. The results also suggest that institutional variables do not contribute substantially

Table 4. OLS estimations: dependent variable *LFDIC*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Constant</i>	-2.730 (0.186)	-3.408 (0.165)	-3.248 (0.071)	-4.224 (0.045)	-4.677 (0.008)	-3.612 (0.014)	-0.866 (0.623)	-1.713 (0.391)
<i>COR</i>	0.067 (0.927)	0.151 (0.837)						
<i>LPRESS</i>			0.0115 (0.963)	-0.031 (0.899)				
<i>CIVIL</i>							-0.422 (0.270)	-0.624 (0.147)
<i>POLIT</i>					0.051 (0.816)	0.112 (0.617)		
<i>LGNI</i>	0.673 (0.041)	0.711 (0.033)	0.744 (0.000)	0.804 (0.000)	0.822 (0.000)	0.768 (0.000)	0.476 (0.046)	0.550 (0.027)
<i>LEXP</i>	0.522 (0.138)		0.517 (0.032)			0.562 (0.021)	0.593 (0.065)	
<i>LINTR</i>		0.489 (0.244)		0.565 (0.068)	0.605 (0.05)			0.573 (0.196)
<i>INFL</i>	0.0006 (0.886)	0.0009 (0.849)	-0.0005 (0.914)	0.0001 (0.866)	0.0001 (0.886)	-0.0001 (0.883)	-0.0004 (0.596)	-0.0001 (0.822)
<i>Cluster Dummy</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>R2-adj</i>	0.36	0.34	0.47	0.46	0.46	0.475	0.513	0.485
<i>F-stat</i>	5.901**	5.53**	13.97**	13.326**	13.35**	14.1**	10.21**	9.224**
<i>Observations</i>	35	35	58	58	58	58	58	58

Source: Authors' own calculation.

Note: p-values in parentheses.

** statistically significant at the 0.01 level.

to the explanation of the cross-country variation of FDI inflows, beyond the control variables. The results, however, do not imply that institutional variables have no impact on FDI and that only market or internationalization matters. It would be more appropriate to test whether FDI decisions require simultaneous improvements in markets, internationalization and institutions. These simultaneous improvements were tested by adding interaction terms to the model. The interaction terms are the products of the *LGNII*, *LEXP* and *LINT* with the variable *CIVIL*. The corresponding results for *LPRESS*, *COR* and *POLIT* are not statistically significant and therefore they are not reported here.

Table 5 presents the estimation results of an alternative specification of the model. The synergetic effects are given by the *LGNII***CIVIL*, *LEXP***CIVIL* and *LINTR***CIVIL* interactive terms. The strong conclusion of these regressions is the role of *CIVIL* in support of *LGNII*, *LEXP* and *LINTR*, on FDI inflows.² The interpretation of these results is that, the better the civil rights level of a country, the more positive is the impact of an increase in per capita income on FDI. Thus, countries in our sample that have promoted economic growth would have attracted more FDI if this had been followed by reforms to improve civil rights.

These results, using different measures for institutional quality, verify previous findings in the literature. Quality institutions render a country attractive for TNCs beyond its market size, its productive endowments and internationalization. The countries in the sample have made significant progress, in terms of political stability, privatization, macroeconomic stabilization and the adoption of laws protecting property rights. However, this progress should be accompanied by improvements in civil rights. Countries that are distinguished by a more equitable system of rule of law, lower corruption and more freedom in economic activity achieved much better performance than countries that are characterized by significant deficiencies. Countries that suffer from limitations in economic activity either

² To check the robustness of the result we repeated the regressions for various specifications and methods (random effects, inclusion of quadratic terms, i.e. CIV squared, cluster dummies and country dummies).

by governmental institutions or non-governmental agencies (that is, the mafia, armed groups) exhibit the worst performance in attracting FDI.

Table 5. Synergetic effects of the interaction between LGNII, LEXP, LINTR and CIVIL: dependent variable LFDIC

Variable	(1)	(2)	(3)	(4)
<i>Constant</i>	-13.701 (0.003)	-17.824 (0.003)	-9.448 (0.064)	-13.424 (0.002)
<i>CIVIL</i>	0.500 (0.038)	0.431 (0.07)	0.0511 (0.887)	-0.818 (0.145)
<i>LGNII</i>	2.088 (0.000)	2.074 (0.000)	2.127 (0.000)	2.521 (0.000)
<i>LEXP</i>	0.468 (0.037)		-0.812 (0.322)	
<i>LINTR</i>		0.461 (0.101)		-0.480 (0.305)
<i>INFL</i>	0.0003 (0.722)	0.0004 (0.563)	-0.00003 (0.965)	0.00001 (0.983)
<i>LGNII*CIVIL</i>	-0.0001 (0.01)	-0.0001 (0.015)	-0.0001 (0.008)	-0.0205 (0.002)
<i>LEXP*CIVIL</i>			0.0127 (0.108)	
<i>LINTR*CIVIL</i>				1.005 (0.017)
<i>Cluster Dummy</i>	Yes	Yes	Yes	Yes
<i>R2-adj.</i>	52.7	51.2	54.2	55.5
<i>F-Statistic</i>	13.942**	13.170**	12.429 **	13.054**
<i>Nr. Obs</i>	58	58	58	58

Source: Authors' own calculation.

Note: p- values in parentheses.

** statistically significant at 1%.

Even though the data span is rather narrow (five years for each country), however, they are the most stable for our sample countries. Furthermore, taking into consideration previous findings in the literature, the findings of this article are an initial hint for policy orientation in these countries in order to catch up with their Western neighbours. Since good institutions guarantee property rights and minimize transaction costs they create an environment conducive to investment. Thus, the

application of policies that aim at the stabilization of the political and social environment and the implementation of an efficient judiciary and bureaucratic system will help these countries to increase FDI inflows. As FDI is a major integrative factor, the new members of the EU will integrate faster into the European economy. As far as the countries of the next wave of enlargement are concerned, the EU should focus not only on policies that will help these countries to improve their physical infrastructure, internationalization, privatization and macroeconomic stability, but also on policies to help them substantially to improve the quality of their institutions, and on creating an environment in which property rights and entrepreneurship are well protected. In this way these countries could be rendered more attractive to foreign firms and they would be enabled to improve their economic performance and to converge faster towards meeting the European standards.

Conclusions

This article, using a data set for a sample of economies in transition for the period 1997-2001, has verified empirically that market size and the internationalization of the host economy explain a significant part of the cross-country variation of FDI inflows. This is the strong point of the region, and in this respect it can be taken as advantageous. However, civil rights, which are related to investment decisions, strengthen these location advantages and also help a country to become a more attractive location for FDI.

The above discussion suggests that a great deal of groundwork, in terms of policy changes, is needed for the new and future members of the EU to increase substantially their share of FDI activity. If there is a role for the host country government, it surely lies in the creation of the necessary preconditions for FDI inflows. A significant component of this changed economic policy must be concerned with the development of political and civil institutions together with an efficient bureaucratic system. Emphasis should be given not only to the attraction of TNCs, e.g. by providing tax incentives, but

also “after entrance-care programmes” for foreign affiliates and this certainly would include the adoption of efficient institutions (Williams, 1997). In view of their expected EU membership, some of these countries could aim at creating a transparent legal environment (Barry, 2002) by adopting the EU institutional framework. The EU could also help its new members in this respect, especially those with lower quality institutions. On the other hand, the countries of the next wave should now start the process of development of quality institutions and the EU should support this process. ■

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