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Main factors behind the substantial increase of FDI in Bulgaria – 2003-2007

Bilyana Shteryanova

Supervisor: Professor Siri Pettersen Strandenes

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NORGES HANDELSHØYSKOLE

ABSTRACT

Since 2003 FDI inflows to Bulgaria have been growing steadily. This paper addresses the question which the main factors determining this significant increase are. The analysis is based on a large amount of macroeconomic data as well as the record of the process of integration of Bulgaria into the European Union (EU) and reforms in the country. Results show that privatization was an important determinant of FDI in the beginning of the examined period (until 2005), but after that other cross-border mergers and acquisitions and especially greenfield investment gained more importance relative to privatization. In addition, low labour costs and removed tariff and non-tariff barriers to trade (as prerequisites for efficiency-seeking FDI) and reforms related to the accession of the country into the EU (which ultimately led to improvement of the business environment) also proved to be important determinants of FDI inflows to Bulgaria.

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Bilyana Shteryanova

M.Sc. International Business student, Norges Handelshøyskole (NHH)

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I. INTRODUCTION

The boom in foreign direct investment (FDI) in the recent decades and especially after the mid 1990s has been widely discussed among scholars. The numbers are indisputable – year 2007 saw another peak in FDI inflows, a rise of 30 % inflows to reach $1,833 billion, well above the previous record peak in 2000 (UNCTAD, 2008). Notably, FDI inflows to all regions of the world, irrespective of the type of countries included (developed, developing, or least developed and transition) registered a record high levels of FDI inflows in 2007. Even though the expected decline in FDI has been happening due to the world financial crisis, the amounts of FDI inflows and stocks in the world economy are so impressive that they deserve unceasing attention.

What makes a difference in the recent years is the growing importance of the developing and transition countries as a recipient and donor of FDI. One of the most attractive destinations of FDI is Central and Eastern European countries (CEECs). After the fall of the Iron curtain in the beginning of 1990s these countries have walked a long way of reforms, opening and integration into the world economy.

In the beginning of 1990s virtually all enterprises in Bulgaria were state-owned and the planned economy had existed for forty-five years. The country had to go through many painful and challenging reforms in order to reach its current position as a European Union member.

One of the biggest successes of the country is its development into an attractive FDI destination. Facts and numbers show that since the year 2003 the FDI inflows started increasing substantially (see Table 1 below).

Table 1: Direct investment in reporting country (Millions of US$, at Current Exchange Rates)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Bulgaria	103	94	108	427	536	813	1 026	812	926	1 421	2 596	4 319	7 535	8 910

Source: UNECE Statistical Division Database, compiled from national and international (CIS, EUROSTAT, IMF, OECD) official sources. Available at http://w3.unece.org/pxweb/Dialog/Saveshow.asp; derived on 24 February 2009. Only years with available data are shown.

In 2006 Bulgaria was the fifth largest recipient among the South-East European (SEE) countries and the Commonwealth of independent states (CIS)[1] with only the Russian Federation, Romania, Kazakhstan, Ukraine (in this order) receiving higher amounts of inward FDI. The large increase in FDI inflows for this year could be attributed to the anticipation of the accession of the country into the EU on 1 January 2007 and to a series of privatization deals (UNCTAD, 2007). But before the inward FDI reached this point, it is indisputable that they started to grow with a fast pace on a yearly basis as early as 2003 as I said above.

Another fact is that in the year 2003 when the FDI inflows to Bulgaria started to rise, their magnitude worldwide shrank for a third consecutive year from $651 billion in 2002 to $560 billion. The inflows to CEECs also decreased by around one third from $31 billion to $21 billion. The interesting fact here is that while the inflows to some of the countries in the region including Bulgaria grew, the CEECs which were anticipated to be accepted into the EU in 2004[2] also saw a plunge into the FDI flows. In addition, this decline occurred despite the effort of some of these countries to enhance their attractiveness to foreign investors by lowering the corporate tax level (UNCTAD, 2003 and 2004). The decline of FDI flows to CEECs, Baltic and CIS countries was mainly due to the end of privatization in the Check republic and Slovakia (UNCTAD, 2004)

Based on the facts presented above, I would like to pay a special attention to the impressive transformation of Bulgaria into an attractive host country for FDI. The purpose of my research which will be presented in this master thesis is to analyse and try to outline the main factors with greatest contribution to the substantial increase of the FDI inflows.

A huge amount of literature exists with main focus on the determinants of FDI. Many empirical studies have been conducted and pointed out various reasons why certain countries are more attractive as recipients of FDI than others. There are also many research papers devoted to the determinants of FDI going to the CEECs named as

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[1] According to EBRD South-East European countries include Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania and Serbia, and the Commonwealth of Independent States includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan (derived from Table A.2.8 from the "Transition report 2007: People in transition" data available at http://www.ebrd.com/country/sector/econo/stats/mptfdi.xls)

[2] Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia and the Check Republic (UNCTAD, 2004)

transition countries[3]. Some of these research papers and their results and conclusions will be presented in the Literature review section of the thesis.

Based on the available research information on the determinants of FDI in general and on the determinants of FDI in the transition countries in CEE, I consider the following factors as possible contributors to the emergence of Bulgaria as an attractive FDI destination:

1. Privatization process;

2. Low labour costs;

3. Reforms undertaken during the transition period, especially the ones related to the EU membership;

4. Accession of Bulgaria into the single European market and EU structures, i.e. the pure economic effects of regional economic integration like reduction and further abolishment of tariffs, quotas and other barriers on trade with goods originating from EU member countries;

5. Improvements in the infrastructure mainly funded with money from EU structural funds, but also with the participation of foreign investors, etc.

Of course, it is too ambitious to try to determine the influence of all the factors. Thus, in this master's thesis, I will focus on the five of them listed above. I realise that it will be very difficult and nearly impossible to separate the influence of one factor from the influence of the rest of them. Because of this I will conduct my analysis in the line to show how all of them contributed to the attraction of mainly efficiency-seeking FDI, i.e. multinational companies (MNCs) invest in Bulgaria in order to operate with minimum costs and thus to be more efficient.

My research is based on data from United Nations Conference on Trade and Development (UNCTAD), United Nations Economic Commission for Europe (UNECE), Eurostat, World Bank, International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD) and official National Statistics Bureaus. The data to be used is derived

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[3] According to the EBRD twenty-three countries in Central and Eastern Europe and among former USSR republics are in transition in Europe. These include Central Europe and the Baltic states – Croatia, Check Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia; South-eastern Europe – Albania, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Montenegro, Romania, Serbia; Western CIS and the Caucasus – Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine; and Russia. Source: EBRD, 2008

from the official publications and reports of the institutions listed above as well as from their databases available online on their websites.

My research is based on the comparison of statistical data for Bulgaria and the rest of EU countries, including older members and newly accepted ones from Central and Eastern Europe as well as data for Bulgaria and the countries which are main donors of FDI. Comparison is also made with some countries which are currently in negotiation process for EU accession as well as with some neighbouring countries. The research will also cover the main points in the negotiation process for EU accession, chronologically following the main events such as accession into the single European market. I will also pay attention to the reforms in the legislation and authorities efforts regarding FDI and the prerequisites concerning the creation of favourable conditions for inward FDI.

By no means, the process that I will concentrate on is a complex one and I do not believe that defining all factors as stand alone contributors should be the main purpose of this master thesis. Based on this belief, I will focus on not just one or two of the factors but rather try to show their joint contribution to the emergence of Bulgaria as an attractive destination for inward FDI based on the efficiency-seeking motive.

The rest of the thesis is organised as follows. In the next section the relevant theories are presented regarding FDI definition, classifications and determinants. In the third part existing literature on FDI determinants and host country effects is reviewed. Then the analysis part follows. The thesis is closed by research limitations and concluding remarks presented in the final two sections.

II. THEORETICAL BACKGROUND

1. *Brief historical overview of FDI.*

FDI is not a new and contemporary phenomenon. During the late nineteenth century there were tremendous flows of capital from Western Europe, and especially the Great Britain, to the periphery areas of Europe and the new world (America). These flows of capital amounted to a large percentage of the GDP of both originating and receiving countries. The greatest difference with what we observe today is the fact that FDI a century ago had a limited scope – they affected only a narrow range of industries, mainly related to natural resources extraction and infrastructure. The mechanism was simple: capital flows, mainly from Western Europe and especially the Great Britain, were going to such projects which would in turn allow receiving countries to export larger volumes of mainly agricultural goods and natural resources to the open markets of investing countries. At this time before the disruption of the World War I net capital outflows reached as high as 9 % of GDP on an annual average basis for Britain (Bordo et al, 1999). By 1914 international production and MNCs activities were an integral part of the global economy. The Great Britain accounted for around 45 % of the world FDI stock in 1914 with the USA, France and Germany being also important investors. At the same time the USA was the largest recipient of inward FDI due to its large market, abundance of natural resources and high import tariffs (Johnson, 2005).

The World War I disrupted the international activities of firms and as a result of the war a large percentage of European FDI stock was destroyed. After the war, during the interwar period, both the global FDI stock and the number of MNCs subsidiaries increased. However, the pre-war level of global FDI stock wasn't reached again before 1930s (Johnson, 2005).

The World War II caused another serious disruption of international activity of firms and destruction of real capital. However, after the end of the war a suitable and favourable environment for MNCs activities was created. The bulk of regulatory institution for international activities concerning both business and governments was established in the decade following the end of the war. These institutions include the International Monetary Fund (IMF), the World Bank, the General Agreement on Trade and Tariffs (GATT) – the predecessor of the World Trade Organisation (WTO) and the Breton Woods system. However, several changes occurred. The new military technologies created during the war were transformed for a use in the business and society. Thus, new areas of business

opportunities occurred. After the WWII the hegemony of the Great Britain as the most important FDI source country ended and it was replaced by the USA. The last change was the shift of inward FDI form developing to developed countries. For example, in 1938 developing countries accounted for two thirds of inward FDI flows while in 1960 two thirds of global FDI flowed to developed countries (Johnson, 2005).

FDI flows, together with world trade flows, grew strongly after the WWII. For example, during the period of fast growth in 1960s, world FDI flows grew twice as quickly as the world GDP and 40 % faster than the world export. The primary sector lost its importance and was no longer the main destination for FDI. After 1960s the trend of developing countries losing importance as FDI recipient and developed countries getting larger share of FDI flows continued. In 1970s the diversity among the source countries of FDI increased. The same decade saw the first outward FDI flows from developing countries. During the same decade manufacturing industry emerged as the most attractive industry for FDI and the importance of the service sector started increasing. In the middle of 1970s the share of FDI going to the service sector started to increase relative to manufacturing sector. This tendency continued in 1980s and 1990s as well (Johnson, 2005).

Until the second half of 1980s, when the growth in FDI took off, FDI and world trade grew at the same pace. The increase in FDI flows and volumes of international trade happened along with a period of intensified globalisation and a growing importance of MNCs (Johnson, 2005).

Table 2: FDI inward stock by host region, millions of $

	1980	1990	2000	2002	2006	2007	Change 1980-2007
World total	692 714	1 950 303	6 089 884	7 371 554	11 998 838	15 210 560	2 096 %
Developed economies	390 740	1 399 509	4 011 686	5 049 786	8 453 853	10 458 610	2 577 %
Developing economies	301 974	547 965	1 939 926	2 093 569	3 155 856	4 246 739	1 306 %
CEECs	…	2 828	138 271	228 199	664 338	970 914	34 232 %

Source: UNCTAD (2004), Annex table B.3. and calculations based on UNCTAD (2007) Annex table B.2. and UNCTAD (2008) Annex table B.2. CEECs include Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Check Republic, Estonia, Hungary, Latvia, Luthuania, Moldova, Poland, Romania, Russian Federation, Serbia and Montenegro, Slovakia, Slovenia, TFYR Macedonia, Ukraine

Table 2 shows the great increase of world FDI inward stock since the beginning of 1980s. The increase between 1980 and 1990 was 182 %, between 1990 and 2000 – 212 %, and between 2007 and 2000 – 150 %. The numbers are really huge. The inward FDI stock in developed countries has been growing faster than in the developing countries. And the countries from Central and Eastern Europe from virtually closed for the world economy in 1990 became attractive recipient for FDI inflows which have been constantly rising. Now these economies are quite well integrated in the global economy.

The biggest recipient and source countries of FDI flows are shown in Tables 3 and 4:

Table 3: Top ten most important source countries of FDI, millions of $

2000			2007		
Country	Stock of outward FDI	% of world total	Country	Stock of outward FDI	% of world total
USA	1 316 247	21.41	USA	2 791 269	17.89
UK	897 845	14.60	UK	1 705 095	10.93
Germany	541 861	8.81[a]	France	1 399 036	8.97
France	445 091	7.24	Germany	1 235 989	7.92
China incl. Hong Kong	416 148	6.77[a]	China incl. Hong Kong	1 122 386[a]	7.19
Netherlands	305 461	4.97	Netherlands	851 274	5.46
Japan	278 442	4.53	Spain	636 830	4.08
Canada	237 639	3.87	Switzerland	603 622	3.87
Switzerland	232 161	3.78	Japan	542 614	3.48
Italy	180 275	2.93	Canada	520 737	3.34
Sum	4 851 170	78.90	Sum	11 408 852	73.12
World total	6 148 211	100.00	World total	15 602 339	100.00

Source: Based on UNCTAD (2008), Annex Table B.2
[a] Estimations by UNCTAD

It can be seen from the table that the list of biggest source countries of FDI did not change much from 2000 to 2007 with the USA being the largest direct investor in the world followed by the UK. However, the percentage share in the world total outward stock, individually and as a group, declined which is due to the growing importance of developing economies as a source of FDI.

Table 4: Top ten most important host countries of FDI, millions of $

	2000			2007	
Country	Stock of inward FDI	% of world total	Country	Stock of inward FDI	% of world total
USA	1 256 867	21.72	USA	2 093 049	13.76
China incl. Hong Kong	648 817	11.21	China incl. Hong Kong	1 511 558	9.94
UK	438 631	7.58	UK	1 347 688	8.86
Germany	271 611	4.69	France	1 026 081	6.75
France	259 775	4.49	Netherlands	673 430	4.43
Netherlands	243 733	4.21	Germany	629 711	4.14[a]
Canada	212 716	3.68	Spain	537 455	3.53
Belgium and Luxemburg	195 219	3.37	Canada	520 737	3.42
Spain	156 348	2.70	Italy	364 839	2.40
Ireland	127 089	2.20	Brazil	328 455	2.16
Sum	3 810 806	65.85	Sum	9 033 003	59.39
World total	5 786 700	100.00	World total	15 210 560	100.00

Source: Based on UNCTAD (2008), Annex Table B.2
[a] Estimates of UNCTAD
Data for Belgium and Luxemburg for 2007 are missing but it is likely that these countries would be among to ten FDI recipients

The list of top ten recipient countries of FDI also did not change much – with USA, China and Hong Kong, and UK in the leading positions. Here, the percentage share of the individual countries and the group as a whole declined as well due to the increasing share of developing countries in the world inward FDI stock. Moreover, Brazil is even included among top ten host countries of FDI.

To conclude, the importance of FDI for the world economy is by no means much greater today than it was a century or even 40 years ago. The evidence is that its role in the world economy and especially for the developing economies will continue to grow given its all time record high level reached in 2007 after a relative slowdown followed the previous peak in 2000. In addition, the importance of the developing countries as a donor and recipient of FDI has been constantly increasing during the last two decades. (UNCTAD, 2008).

2. Definition of FDI.

OECD (2008), together with IMF (2003), defines FDI as the category of international investment which reflects the objective of an enterprise in one economy to establish a lasting interest in an enterprise in another economy different from its country of origin. The objective of lasting interest implies that the investment is undertaken in order a long-term relationship to be created between the direct investor and the direct investment enterprise. The long-term

relationship results in the ability of the direct investor to influence the management decisions of the direct investment enterprise. It is considered that possession of 10 % of voting shares of the investment enterprise is enough to assure the exertion of such influence over the management of the enterprise receiving FDI. The motivation to influence significantly or to control an enterprise in an economy different from the residence economy of the investing enterprise is the underlying factor that differentiates direct investment from cross-border portfolio investments.

The lasting interest in a direct investment enterprise usually involves the establishment of manufacturing facilities or other permanent organizations abroad. This may be accomplished through creation of a new establishment abroad, i.e. greenfield investment, a joint venture or an acquisition of existing enterprise abroad (merger and/or acquisition or so called brownfield investment). Once a direct investment relationship has been established, all subsequent capital transactions between the direct investor and the direct investment enterprise and among affiliated enterprises resident in different economies are considered to be direct investment. (IMF, 2004)

3. FDI data reporting.

In international economic statistics, FDI data are presented as flows and stocks. FDI flows are recorded on net basis and they consist of equity capital, reinvested earnings and other capital. The equity capital refers to the initial and any subsequent investment in equity of the direct investment enterprise. Reinvested earnings include any retained earnings which are not distributed as dividends or remittances to the investing enterprise. The third component of FDI flows – other capital, refers to intercompany debt which includes loans, trade credits and any other advances to the direct investment enterprise. Similarly, FDI stocks consist of equity capital, reinvested earnings and other capital. In addition, some other factors influence the value of recorded FDI stocks:

- price changes – changes in the market values of shares or assets of the direct investment enterprise;
- exchange rate changes – fluctuation in the value of shares or intercompany loans denominated in a foreign to the investing enterprise currency;

- "other adjustments" - e.g. reclassification of portfolio investment into a direct investment due to reaching and exceeding the criterion of holding 10 % of voting shares. (IMF, 2004)

Most often data about FDI are derived from the financial account of balance of payment of different countries which are prepared in accordance with "Benchmark definition of FDI" prepared by OECD and "Balance of payment manual" issued by IMF. Following the rules of the two documents provides consistency and comparability of the data. The statistics of FDI in Balance of payments are prepared on aggregate level. It is recommended that countries also prepare disaggregated statistics of FDI by major industry sector and partner country as well as by classifying FDI as mergers and acquisitions (M&A) and greenfield investments.

As described in "OECD benchmark definition of Foreign direct investment" (2008) FDI statistics include three distinct statistical accounts: direct investment positions (stocks of investment) – which provide information on the total stock of investment made abroad (outward) and received from abroad (inward), broken down by instrument (equity and debt) for a given reference date; direct investment financial transactions – which show the net inward and outward investments presented separately by instrument (equity and debt) in any given reference period; and direct investment income - which provides information on the earnings of direct investors and of the direct investment enterprises. Direct investment earnings may arise from equity, i.e. essentially the profits generated by the enterprise in the reference period and consisting of distributed earnings (dividends) as well as undistributed earnings which are treated as the reinvestment of earnings in the enterprise, and from debt i.e. interest from inter-company loans, trade credits and other forms of debt. The concept of income is closely related to direct investment positions as it is the size of the overall investment that largely determines the income, not just the most recent transactions.

4. Types of FDI

4.1. Market-seeking, resource seeking and efficiency seeking FDI

The motivation for undertaking FDI varies and it is determined by many factors including firm-specific, industry-specific and country-specific. Closely related to the country-specific determinants is the classification of FDI into market-seeking, resource seeking and efficiency seeking. These types of FDI are attracted by large and affluent local market with high

perspective demand, natural resource abundance and low cost of production factors, respectively (Johnson, 1995).

4.2. Horizontal and vertical FDI

Traditionally, economic literature also distinguishes between horizontal and vertical FDI. Horizontal FDI (HFDI) refers to duplicating some of the firms' activities in a foreign country. Examples include building another factory producing the same goods as in the home country. By doing this the company forsakes some economies of scale at plant level meaning that it incurs losses from maintaining the same production operations in several locations (Navaretti & Venables, 2004). The underlying motive for undertaking HFDI is market-seeking – MNCs locate near the markets they serve in order to satisfy the local preferences more easily and to respond to changes in local demand more quickly by adapting their products (Johnson, 2005).

On the other hand, vertical FDI (VFDI) occurs when firms split their activities by function. In this case we observe break in the value-added chain. Examples include building an assembling factory in a foreign country. Most often VFDI result in disintegration costs but the company gains access to cheaper production factors (Navaretti & Venables, 2004). The motivation behind VFDI if primarily efficiency-seeking, i.e. lowering the production costs by taking advantage of the differences of production factors prices (Johnson, 2005).

5. *Determinants of FDI*

5.1. OLI framework and its extensions

One of the well-known explanations about why companies invest abroad is OLI framework, first introduced by John Dunning in 1976 (Dunning, 1988). According to Dunning firms which decide to compete with foreign companies in the environment of the latter must possess certain advantages that compensate for and neutralize the disadvantages stemming from operating in unknown environment. Multinational companies must have some qualities which national companies do not possess in order to compete successfully in the domestic market of the national firms and overcome the liability of foreignness. These advantages include ownership advantages, location advantages and internalization advantages, i.e. OLI. They determine the extent, form and pattern of international production by multinational enterprises, including the initial production and its expansion that may follow.

Ownership advantages refer to anything that can outweigh the initial disadvantage of an MNE to operate and produce in a foreign environment. Ownership advantages are enterprise specific assets (Kind & Strandeness, 2000). Dunning (1988) lists three types of ownership advantages that companies may employ: possession or access to specific income-generating assets; advantages that branch plants have as opposed to a new start-up; advantages originating from diversification and "multinationality per se" (p.2). Generally, ownership advantages come from a possession of assets which reduce costs or increase productivity of the respective MNC. This advantage comes from the ownership of patents, certain technology or management skills. A necessary condition for a MNC to be able to exploit this advantage is its domestic rivals not to have access to these assets. In addition, these assets must be transferable to a foreign country and possible to use in more than one location in order to create an advantage and precondition for FDI (Johnson, 2005). Dunning (1988) distinguishes between asset and transaction advantages of MNCs. The former relates to the ownership of assets which the other enterprises do not have access to and the latter one refers to MNCs capacity to capture the transactional benefits arising from the common management of assets located in different countries.

According to Dunning (1988) location advantages occur whenever the MNCs find it in their best interests to combine their home activities with activities in foreign countries. This usually results in reduction of production costs in a certain location. Thus location advantages explain why one country is preferred over other countries including the home country of an MNC as a destination of investment and production (Kind & Strandenes, 2000). Location advantages cannot be transferred to another location but they might be used by several companies simultaneously (Johnson, 2005).

The final element of the OLI framework – internalisation, refers to the company's decision to keep its firm-specific ownership advantages within the company and not to sell them, or the rights to use them, to another enterprise when transferring them abroad. The reasoning behind such a decision is due to three factors – risk and uncertainty; firm's ability to exploit economies of large-scale production; and the presence of external to the company transactions costs and benefits which are not specified between the parties in advance (Dunning, 1988) which is somehow related to the risk and uncertainty as well.

Dunning (1988) also points out that ownership, location and internalisation advantages arise from structural and transactional market imperfections, i.e. when market are not perfect.

The OLI paradigm also allows many additional factors to be included in the analysis of firms' choice to engage in FDI. The additional variable influencing companies' decisions may be listed as country-specific, industry-specific and firm-specific. Countries specific variables include factor endowments, government policy in the field of economy and tax regulations, etc. Industry-specific variables relate to the technological and other features typical for the sector in which firms operate. Dunning (1988) points that it is much difficult for the firm-specific variables to be captured but also not impossible. He argues that despite the obvious differences between the firms there are similarities referring to the fact that they have "broadly similar goals" (p.7) and they act in a rational and consistent way trying to achieve them.

A closely related to Dunning's OLI framework concept is the one of "knowledge-based, firm-specific assets" (p.174, Markusen, 1995). Markusen's argument is based on the evidence that industries which tend to have a large proportion of multinational enterprises usually are characterized by high levels of research and development and marketing expenditures and high proportion of workers with scientific and technical knowledge. In addition the produced goods are relatively new and advanced and the product differentiation is the leading strategy. Based on this Markusen argues that the important determinants of FDI in such industries are knowledge-based assets, such as human capital, patents, trademarks, blueprints, knowledge, management skills, reputation, etc. It is much cheaper to transfer these assets in a foreign location in comparison with physical capital transfers and there is no reduction of there profitability in all locations of firms' activities. Because of the easy and cheap transferability of the knowledge-based assets they give an inherent advantage of multinational companies over the single plant domestic firms, because MNCs can use them in different locations without further investment and all single plant domestic firms should invest in order to create such assets on their own.

In addition, Dunning introduces the concept of Investment development path (IDP), also based on the assumptions of OLI framework (Dunning, 1988). This concept deals with the dynamic aspect of FDI. The basic proposition of IDP is that country's position as a net recipient or donor of FDI depends on "(i) its stage of economic development, (ii) the structure of its factor endowments and markets, (iii) its political and economic systems, and (iv) the nature and extent of market failure in the transaction of intermediate products across national boundaries." (p. 15). Put shortly, a country's inward and outward investments position depends on its level of economic development relative to the rest of the world. According to Dunning and Narula (1996) as the

economic development advances the country moves through five different stages and in each stage country's position as a recipient and donor of FDI changes according to "the extent and pattern of the competitive or ownership specific (O) advantages of the indigenous firms of the countries concerned relative to those of firms of other countries; the competitiveness of location-bound resources and capabilities of that country, relative to those of other countries (the L specific advantages of that country); and the extent to which indigenous and foreign firms choose to utilize their O specific advantages jointly with the location bound endowments of home or foreign countries through internalizing the cross-border market for these advantages, rather than some other organizational route (i.e. their perceived I advantages)" (p.1).

In the first stage, countries cannot offer location specific advantages apart from natural resources that they might possess to investors and thus they receive very limited mount of FDI. At this stage markets are small with no good perspectives for growing, infrastructure is of poor quality, government policies and economic systems are inadequate, labour force is poorly educated and trained. Because of these, foreign firms choose to serve the markets of the countries in the first stage of IDP through exports or through non-equity arrangements with domestic firms because the ownership advantages of domestic firms are very few and the ones that exist are in labour-intensive manufacturing sector and primary sector. Governments' involvement in policies aiming at overcoming countries' deficiencies is only limited. In the second stage inward FDI starts to grow while outward FDI stays quite limited. Inward FDI grows due to increase either in the size or in the purchasing capacity of the market. Very often at this stage inward FDI is import substituting and due to tariff and non-tariff trade barriers. Depending on the development strategy and improvements in infrastructure countries might be able to attract also export-oriented FDI. At this stage production moves from labour-intensive industries towards semi-skilled and moderately knowledge intensive consumer goods production. Outward FDI that emerges are mainly market-seeking and strategic-asset-seeking types. The growth rate of inward FDI is much higher than the growth rate of outward FDI thus net inward investment increases. As approaching the end of the second stage the growth rates of inward and outward investment will start converging.

In the third stage of IDP the growth rate of inward FDI starts to slow down and the growth rate of outward FDI starts increasing. As the technological development of a country advances, production shifts to more standardized goods. At this stage wages increases, consumers begin to require higher quality goods and countries' comparative advantage in labour-intensive industries deteriorates. Importance of the initial ownership advantages of the direct investor vanishes as

domestic firms gain their own competitive advantages and compete with foreign firms in the same sectors. The level of education, training and innovatory activities in the country increases. Ownership advantages of foreign firms shift towards technological, managerial and marketing innovations. Growing location advantages stemming from created assets and enlarged market will be a prerequisite for the shift of production towards more technology-intensive manufacturing and higher value-added production. The motives for inward FDI at this stage are efficiency-seeking and strategic-assets-seeking in industries where domestic firms have gained competitive advantages. Outward FDI are directed to countries at stages one and two of IDP and it is mainly with market-seeking and exports oriented character. Outward FDI is also directed to countries at stages three and four with the goal to acquire strategic assets to strengthen ownership advantages of domestic firms. Governments' efforts at this stage aim at encouraging inward FDI in industries where domestic firms ownership advantages are the weakest and location-bound advantages of the country are the strongest. Logically, governments will encourage outward FDI in the sectors where ownership advantages are the strongest and location advantages are the weakest.

The fourth stage is reached when a country's outward FDI stocks equals to or exceeds inward FDI stocks and the growth rate of outward FDI is still higher than the growth rate of inward FDI. At this stage domestic firms have developed competitive advantages so that they compete successfully with foreign firms not only in their own country but also in foreign markets. As the cost of capital is lower than the cost of labour, capital-intensive industries will dominate the national production structure. At this stage location advantages are based mainly on created assets. Inward FDI comes mostly from other countries at stage four with asset-seeking goal. There may be a little proportion of market-seeking FDI coming from countries at lower stages of IDP. Outward FDI will continue growing as firms relocate part of their activities offshore in order to maintain their competitiveness which would decrease if they keep their activities in the home country. Another reason for outward FDI is to overcome trade barriers installed by countries at all stages of IDP. The propensity of domestic firms to internalize their ownership advantages will lead to further increase in outward FDI. Since the ownership advantages of countries at stage four are broadly similar, intra-industry trade gains importance and both inter- and intra-industry trade tend to be conducted within MNCs. Governments' policy is directed to structural adjustment of the location-bound advantages and technological capabilities, and reducing transaction costs of economic activity and facilitating markets to operate efficiently.

When countries enter the fifth stage they settle down to a fluctuating equilibrium with roughly equal amounts of inward and outward FDI while both are rising in value. Inward FDI will come mainly from countries at lower stages of IDP in the form of market-seeking and knowledge-seeking FDI, and from countries at stage four and five with firms trying to further rationalise their production activities by spreading them among different locations. In this stage no country will have location bound created assets which are essentially better than those of other countries at stage five. However, the relative attraction of a particular location will depend mainly on created assets. The abilities of a country to upgrade its technological and human capabilities are a function of its factor endowments, markets characteristics and strategies of its government. Thus the role of governments cannot be neglected, though it cannot be overstated either. The ownership advantages of companies are less dependent on their home countries natural resources, and getting more and more dependent on firms' ability to acquire assets and fully exploit the advantages of internalizing their activities through cross-border governance emphasizing on cross-border alliances, mergers and acquisitions. Nationalities of MNCs will become more and more blurred.

A concluding remark of the theory chapter of Dunning and Narula's book (1996) is that after a certain point the absolute size of the GDP of a country is not a reliable guide for its competitiveness and net investment position. This is because the rate and characteristics of growth of a country relative to its main competitors is what matters. In addition, since the motivation of FDI shifts from exploitation of existing ownership assets to creation of new ones, it is the countries which offer location-bound resources for creation of such assets that will gain competitive advantage.

5.2. Agglomeration forces as a shaping factor for companies location decisions – "new economic geography" theory.

Another theory related to location decisions of MNCs is the "new economic geography" introduced with its current statements by Paul Krugman in his paper from 1991. In his initial work Krugman (1991) ends his research up to the point where manufacturing is concentrated in one region and agricultural production is left in the periphery region. In his later work together with Venables (1995) he expands the analysis beyond this point.

According to Krugman and Venables (1995) there are certain forces appearing at different levels of transport and trade costs which contributes to a great extent to concentration of production activities of firms in a certain location. The argument is built on the existence of two regions – North and South which are identical in endowments, preferences and

technology. Each region produces two kinds of goods – agricultural goods which are produced with constant returns to scale and employ extensively immobile production factors, i.e. land (Krugman, 1991), and manufactured goods which are produced with increasing returns to scale and limited use of immobile factors (Krugman, 1991). The manufacturing sectors in both countries can produce two types of goods – final goods sold to the final consumers, and intermediate goods sold for production inputs to other firms. Key assumptions of the model are increasing returns to scale, the presence of transport costs at different levels (Krugman and Venables, 1995), high proportion of income spent on manufacturing goods (Krugman, 1991).

When transport costs are very high each economy is self sufficient and produces both agricultural and manufactured goods. There is no international trade and no specialization. When transport costs decline gradually international trade occurs. At some point a certain process arise leading to a regional differentiation because for some reasons the manufacturing sector in one region becomes bigger than the manufacturing sector in the other region. As a result two kinds of pecuniary externalities will occur. Larger manufacturing sector in one region means larger market for intermediate manufactured goods which makes this location more attractive for the producers of manufactured goods. This is an example of backward linkages. On the other hand, better access to intermediate manufactured goods of the firms in this region will lower production costs of final manufactured goods which will lead to a further shift of manufacturing firms to this region, which is an example of forward linkages.

As a result of the self-reinforcing backward and forward linkages, the demand for labour in the industrialized region increases while the demand for labour in the other region employed mainly in agricultural production decreases. This will lead to a rise in wages in the industrialized core region and a decline in wages in the agricultural periphery region. Thus economic integration will lead to uneven development.

But as transport costs continue to fall the importance of being close to markets and suppliers will decline. At the same time the periphery region will be gaining advantage over the core region by offering lower labour costs. After a certain point sufficiently low transport costs and wage differential will more than offset the disadvantage of the periphery region of being remote from the markets and suppliers in the core region. When this happens, manufacturing firms will have incentives to move from the core to the periphery region, forcing a convergence in real wages.

The model presented above is a general equilibrium model so each firm must compete in two fronts – with foreign firms in the same industry for markets and with domestic firms for inputs (Krugman and Venables, 1995).

In general, there are three main reasons for agglomeration:
- the concentration of several firms in a single location creates a market for workers with industry-specific skills meaning that the probability for both unemployment and labour shortage decrease;
- industries which locate in one site offer opportunities for production and respectively consumption of non-tradable inputs;
- informational spillover can contribute to clustered firms having better production functions than isolated ones (Krugman, 1991).

At the presence of transport costs rising with distance and scale economies at plant and corporate level, firms are confronted with the so called proximity-concentration trade-off. When expanding their activities abroad companies must choose whether to do so via exporting or via direct investment choosing between proximity advantages and scale advantages based on concentration of production activities (Brainard, 1993). Brainard (1997) shows that "firms are more likely to expand production horizontally across borders the higher are transport costs and trade barriers and the lower are investment barriers and the size of scale economies at the plant level relative to the corporate level" (p. 521). On the other hand, the traditional rationale for multinational activities as vertical expansion due to factor price differentials and differences in factor endowments also holds (Brainard, 1993).

5.3. Horizontal and Vertical FDI determinants

Motivation for undertaking HFDI is quite different from motivation to undertake VFDI. When firms decide to invest abroad, i.e. to become MNCs or to expand their operations abroad, a number of possible gains and losses should be considered. Thus determinants of FDI will have different importance regarding horizontal and vertical FDI.

The most important determinants according to Navaretti and Venables (2004) are summarized in the following table:

Table 5: Determinants of HFDI and VFDI

Determinants	Prediction by type of investment	
	HFDI	VFDI
Determinants relate to types of firms or industries		
Firm-lever economies of scale	+	+
Plant-level economies of scale	-	?
Product-specific trade costs	+	-
Costs to disintegrate stages of production	-	-
Difference in factor intensity between stages of production	?	+
Determinants relate to types of countries		
Trade costs (distance, trade barriers, etc.)	+	-
Market size	+	?
Factor cost differentials	?	+

Source: Navaretti and Venables (2004, p.31)

One important distinction here is between firm-level and plant level economies of scale. Firm-level economies of scales refer to firm-level assets which can be tangible or intangible. Intangible firm-level assets might be management practices, production technologies, reputation, brand name, patents, etc. Headquarters personnel and office buildings can be referred as firm-level tangible assets. Some of them can be applied in different locations without losing any of their value for the firm like production technology, management skills, etc. Others serve the activities of the entire company – doubling company's activities does not necessarily means that headquarter personnel should be doubled. Having such firm-level assets allows companies to realise firm-level economies of scales because it is not necessary when expanding operations abroad to replicate these assets and activities everywhere. These firm-level economies of scale are the basis for undertaking both horizontal and vertical FDI.

When undertaking HFDI by duplicating some of the activities abroad companies forsake the economies of scale realised at plant level because production costs are not split among all the units produced by the company. However, some plant-level economies of scale might be realised when VFDI occur – in the case that all activities at a certain production stage are concentrated in one location.

Usually HFDI are undertaken in order big and affluent markets to be reached when it is not efficient to serve them through export because of high trade costs and barriers. Thus trade costs and HFDI are positively correlated. On the other hand, the correlation between product-specific trade costs and VFDI is negative since it is expensive to transfer intermediate goods at different stages of production process between different locations in different countries.

Disintegration costs include all the costs related to transferring the intermediate and final goods between the locations of the consecutive production stages. These costs include transportation costs, packing and unpacking costs, costs due to the time of transportation, depreciation, decrease of the value of the goods, etc. Somehow abstract but also very important are the costs related to the loss of efficiency due to disintegration of the production process. Navaretti and Venables (2004) give the example of processing of steel where during the entire process the steel is kept warm. If part of the process is set up in another country then the steel should be cooled down, transported and then heated again.

In order VFDI to be undertaken it is necessary that different stages of the production process have different factor intensities. Only in this case it is justified different stages to be located in different countries in order to be taken advantage of different factor costs. If all stages have the same factor intensity, separating them in different locations will create no advantage for the company.

Determinants listed above are related to the characteristics of the firms or industries. Country-specific determinants, on the other hand, include trade costs, market size and factor cost differentials. As I already mentioned trade costs are positively correlated with HFDI and negatively correlated with VFDI. Market size is very important determinant when it comes to HFDI but its effect on VFDI is ambiguous. In addition factor costs differentials have a strong positive effect on VFDI and not such a profound one on HFDI.

It is generally referred to the difference in factor costs as a main determinant of FDI. Although sometimes this is the case, in other cases other determinants are more important and crucial.

III. LITERATURE REVIEW

Many research papers exist dedicated to different aspects of FDI. In general research areas regarding FDI which are relevant to the thesis can be classified in three broad areas – studies related to determinants of FDI, research papers concerning the specific determinants of FDI relevant for transition countries, and studies on host country effects of FDI. They all contain valuable information and empirical results. Thus, I revisit them in order to get insights and guiding points.

1. Review of the literature on determinants of FDI

The question about determinants of FDI has been widely discussed because of the importance that direct investment gained during the passed decades in the world economy. Many studies exist which deal with factors attracting and encouraging FDI. These studies use different data and research methods, have their limitations but they also are a valuable source for any further research.

During the last couple of decades, the focus of researchers' attention has switched from traditional determinants of FDI like market size, growth potential and factor costs, which have more or less unambiguous effects on FDI when taking into account the particular type and purpose of the direct investment (see for example Navaretti and Venables, 2004), to more complex to quantify and measure determinants like democracy, institutions, corruption and economic integration. The articles reviewed in the current section are focused on the latter group of determinants.

For example, Motta and Norman (1996) model the impact of economic integration on oligopolistic foreign direct investment activities and international trade in their attempt to give explanation to the boom of FDI in the three major regional blocks – the European Union (EU), the North American Free Trade Area (NAFTA) and the Association of South East Asian Nations (ASEAN) in the beginning of 1990s. Their analysis is based on the game-theoretic models of FDI and includes three countries with equal sizes, identical consumers and homogeneous products, one firm in each country with identical production costs and formation of a regional block between two of the countries. The creation of regional integration agreement (RIA) is likely to lead to improvement of intra-regional market accessibility, i.e. reduction in intra-region tariff and non-tariff trade barriers, and maybe to a

coordinated extra-regional trade policy, but not necessarily leading to increase in extra-regional barriers. Their analysis shows that improvement of market accessibility by lowering or removing tariff and non-tariff trade barriers between countries in the regional block has greater impact on attracting FDI into the area than raising the external barriers. It is also shown that whether there will be a net increase in FDI in the regional block as a whole depends on the previous existence of FDI in the area, because lowering of the internal trade barriers may lead to concentration of previously dispersed FDI into the most efficient location and servicing the rest of the countries via exports.

Te Velte and Bezemer (2006) also examine the relations between regional integration (RI) and FDI in developing countries but their approach is empirical. They use data for the real stock of FDI of USA and GB in developing countries for the period 1980-2001, since these two countries are among the biggest investors. They argue that whether or not regional integration agreements (RIAs) leads to further extra- and intra-regional FDI depends on the type of FDI – horizontal or vertical, and on the purpose of FDI – market-seeking or efficiency-seeking. In particular, their model includes traditional explanatory variables for FDI in developing countries such as market size and growth potential, infrastructure and human capital. They use a separate variable for the specific investment provisions which would boost FDI. In order to capture differences among countries they evaluate the relative positions of all countries included in the research. The purpose is to determine whether countries with different sizes, levels of productivity and wealth, located at different distances from the core countries attract different amounts of FDI and exactly which types of RIAs lead to increase in FDI. Their findings show that not all RIAs lead to further increase of FDI but only those which include certain investment and trade provisions which are enough to guarantee stable and predictable investment climate. They also find that smaller countries and the ones located further away from the core, represented by the largest country in the region, receive less FDI than the bigger countries and the countries located near the core.

Habib and Zurawicki (2002) focus on the research of the impact of corruption level both in host and home country on FDI flows. They use data for the period 1996-1998 covering eighty-nine countries comprising developed, developing and transition countries. They show that the perceived corruption level in the host country as measured by Corruption Perception Index produced by Transparency International has a negative effect on FDI. In addition, this negative effect is persistent even when Transparency International is present in the country

and when political stability is achieved (high levels of corruption are generally associated with political instability). Habib and Zurawicki also find out that with increasing of the absolute difference in the corruption levels between couples of countries FDI flows between them in either direction (from the less corrupt to the more corrupt country and vice versa) diminish. This is a result from the difficulty that firms experience from operating in an administratively distant environment.

Jensen (2004) explores the impact of signing an agreement with IMF on FDI inflows using data for sixty-eight countries for the period 1968-2000. His conclusion is striking because it is strictly opposite to the conventional belief that IMF agreements should have positive effect on FDI inflows. Jensen finds out that this effect is negative and estimates that, after controlling for the presence of financial crises as a main reason for signing agreements with IMF, it amounts to 25 % decrease in FDI inflows relative to countries which do not have such agreements. According to him this is due mainly to the ambiguous effect that agreements with IMF have on the macroeconomic performance and political stability in the country which receives the funding.

In his earlier research, Jensen (2003) also explores the impact of democracy and democratic political institutions on FDI inflows covering one hundred and fourteen countries and using data for the 1980s and 1990s. Jensen estimates that countries with democratic governments attract on average 70 % more FDI as a percentage of GDP, after controlling for other political and economic factors. Jensen explains this result by the fact that once an investment has been done it becomes illiquid and immobile and therefore represents a sunk-cost. Moreover, MNCs business operations in a particular country are highly dependent on decisions which political institutions are making. Among those decisions, the most important are the ones concerning nationalization and expropriation of ownership and revenues, tax rates, tariff rates, depreciation schedules and others regarding political stability and credibility of political regimes. There are a number of mechanisms which help preventing drastic change in governments' policy, e.g. political players with veto authorization, electoral costs related to change of governments after elections, etc.

2. *Review of the literature on determinants of FDI in transition countries*

Alongside with analysing specific determinants of FDI relevant for transition economies, most of the quantitative papers dedicated to them also deal with traditional determinants with

strictly similar results with only one exception among the revisited papers – the research of Garibaldi, Mora, Sahay and Zettelmeyer (2001). Most of the studies investigate FDI determinants in CEECs. Several studies enrich their results by comparing the determinants relevant for CEECs with FDI determinants having impact on Latin American countries (Campos and Kinoshita, 2008) or by comparing groups of transition economies (Campos and Kinoshita, 2003). Two studies use methodology which is not typical for economics research papers – Bandelj (2002) who is using relational approach which is widely used in economic sociology and Altomonte (2000) who is using option theory to model influence of FDI determinants.

For example, Janicki and Wunnava (2004) take a rather conventional approach in exploring the main determinants of FDI flows from the fifteen older members of EU[4] into nine, perspective in 1997, candidates for accession countries[5]. They confirm the greater degree of openness to trade, larger market size, lower labour costs and lower country risk, as measured by the Institutional Investor country risk rating[6], to be the most important factors influencing the FDI inflows to CEECs originating from older EU member states. Janicki and Wunnava (2004) estimate the level of factors influence: an increase of 1 % in the import between source and receiving countries (a proxy for trade openness) leads to $140.28 million increase in FDI inflows for each specific country; $1 change in annual wage difference in manufacturing sector between donor and recipient country (a proxy for labour costs) leads to a change of $17 278 of FDI; and one unit improvement in credit rating leads to an increase of FDI in the host country with $10.315 million.

However, most of the existing research papers concentrate on more specific determinants of FDI in transition economies. For example, Majocchi and Strange (2007) explore the effect of market, trade and financial liberalization as well as openness of domestic bank industry in the sense of presence of foreign banks. They argue that market, trade and financial liberalization all have positive impact on attracting FDI to transition countries though with different magnitude. The most important is trade liberalization and all three types of liberalization seem to be more important to manufacturing firms. According to Majocchi and Strange (2007), the presence of many transnational banks in domestic bank industry has a negative effect on FDI

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[4] Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Ireland, Luxemburg, The Netherlands, Portugal, Spain, Sweden, and United Kingdom
[5] Bulgaria, Czech Republic, Estonia, Hungary, Poland, Slovakia, Slovenia, Romania, and Ukraine
[6] http://www.worldbank.org/fandd/english/0397/articles/020397.htm

inflows. They also show that other factors such as market size and potential, the quality of infrastructure, the availability of labour and agglomeration economies have positive effect on attracting FDI. However their research has certain limitations because it is based on firm level data regarding small and middle size (SME) Italian enterprises. On the one hand, they haven't needed to control for cultural and geographical proximity since the SME originate from one country. On the other hand, the scope of their research is limited since it is investigating only SME. For example it is quite possible that at least one of their findings is not relevant for MNCs, i.e. the negative impact of the presence of many transnational banks in domestic bank industry. It is likely that MNCs would not face the same difficulty as SME when raising capital in domestic financial market because presumably their activities are assumed as less risky compared to the activities of SME.

Bevan and Estrin (Bevan, Estrin and Grabbe, 2001) examine the impact of announcement of decisions regarding eastward enlargement of EU on the level of FDI into candidate countries from CEE. They find out, after controlling for all other factors influencing investment decisions, that the public announcement of commitment to eastward enlargement made by the EU member in 1994 actually led to an increase of FDI inflows to the front-runner candidate countries (Check Republic, Hungary and Poland). They also point that the decision of EU members to open negotiations for accession with five countries in 1997 (Check Republic, Estonia, Hungary, Poland and Slovenia) and all further progress announcements have lead to a further increase in FDI flows to these leading countries. Their findings are in line with existing literature exploring the impact of international and regional integration on FDI.

In addition, Pournarakis and Varsakelis (2004) test the importance of international integration, measured by the percentages of exports and trade to GDP, and quality of institutions, measured by the indices of political rights, civil liberties, freedom of press and Transparency International corruption index, as factors influencing the distribution of FDI among economies in transition. Their research covers a period of five years and twelve CEE transition countries. Their findings confirm the widespread belief that market size, measured by the GDP per capita with one year lag, and internalisation, i.e. international integration influence to a large extent MNCs decision to undertake investment in a certain host country. Nevertheless, they also find out that even not influencing to a great extent FDI flows, institutions are far from having no impact. Moreover, they find 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"

(p. 89). More general, their findings confirm that better quality institutions enhance to a great extent the ability of countries to attract FDI. Countries with more freedom in economic activities, lower corruption, stricter application of rule of law, less bureaucracy and stronger property rights protection perform better and are more attractive to investors than countries suffering form serious deficiencies in the mentioned areas.

In his research, Cass (2007) argues that employment of investment incentives and Investment promotion agencies (IPAs) activities in order to support and encourage inward FDI is widely spread among Central and Eastern European countries. Cass's analysis is mainly qualitative examining the level of offered investment incentives and the extent of IPAs activities. He finds out that contrary to the most logical prediction that incentives and IPAs activity should be widely used in the beginning of transition process in order to compensate for the lack of political and macroeconomic stability, they are in general employed in later stages of transition process when counties actually have improved conditions which might attract investors. Investment incentives are offered irrespective of the changes in tax system and overall lowering of tax rates. IPAs activities are divided in four major categories: investor services, image building, investment generation and policy advocacy. However, most IPAs perform mainly investor services activities. His findings are important, because investment incentives and IPAs activities play important role in attracting FDI. It is also worth to point out that different countries advanced with different speed in the transition process. Thus, the importance and therefore practical results of investment incentives and IPAs activities has been growing and has reached its peak at different points of time for the different countries. In this line of reasoning, increase of FDI in transition countries may appear in different times also due to investment incentives and IPAs activities.

In their research, focused mainly on the relation between structural reforms and FDI, Campos and Kinoshita (2008) use panel data for nineteen Latin American and twenty-five transition economies for the period 1989-2004. They argue that successful implementation of structural reforms by governments plays the role of a signal to investors of decreasing investment risk. Moreover, structural reforms improve the conditions in which foreign investors operate in host countries. More precisely, reform of financial sector determined as an effort rather than an outcome influences investors' decision about undertaking FDI to a much larger extent than privatization and trade liberalization. Privatization is still an important determinant of FDI with greater influence for Latin American countries. From institutional factors the one with

greater importance is the quality of bureaucracy, while rule of law plays a role in attracting FDI only in Latin American countries, and all traditional determinants like market size, factor endowments, macroeconomic stability and quality infrastructure have a positive impact on investment decisions of MNCs. According to Campos and Kinoshita (2008), the explanation for the greatest importance of financial sector reforms is that they are a prerequisite for maximization of spillover effects from backward linkages to international investors, meaning that it is not very likely that MNCs will search from financing at local financial markets but availability of capital will allow domestic suppliers to invest further in improvements of productivity level and quality of intermediate inputs and thus leading to benefits for foreign investors.

In their earlier research based on panel data from twenty-five transition economies from Central and Eastern Europe, the Commonwealth of independent states (CIS) and Baltic States for the period 1990-1998, Campos and Kinoshita (2003) find differences regarding variables determining FDI inflows for the various groups of countries. They point out the evidence that all types of FDI are present in the region, which is to confirm that all traditional determinants of FDI like market size, lower labour costs and resource abundance have great importance. The quality of institutions, reforms and policy also turn out to be very strong determinants for all countries. More precisely, greater trade liberalization, good system of law and law enforcement, high quality bureaucracy and fewer restrictions on FDI enhance inward FDI. Agglomeration economies are also a key factor. However, for the non-CIS countries the most important determinants of FDI appear to be agglomeration economies and institutions, which is explained by the fact that in these countries the predominant sector receiving foreign capitals is manufacturing which typically is characterized by presence and possibilities to take advantage of spillovers. As for the CIS countries, where FDI goes predominantly to the resource sector, natural resource abundance and quality infrastructure are the crucial factors.

Garibaldi, Mora, Sahay and Zettelmeyer (2001) have conducted a similar research to Campos and Kinoshita's ones. Garibaldi et al.'s research (2001) covers twenty-six transition economies and encompasses the years from the early stage of transition (1990 to 1992 with variations among countries) up to 1999. They find out that good economic performance, measured by high fiscal balance and high growth, greater economic liberalization, successful reforms in the area of trade liberalization, natural resource abundance and fixed or stable exchange rate regime increase FDI inflows. These results are broadly similar with previous

research. Other key factors are method of privatization and restrictions to FDI, with direct sales as a main privatization method having positive and the presence of restrictions having negative impact. What is surprising in the findings is the fact that low inflation rate as a proxy for macroeconomic stability and low wage rate as a proxy for the competitiveness of countries are not significant determinants of FDI inflows. Another surprising finding is that institutional determinants have rather negligible influence on FDI with only bureaucratic obstacles to investment and entrepreneurship having important and negative impact on attracting FDI. In addition, researchers find out that investors' perception of risk and attractiveness of countries as recipients of FDI, as expressed by investor magazine ratings, have predictable power larger than expected based on the included economic indicators. This indicates that investors use such ratings as a proxy for fundamental indicators that determine the decision of undertaking FDI when information about these indicators is not readily available and that market perceptions which are not based on these fundamental factors influence investors' decisions.

Holland and Pain (1998) use data from eleven CEECs for the period 1992-1996 in order to determine the main factors influencing investment decisions in those countries as well as the host country effects. They find out that privatization method and perceptions of risk are important yet correlated determinants. The employment of direct-sales method of privatization affects positively FDI inflows as well as lower level of perceived risks. Among other factors that influence investment decisions according to their research are proximity to larger markets of the EU members, relative labour costs and past trade linkages, the latter one used as a source of decreasing unfamiliarity and uncertainty regarding host countries markets. Macroeconomic stability also is a crucial factor in shaping investors' decisions which is consistent with most of other existing research work.

Demekas, Horváth, Ribakova and Wu (2005) concentrate their research on the FDI flows to South-eastern European in order to determine the most important factors for attraction FDI inflows and to what extent government policy can influence positively incoming investment flows. They argue that market size and geographical and cultural proximity between source and host countries have the greatest positive impact in attraction FDI by transition economies. But policy environment also matters. High corporate tax rates, high labour costs and high levels of import tariffs repel FDI and quality infrastructure and trade and foreign exchange liberalization attract FDI. In addition, tax holidays and corruption do not have direct impact on capital inflows but they affect FDI indirectly by shaping the business environment in host

countries. In addition, they find out that below the threshold level of 12% of non-privatization related FDI to GDP, determinants like market size, proximity and labour costs matter the most to foreign investors and after this level host countries prosperity, institutional factors and quality of business environment gain greater importance. They explain this finding by the changing nature of FDI as the host country attracts larger amounts of FDI, and changing motives for investing. They also argue that FDI becomes fairly immune to risk and distortions once investor-friendly economic and legal environment is established after the initial stage of attracting FDI.

Bandelj (2002) takes a rather interesting perspective in examining the determinants of FDI in CEECs. Her research encompasses eleven transition economies from the region as recipients of FDI and twenty-seven investor countries including the biggest investors in the world and the biggest investors in the region for the period 1995-1997. Bandelj argues that social embedded factors like institutional arrangements, political alliances, personal and business networks and cultural ties between investor and host countries determine FDI flows into CEECs to a much greater extent than traditional determinants like market size, political stability and the policy towards FDI. In particular, she shows that political alliances as proxy by official government aid from the donor country to the recipient country, personal and business networks as proxy by long-term immigration from host to investing countries and pre-existing business ties between countries expressed by the level of export from investing to host country respectively, and cultural ties as proxy by national non-immigrant minorities in host and investing countries, determine to a great extent the volume of FDI inflows. On the other hand, market size, political stability and FDI policy have a limited explanatory power regarding FDI decisions which is dependent on overall investment level of the country of origin. As of institutional arrangements as proxy by bilateral investment treaties and European Union agreements, the results of research show that standardization of the institutional environment between countries is not of significant importance when investing countries characteristics are taken into consideration.

Another interesting research paper taking a somehow unusual perspective towards FDI determinants in transition economies is the one by Altomonte (2000). He employs the real option theory in modelling factors influencing direct investment decisions. According to his research results, along with traditional determinants derived from OLI framework (market size and demand and relative labour costs; distance is not a factor with significant importance

in his model) investors' perception of uncertainty, underlying volatility of economy and irreversibility of investment are all important determinants of FDI. Moreover, the subjective measure of investors' expectations about uncertainty in the host economy as expressed by the general quality if business climate and the extent of giving nationals preferential treatment, is the more important variable measuring institutional framework of the host country than the objective variable measuring the mere content of local institutional environment with the latter having turned out not statistically significant. Among other variables industry specific differences in sunk costs are an important determinant of FDI while underlying volatility of host economy as measured by the standard deviation of production indices in manufacturing industries in host countries have turned out not strongly significant, probably because it is associated with transition progress captured by other variables.

To sum up, despite of the differences in their focus and methodology, the reviewed studies do not produce contradictory results. In general, liberalization, international integration, quality institutions, macroeconomic stability and growth, direct and transparent privatization, policy aiming at stabilization and encouragement of FDI which respectively decreases risk and uncertainty, and cultural proximity and familiarity are factors which have a positive effect on FDI in transition economies.

3. Review of the literature on host country effects of FDI

In general, the research papers dealing with the host country effects of FDI show that the overall effect is positive although there are differences in the reasoning why this is so and under what form this positive impact takes place.

Rutkowski (2006) examines the effect of FDI on the competition and concentration of the host country industries in transition economies. He has expected the impact of FDI to be significant because large MNCs enter the market bringing their unique skills and resources, with clear technological and organizational advantage over the smaller and recently established (and therefore lacking market experience) domestic competitors. These firm-specific skills and resources may easily lead to strategic advantages. It is also likely that MNCs, which have access to broad international financial resources, will take over more efficient domestic firms. In this way only less efficient firms will stay in local possession leading to MNCs being overall more efficient and competitive than local firms. Furthermore by taking away market shares from domestic firms, MNCs may force them to produce in less

efficient production scales. At the same time the unique knowledge of domestic firms about local market becomes less important in competing with foreign entrants as these transition countries integrate with developed countries and harmonize their business environments with the old EU members. This also means that the liability of foreignness becomes smaller.

In order to examine the impact of FDI on the level of host country competition Rutkowski (2006) applies linear and non-linear regression models to evaluate the relationship between foreign presence and concentration across industries as well the profitability of domestic firms using data for thirteen CEECs. He finds out that FDI actually strengthens domestic enterprises and reduces concentration in industries. More precisely "a 1% rise in inward FDI stock/GDP ratio (which corresponds to an extra accumulation of FDI equal to approximately 0.2% of GDP) results in 2,2–4,9 % increase in the domestic profit/sales ratio. On the other hand, a 1% rise in inward FDI stock/GDP ratio reduced the probability of concentration by 15-29 %" (p. 126). He also finds out that foreign investors respond positively to anticompetitive practices and labour legislation protecting employees, and that state-owned enterprises are generally less profitable. In general, spillovers seem to outweigh competitive impact of FDI and thus strengthening domestic firms.

In addition, Javorcik (2004) examines the correlation between productivity of local firms and the presence of MNCs in downstream (potential customers) or upstream (potential suppliers of intermediate goods) sectors and across the same industry, and whether these productivity spillovers are determined by the extent of foreign ownership of affiliates. She uses firm-level panel data set from Lithuania for the period 1996-2000. Javorcik's findings show that productivity spillovers from FDI take place through backward linkages, i.e. foreign affiliates sourcing from local suppliers. There is no evidence for productivity spillovers though horizontal or forward linkages. These findings can be explained by the determination of MNCs to prevent any knowledge, technology and other leakages to their local competitors and their willingness to support local suppliers from which they source outputs to improve their production and managerial techniques. According to Javorcik's research "a one-standard-deviation increase in the foreign presence in downstream sectors is associated with a 15-percent rise in output of each domestic firm in the supplying industries" (p.625). It is found that these spillovers originate from affiliates with mixed capital structure, i.e. not fully owned foreign affiliates. This could be explained with the usage of previously established relations of the local partners with domestic suppliers and knowledge about the upstream

industry and the difficulty and high cost of establishing such relations on the side of MNCs and thus the inclination of fully owned subsidiaries to rely on import of intermediate goods.

Haskel, Pereira and Slaughter (2002) also find similar results in their research based on plant-level data about all United Kingdom manufacturing firms for the period 1973-1992. Unlike the previous study, they examine the influence of FDI coming from a number of developed countries into one of the most developed countries in economic perspective – the UK. Their results are broadly similar with the ones from the previous study – a 10 % increase in the foreign presence in an industry in the UK raises productivity in this industry by 0.5 %. The boost of productivity realizes only at industry but not on regional level. Haskel et al. (2002) also find that this productivity spillovers accrues mainly to plants which are smaller and are laggards in technological perspective and are less skilled intensive. They also find evidence that the presence of productivity increase depends on the source country of FDI - spillovers are significant for the US and French FDI, insignificant for German FDI and significantly negative for Japanese FDI. In addition, their research regarding four major FDI projects worldwide involving incentives granted by governments, show that in most cases the value of incentives per worker is greater than the increase in productivity at industry-level per worker. It is worth mentioning that they neglect the benefit for the society stemming from job creation.

Holland and Pain (1998) also determine a positive effect from the presence of MNCs on productivity level in transition economies. However, their findings are strikingly different in explaining the cause of the raise in productivity. According to them "the main impact of foreign firms on the transition economies has arisen from the rapid growth in the number of such firms rather than from significant spillovers into the technologies and working practices of indigenous firms" (p.30) and thus differences in levels of education between different country do not have a significant impact on the absorptive capacity of domestic firms. It is though important to note that their data cover the period 1992-1996 and it is much likely that at a later stage of economic development of transition countries, the results of a similar research would be consistent with the findings from the research papers presented above.

IV. ANALYSIS PART– DETERMINANTS OF FDI INFLOWS TO BULGARIA

1. Some additional facts about the examined issue

In order to gain understanding about the relative size of inward FDI to the economy of Bulgaria, a comparison between the country and the EU members from the previous wave of enlargement in 2004 and some neighbouring countries (including an applicant for accession in EU) has been made, which is presented in the graph below:

Graph 1: FDI inflows, Millions of US $
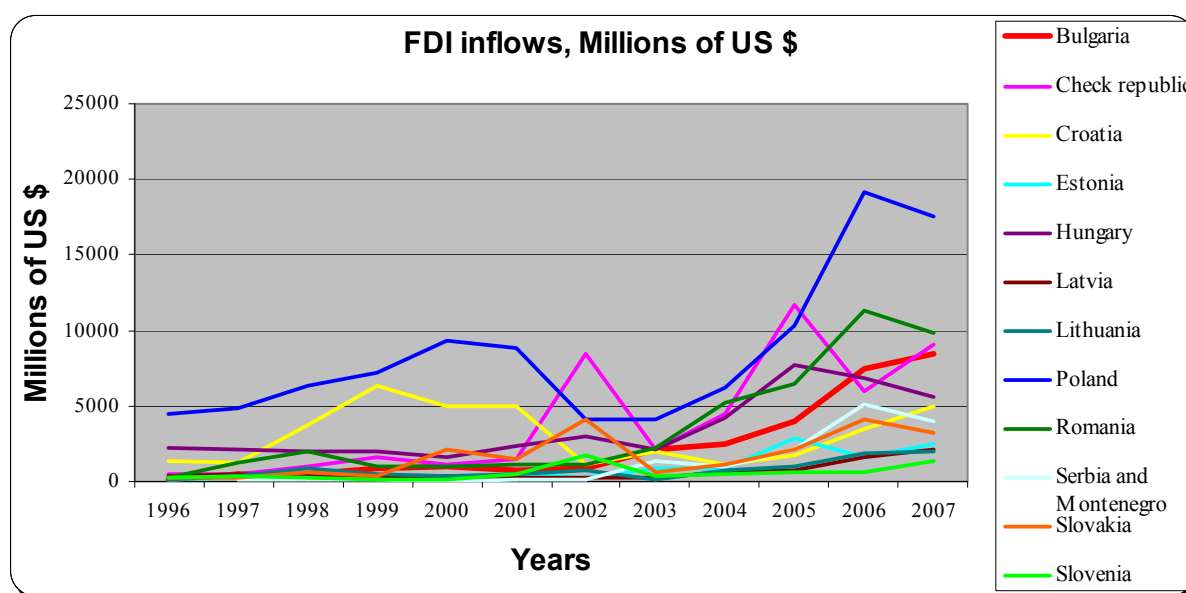
Source: Annex table B.1., UNCTAD (2002, 2004, 2005, 2008). See data table in Annex 1.

It can be seen from the graph that Bulgaria walked the way of transforming from a laggard into a leading country regarding FDI inflows. All of the leading countries – Check republic, Poland, Hungary and Slovakia made a huge progress in attracting FDI. But while the rest of the countries (including Romania which also manages to attract large amounts of FDI inflows) exhibit some kind of meandering pattern of increasing foreign investment, FDI into Bulgaria has been rising constantly with a large pace during the last five years. This fact supports the conclusion that Bulgaria currently is in the second stage of its Investment Development Path (IDP) with high rate of growth of inward FDI. In this stage, FDI is directed towards servicing the growing domestic market as well as establishing facilities for export-

oriented activities. Investors are taking advantage of the abundance of skilled labour in the country (Dunning and Narula, 1995).

However, it is difficult to judge how successful different CEECs have been in attracting FDI by looking only at the absolute value of the FDI inflows. Since these countries are quite different with respect of their size, it is worth presenting amounts of FDI inflows scaled by their relative size, measured by respective GDP indicators.

Graph 2: FDI inflows as a percentage share of GDP
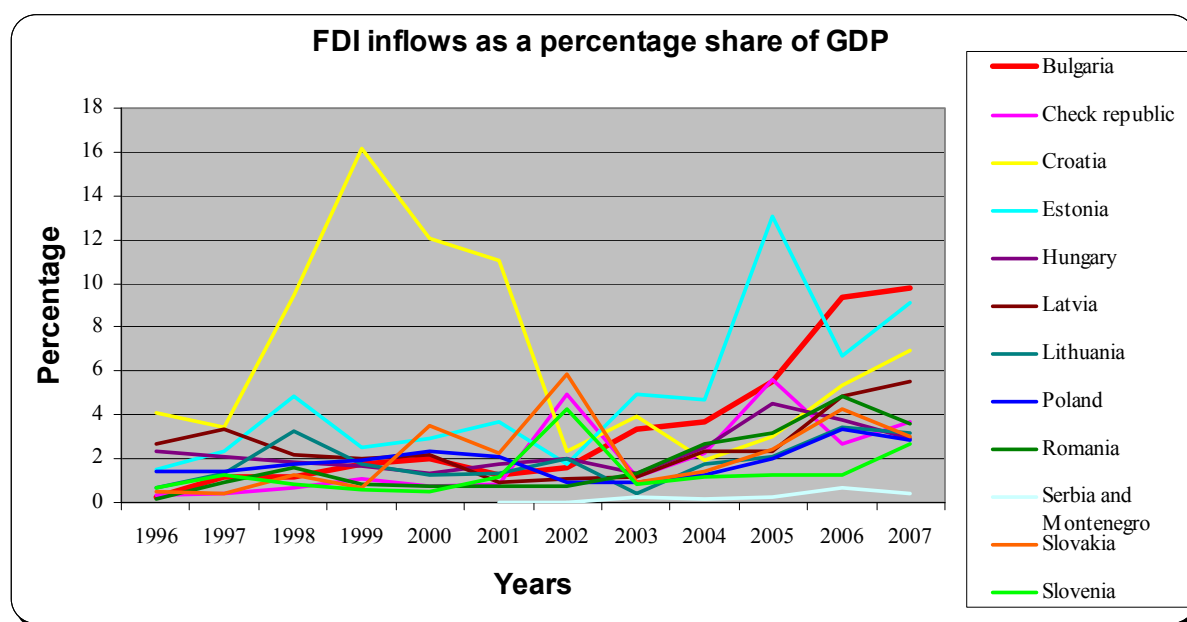
Source: Annex table B.1., UNCTAD (2002, 2004, 2005, 2008); http://w3.unece.org/pxweb/Dialog/Saveshow.asp for GDP in Millions of US $ at prices and purchasing power parities (PPPs) of current year; author's calculations

It is obvious that Bulgaria and Estonia have managed to attract the largest inflows of FDI relative to their size. However, it would be difficult to compare these countries because FDI flows to the Baltic states (Estonia, Latvia and Lithuania) are directed predominantly to the resource extracting industries (Kampos and Kinoshita, 2003). It is worth pointing that Croatia had been doing relatively great compared to the rest of the countries in the list in 1999, 2000 and 2001. After a slowdown, direct investment to this country is again on the edge of acceleration, most likely due to its current negotiation for EU accession and the expected successful completion.

2. *The first decade of transition in Bulgaria (1990-2000): mistakes and lessons*

The first decade of transition turned out to be very difficult for Bulgaria for many reasons. The macroeconomic performance of the country was much weaker compared to the other

CEECs. The economic output declined significantly during the most years between 1990 and 1997 reaching a cumulative decline of 37 % in 1997. The real GDP per capita fell far behind the rest of the countries in the region and inflation was always in high double and triple digits during 1990-1997 (IMF, 1999).

While it is true that initial conditions in Bulgaria were far from favourable (high external and internal debt, heavily industrialized economy with state-owned enterprises (SOEs) most of which operating at a loss) and that the country was affected by many negative external shocks like the Yugoslav and gulf wars, the main reason for the lack of success in the early years of transition was the stop-and-go nature of stabilization policies and slow pace of structural reforms. There were certain efforts aiming at accelerating reforms but they failed to reach any results due to the lack of persistence in governments (IMF, 1999).

The economic problems due to the lack of political will and determination for a successive implementation of reforms culminated in a severe banking and foreign exchange crisis at the end of 1996 and the beginning of 1997. As a result the output collapsed, the national currency depreciated severely and the inflation, which reached 240 % on a monthly basis, virtually wiped the savings of the population (IMF, 1999).

A comparison between Bulgaria and some chosen Central and Eastern European economies is presented in Figure 1. It is obvious that as of 1997 Bulgaria was quite behind in its development relative to the rest of the countries.

Figure 1: Bulgaria: international comparison, 1997
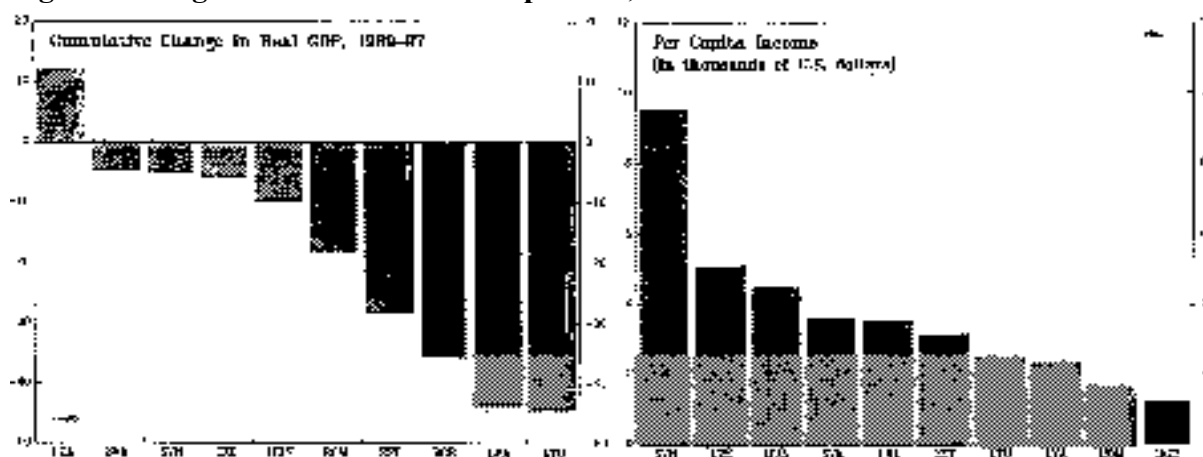
Source: IMF (1999).
Note: BGR – Bulgaria, CZE – Check republic, EST – Estonia, HUN – Hungary, LVA – Latvia, LTU – Lithuania, POL – Poland, ROM – Romania, SVK – Slovak republic, SVN - Slovenia

The crisis of 1996-1997 played the role of a painful wakening for the politicians and gave the start of radical, determined and fast-paced reforms which the country needed to be implemented half a decade earlier. The need for stabilization resulted in enforcement of Currency Board Arrangement on 1 July 1997 with the IMF support. The results were remarkable: inflation fell dramatically, the output started increasing virtually overnight, the confidence in the banking sector was restored (partially by selling a number of state owned banks to strategic investors (Kaminiski, 2006)) and a program of accelerated structural reforms was put in place (IMF, 1999). For the three years following the crises the real GDP grew by 11 % despite the negative impact of the global financial crises and the war in Kosovo (IMF, 2001). However, according to all economic indicators Bulgarian economy hit the bottom again during the Kosovo crisis and the output and exports started to recover in the middle of 1999 to reach the impressive increase during the 1998-2000 period on average (IMF, 2000).

Figure 2: Bulgaria: indicators of progress, 1991-2000
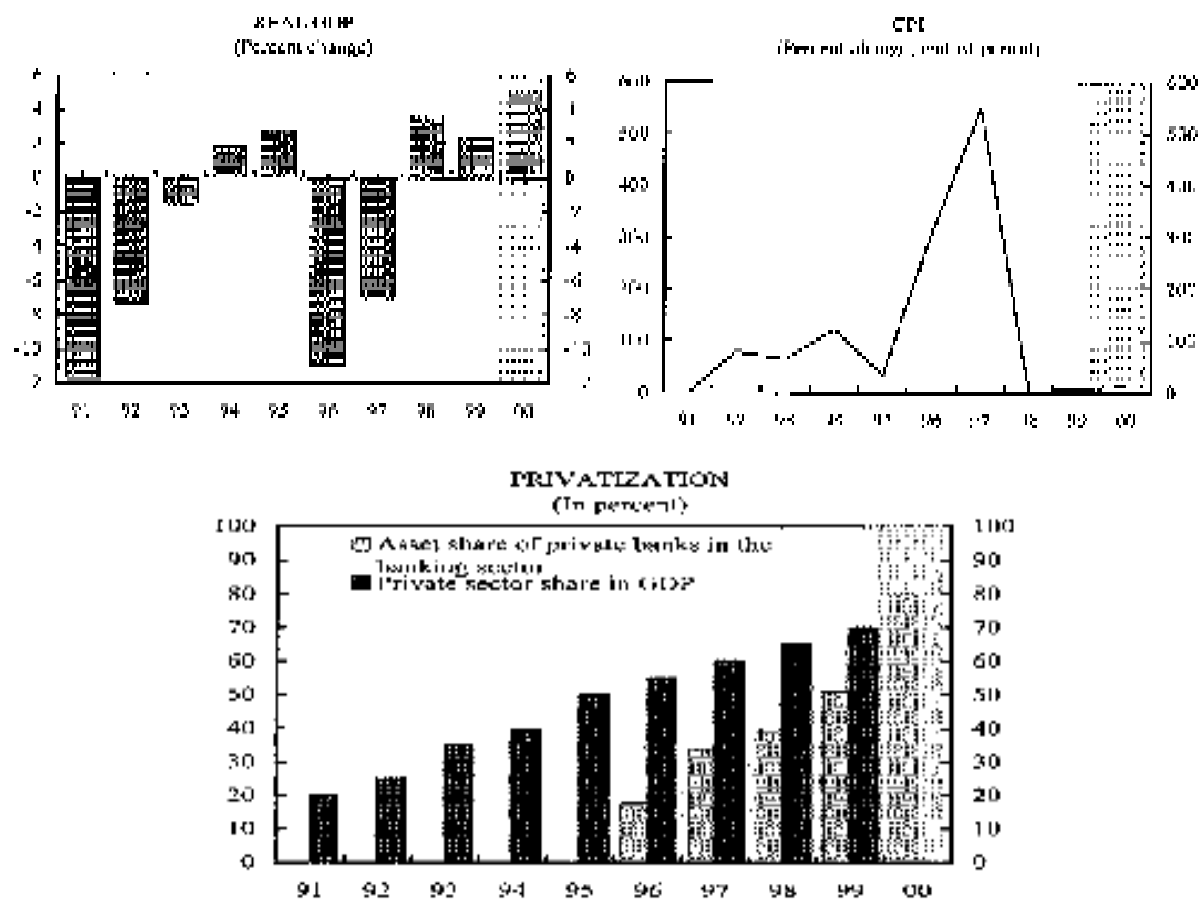
Source: IMF (2001)

Nevertheless, in 2000 the government and authorities still had many challenges to face if Bulgaria were to become a competitive international player and a EU member in further perspective.

Figure 3: Macroeconomic indicators in selected EU accession countries, 1999
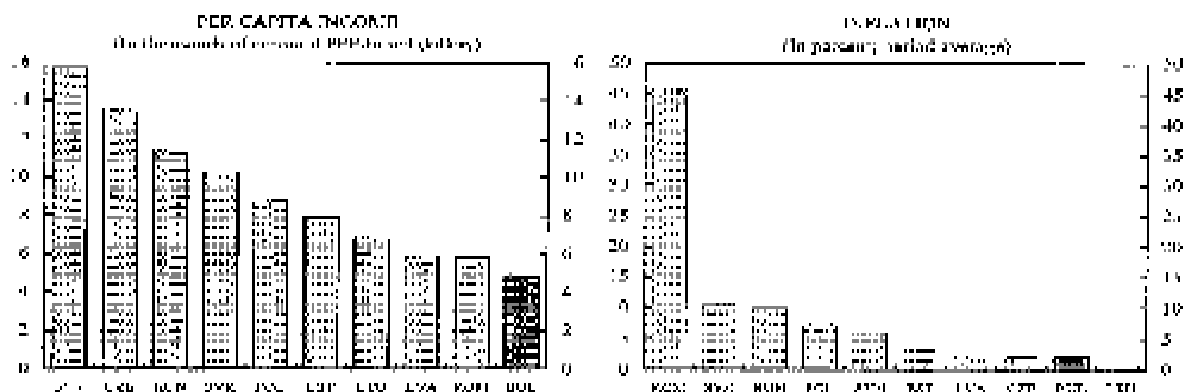
Source: IMF (2001).

The major part of structural reforms – the enterprise reform, was constantly delayed during the first years of transition. This was one of the main reasons for the substantial decline in the output. Immediately after the 1996-1997 crisis, advancement in structural reforms was made resulting mainly in privatization of small and medium enterprises (IMF, 1999). Afterwards, a huge progress in privatization was reached.

2.1. Privatization process 1990-2000

Until late 1996 the privatization process had been advancing very slowly. Virtually no progress had been achieved regarding privatization of large-scale SOEs in heavy industry, manufacturing and infrastructure. There had been several waves of accelerated privatization concerning small-scale enterprises which did not change the situation significantly. The lack of success was due to the bad coordination of privatization process with a few institutions responsible and involved, i.e. Privatization Agency (PA), the Centre for Mass Privatization (CMP) and the branch ministries. In addition, there was little interest on behalf of foreign strategic investors due to the macroeconomic instability and poor legislative framework (IMF, 1999).

Moreover, the first wave of privatization which started in 1996 was designed after the voucher privatization program applied in the Check republic. Approximately 75 million Bulgarian leva were distributed among citizens. This money were invested in privatization funds which afterwards bid for up to thirty percent ownership in mainly small and middle size

SOEs. By applying this method of privatization authorities basically cut off strategic foreign investors. In addition, according Bulgarian legislation at that time, possession of thirty-three percents of an enterprise was enough to block main decisions concerning the respective enterprise. Besides this, since 1994 The Transformation and Privatization of State-Owned and Municipal-Owned Enterprises Act gave clear advantages to manager-employee buyouts (MEBOs) in bidding for enterprises, especially regarding schedules of payments. Soon after that MEBOs proved largely inefficient because of the lack of confidence in them on behalf of the bank system and failure to provide necessary investment. Other obstacles in front of privatization were large-scale asset-stripping in SOEs, which resulted in reluctance to put enterprises on sale, inefficient accounting standards, which allowed for masking financial losses, and the lack of transparency of privatization procedures. (IMF, 1999).

Increased awareness of costs of delayed privatization prompted acceleration in direct sales which resulted in boom of receipts in 1997. The year 1998 saw a further increase regarding the number of deals but a decline in the amount of proceeds. The second wave of privatization started in early 1999 and aimed at disposition of residual state shares in SOEs and cash privatization of large SOEs (IMF, 1999). As a result a record number of deals were concluded in 1999 resulting in 49 % share of privatized assets and 71 % of privatized assets excluding infrastructure. The major sales in non-financial sector included the oil refinery Neftochim, the steel giant Kremikovtsi, the fertilizer producer Agropolichim and Balkan airlines (IMF, 2000). In 2000 amendments to Privatization law aiming at increasing transparency and efficiency were approved. In general, the pace of privatization slowed down during 2000 with the main achievement being disposition of residual state shares. The share of privatized assets reached 51 % and that of assets excluding infrastructure – 78 % (IMF, 2001).

It is widely recognized that privatization is the main channel for attracting FDI in transition countries. Regarding this, all of the facts listed above turned Bulgaria into a laggard in receiving FDI during almost the entire decade, compared to its peers among CEECs applying for a membership in the EU.

3. *Bulgaria 2001-2007: Development of main factors attracting FDI*

3.1. Privatization

It is widely recognized that one of the main channels for inward FDI to transition economies in Central and Eastern Europe has been privatization. At the beginning of transition virtually

all assets in these countries, including Bulgaria, were state-owned. The progress of privatization in Bulgaria has been quite uneven, which can be seen from the next table:

Table 6: Percent of privatized assets in the total amount of the state-owned assets (balance values 31.12.1995)

State bodies	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total
Privatization agency	0.32	1.47	0.50	3.53	2.38	1.76	13.99	2.32	0.60	0.99	1.36	2,58	1,51	1,02	0,43	5,08	39,84
All state bodies	0.37	1.63	1.07	4.09	3.78	4.47	16.96	4.43	0.97	1.16	1.36	2,58	1,51	1,02	0,43	5,08	50,91
Centre for mass privatization					14.58												14,58
Total	0.37	1.63	1.07	4.09	18.36	4.47	16.96	4.43	0.97	1.16	1.36	2,58	1,51	1,02	0,43	5,08	65,49

Source: Privatization Agency of Bulgaria. Derived on 15 April 2009 from
http://priv.government.bg/apnew/Root/Files/stats/stats1405.htm.
* The calculations are made from the data of 31.12.2008, according to the World Bank
** Percent of the state-owned assets privatized is calculated towards the total balance value /580 mill/

As it was mentioned above, privatization process has reached two peaks – in 1997 (the first wave of privatization – the mass privatization) and in 1999 (the second wave of privatization – direct sales of large SOEs). After year 2000, the advancement has been quite modest with some evidence of acceleration in 2008.

In 2002 the new Law on Privatization and Post-Privatization Control was adopted. According to it privatization of all remaining SOEs became centralized in the Privatization Agency. Another novelty was specification of the major methods to be employed in the privatization – public auctions and tenders, centralized public auctions and privatization through Bulgarian stock exchange – Sofia. The priorities of the privatization policy were set to be the rapid sale of remaining SOEs, guaranteeing transparency and openness of the privatization procedures and restructuring and privatization of the natural monopolies. With the new law, the post-privatization activities were separated in another agency - Post-privatization Control Agency[7].

According to Bulgarian authorities, the goal of privatization is to transform SOEs into private property of foreign and Bulgarian investors. Thus, the information on the progress of privatization process and the share of privatized assets is not entirely reliable in evaluating the contribution of privatization to the significant increase of FDI inflows to Bulgaria after 2002. In order a more accurate analysis to be presented, I think that the value of cross-border M&As

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[7] http://priv.government.bg/apnew/Root/index.php?magic=0.56.1.1.2

is a good proxy for the FDI going to Bulgaria through privatization channel. The data is again presented in comparison with the peers of Bulgaria in Central and Eastern Europe.

Table 7: Value of cross-border M&A, Sales, Millions of $

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Bulgaria	...	...	...	20	90	32	71	497	61	1133
Check republic	...	...	...	226	408	2366	507	671	362	2402
Croatia	...	...	43	23	45	94	48	61	16	1164
Estonia	...	...	...	...	...	28	23	64	149	114
Hungary	226	267	392	382	139	2106	1594	298	612	537
Latvia	...	...	...	...	3	23	57	63	11	20
Lithuania					9	...	...	12	632	427
Poland	...	74	1 396	197	357	983	993	808	1789	3707
Romania	...	...	...	...	181	229	94	391	1 284	447
Serbia and Montenegro	...	...	...	...	...	...	...	45	...	...
Slovakia	...	...	...	21	83	4	138	38	54	41
Slovenia	...	...	...	...	41	18	30	133	…	14

Country	2000	2001	2002	2003	2004	2005	2006	2007
Bulgaria	582	11	138	383	2685	2548	789	854
Check republic	1924	1968	5204	1756	558	6378	716	354
Croatia	146	676	875	613	51	536	2535	672
Estonia	131	88	15	14	18	82	4	13
Hungary	1117	1370	1278	1109	453	2498	2524	721
Latvia	342	39	4	12	...	9	11	33
Lithuania	173	193	225	135	102	61	88	35
Poland	9316	3493	3131	802	1275	1598	974	1346
Romania	536	66	124	493	2200	1851	5324	1784
Serbia and Montenegro	...	2	268	...	38	...	112	274
Slovakia	1849	1194	3350	160	432	120	1426	50
Slovenia	…	381	1502	1	168	160	15	52

Source: Annex table B.7., UNCTAD (2003), Annex table B.4. UNCTAD (2005, 2008)

It is visible from the data that each country with the exception of Serbia and Montenegro experienced one or several booms in the value of cross-border M&A which most likely occurred in a result of certain cases of acceleration in privatization in the respective countries. At least for Bulgaria this is the case – the peaks in the value of cross-border M&As are result of the second wave of privatization launched in 1999 (IMF, 1999) and conclusion of some major deals in 2004 including those for the telecommunication state company BTC and seven

big enterprises in the electricity sector where the state monopoly was dismantled[8]. However, in 2005 no privatization deals were finalized[9], so a very probable conclusion is that M&As were conducted between large private companies. In 2005 the entire region of Central and Eastern Europe experienced a surge in the volume and value of M&As deals which was determined by the expected accession of some of the countries in the EU. The competition on the side of Western companies, searching to expand their activities and to increase efficiency, rose and many enterprises in Central and Eastern Europe combined their efforts to withstand the pressure. However some companies were acquired by foreign investors or risk capital funds[10]. Anyway, after the boom in 2004 and 2005 which affected the CEECs, the relative importance of M&As as a channel for FDI in the region decreased which can be seen from the percentage share of their value relative to the GDP of the countries in the region.

Table 8: Cross-border M&A value as a percentage share of GDP

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Bulgaria	0.16	1.18	0.14	2.46	1.16	0.02	0.24	0.62	3.99	3.57	0.99	0.99
Check republic	0.36	0.47	0.25	1.63	1.25	1.19	3.02	0.96	0.28	3.06	0.32	0.14
Croatia	0.14	0.16	0.04	2.97	0.35	1.52	1.81	1.19	0.09	0.91	3.94	0.95
Estonia	0.23	0.57	1.25	0.94	0.98	0.61	0.09	0.08	0.09	0.37	0.02	0.05
Hungary	1.64	0.29	0.56	0.46	0.89	0.99	0.86	0.71	0.28	1.46	1.39	0.38
Latvia	0.40	0.40	0.07	0.11	1.80	0.19	0.02	0.05	…	0.03	0.03	0.08
Lithuania	…	0.05	2.24	1.52	0.57	0.58	0.61	0.32	0.23	0.13	0.16	0.06
Poland	0.32	0.24	0.49	0.97	2.31	0.83	0.71	0.18	0.26	0.30	0.17	0.22
Romania	0.07	0.30	1.03	0.36	0.41	0.04	0.08	0.30	1.16	0.91	2.27	0.66
Serbia and Montenegro	…	…	…	…	…	0.00	0.04	…	0.01	…	0.01	0.03
Slovakia	0.28	0.07	0.10	0.07	3.12	1.84	4.80	0.22	0.55	0.14	1.47	0.05
Slovenia	0.11	0.45	…	0.04	…	1.04	3.82	0.00	0.38	0.34	0.03	0.10

Source: Annex table B.7., UNCTAD (2003), Annex table B.4. UNCTAD (2005, 2008);
http://w3.unece.org/pxweb/Dialog/Saveshow.asp for GDP in Millions of US $ at prices and PPPs of current year; author's calculations

Since 2005 FDI in Bulgaria grew more rapidly than the value of M&As deals. IMF (2006) points out that in this year the increase in FDI was driven by the greenfield investment projects. The number of greenfield projects in the leading countries excluding Hungary, which was outpaced by its peers (Check republic, Poland and Slovakia), and the one in Bulgaria and Romania, were constantly increasing during the last four years. This fact proves again the importance which greenfield investment has been gaining in the region as a channel of FDI.

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[8] http://priv.government.bg/apnew/Root/Files/stats/stats1406.htm
[9] http://priv.government.bg/apnew/Root/Files/stats/stats1406.htm
[10] http://www.econ.bg/news86022/article67974.html (available in Bulgarian only)

Table 9: Number of greenfield FDI projects by destination economy, 2003-2007

Country	2002	2003	2004	2005	2006	2007
Bulgaria	77	98	109	142	298	151
Check republic	94	145	148	152	181	149
Croatia	33	44	40	46	39	32
Estonia	32	30	43	65	60	32
Hungary	210	218	224	212	256	219
Latvia	38	44	30	87	121	33
Lithuania	36	42	23	81	61	44
Poland	91	154	240	275	350	333
Romania	112	116	182	264	385	366
Serbia and Montenegro	42	48	51	53	46	82
Slovakia	44	66	89	119	118	100
Slovenia	13	23	22	19	26	23

Source: Annex table A.I.2., UNCTAD (2005), Annex table A.I.1., UNCTAD (2008)

Regarding privatization as a factor determining FDI inflows to Bulgaria, it could be concluded that in the first couple of years of increasing growth of FDI, it actually led to the most of FDI in the country. But since 2005 other cross-border M&As between private companies and greenfield investment, especially after 2005, have gained more importance than the privatization.

3.2. Prerequisites determining efficiency-seeking FDI

In this part of analysis, I will concentrate jointly on two factors listed in the introduction – labour costs and pre-accession agreements with the EU.

To start with, I would like to present and concentrate on the development of import and export of Bulgaria, which is presented in the following table.

Table 10: FDI, exports and imports in millions of US$, at current exchange rates

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
FDI	..	103	94	108	427	536	813	1026	812	926	1421	2596	4319	7535	8910
FDI % change from previous year	..	..	-8.74	14.89	295.37	25.53	51.68	26.20	-20.86	14.04	53.46	82.69	66.37	74.46	18.25
Exports: Goods	3728	3923	5336	4891	4854	4196	3977	4823	5135	5730	7548	9932	11765	15070	18494
Exports % change from previous year	..	5.23	36.02	-8.34	-0.76	-13.56	-5.22	21.27	6.47	11.59	31.73	31.58	18.46	28.09	22.72
Imports: Goods	4613	3959	5216	4703	4372	4565	5046	6005	6732	7330	10036	13603	17246	22049	28490
Imports % change from previous year	..	-14.18	31.75	-9.84	-7.04	4.41	10.54	19.01	12.11	8.88	36.92	35.54	26.78	27.85	29.21

Source: http://w3.unece.org/pxweb/Dialog/Saveshow.asp

From the table, it can be observed that after 2002, export and import of Bulgaria have been growing very rapidly. Import growth started outpacing the increase in export in 2003, which could be explained by the increase in domestic private consumption and investment goods (IMF, 2004). The following years domestic consumption surged driven by the expansion of household credits and increase in FDI (IMF, 2006). During the same period (2002-2006) the private consumption/GDP ratio was exhibiting a diminishing trend and consumer goods imports increased only moderately (IMF, 2007) which supports the assumption that the major part of the imported goods in this period entered the country as a stage of the process of efficiency-seeking FDI into the region.

Evidence which back up this suggestion include data for the level of labour costs in Bulgaria and Romania which entered the EU in 2007 but were well integrated into its structures several years before that.

Table 11: Earnings in industry and services in EUR (average gross annual earnings of full time employees in enterprises with 10 or more employees)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EU-27	:	:	:	:	:	27 948	30 142	30 349	28 454	29 247	:
Euro area	:	:	:	:	28 786	29 588	30 379	31 089	32 481	33 176	:
Belgium	29 131	28 901	29 616	30 701	31 644	33 109	34 330	34 643	35 704	36 673	37 674
Bulgaria	:	896	1 216	1 330	1 436	1 518	1 588	1 678	1 784	1 978	:
Czech Republic	:	:	:	:	:	:	6 016	6 137	6 569	7 405	8 284
Denmark	36 376	36 235	37 209	39 515	40 962	41 661	43 577	44 692	46 122	47 529	:
Germany	35 254	35 093	35 432	36 228	37 319	38 204	39 153	40 056	40 954	41 694	42 382
Estonia	:	:	:	:	:	:	:	:	:	:	:
Ireland	:	:	:	:	:	:	:	:	:	:	:
Greece	11 917	12 605	13 210	13 926	14 721	15 431	16 278	16 739	:	:	:
Spain	16 043	16 192	16 528	17 038	17 432	17 768	18 462	19 220	19 828	20 439	21 150
France	25 089	25 545	25 777	26 339	26 712	27 418	28 185	28 847	29 608	30 521	:
Italy	:	:	:	:	:	:	:	:	:	:	:
Cyprus	12 980	14 021	14 709	15 161	16 335	16 948	17 740	18 406	19 290	20 549	21 310
Latvia	:	:	:	:	:	:	:	:	3 806	4 246	5 211
Lithuania	1 597	2 286	2 799	3 017	:	:	:	:	:	:	:
Luxembourg	:	32 600	33 337	34 462	35 875	37 745	38 442	39 587	40 575	42 135	43 621
Hungary	3 158	3 543	3 686	3 770	4 172	4 898	5 846	6 196	7 099	7 798	7 840
Malta	9 287	10 114	10 713	11 581	12 553	13 320	13 460	13 603	11 926	11 180	:
Netherlands	28 140	28 061	29 189	30 426	31 901	33 900	35 200	36 600	37 900	38 700	:
Austria	:	:	:	:	:	:	:	:	34 995	36 032	:
Poland	3 076	:	4 156	5 310	:	7 509	:	:	6 230	6 270	:
Portugal	:	:	:	:	12 620	13 338	13 322	13 871	14 253	14 715	:
Romania	:	:	:	:	:	:	:	:	2 414	3 155	3 713
Slovenia	:	:	:	:	:	:	:	:	:	:	:
Slovakia	:	3 179	3 292	3 125	3 583	3 837	4 582	4 944	5 706	6 374	7 040
Finland	23 883	24 005	24 944	25 739	27 398	28 555	29 916	30 978	31 988	33 290	34 081
Sweden	:	:	:	:	31 621	30 467	31 164	32 177	33 620	34 049	35 084
United Kingdom	:	:	29 370	32 269	37 677	39 233	40 553	38 792	41 253	42 866	:
Iceland	:	:	:	32 311	37 638	34 101	36 764	:	:	:	:
Norway	:	:	31 456	33 741	36 202	38 604	43 736	42 882	42 224	45 485	47 221
Switzerland	42 194	:	40 727	:	43 683	:	48 498	:	45 760	:	:

Source: European commission (2008)

Table 12: Labour costs in EUR (average hourly labour costs in industry and services of full-time employees in enterprises with 10 or more employees)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EU-27	16.17	16.99	17.09	17.80	18.32	18.76	19.44	19.66	20.39	20.53	:
Euro area	19.39	19.74	19.86	20.31	21.18	21.69	22.42	22.96	23.77	24.71	:
Belgium	:	:	:	:	26.61	27.89	29.17	29.58	30.29	30.73	:
Bulgaria	:	:	1.11	1.22	1.23	1.29	1.32	1.39	1.45	1.55	:
Czech Republic	2.80	2.97	3.23	3.41	3.86	4.64	5.39	5.47	5.85	6.63	7.14
Denmark	:	23.40	24.63	25.92	26.53	28.54	29.06	30.30	30.70	31.98	:
Germany	22.90	23.30	23.60	24.00	25.00	25.60	26.20	26.80	26.90	27.20	27.70
Estonia	1.85	2.13	2.42	2.60	2.85	3.22	3.67	4.01	4.24	4.67	5.49
Ireland	:	:	:	:	:	:	:	:	:	:	:
Greece	9.26	9.77	9.77	10.60	10.98	11.62	12.46	13.37	:	:	:
Spain	14.43	14.19	14.13	14.22	14.22	13.07	13.63	14.21	14.76	15.22	15.77
France	22.09	22.52	22.94	23.57	24.84	26.00	27.04	27.68	28.46	29.29	30.31
Italy	17.59	18.92	18.30	18.68	18.99	19.27	19.99	20.64	21.39	:	:
Cyprus	7.25	7.83	8.19	8.41	9.10	9.43	9.91	10.68	11.10	11.65	11.98
Latvia	:	1.59	1.71	1.85	2.22	2.29	2.39	2.37	2.52	2.77	3.41
Lithuania	1.32	1.68	1.95	2.16	2.63	2.76	2.90	3.10	3.22	3.56	4.21
Luxembourg	21.38	21.26	21.56	22.52	24.48	25.39	26.21	27.02	29.97	31.10	31.98
Hungary	2.86	3.15	3.02	3.14	3.63	4.04	4.91	5.10	5.54	6.14	6.34
Malta	:	:	:	:	:	:	7.59	7.77	7.77	8.35	:
Netherlands	20.39	19.13	20.18	21.14	22.31	23.88	25.19	26.45	27.23	27.41	:
Austria	21.96	21.90	22.38	23.21	22.87	23.88	24.93	:	25.32	:	:
Poland	2.95	3.38	3.73	4.05	4.48	5.30	5.27	4.70	4.74	5.55	6.03
Portugal	7.18	7.40	7.60	7.99	8.13	8.60	9.10	9.60	10.20	10.60	10.97
Romania	:	:	:	:	1.41	1.55	1.67	1.60	1.76	2.33	2.68
Slovenia	7.35	7.90	8.51	8.94	8.98	9.58	9.70	10.54	10.41	10.76	:
Slovakia	2.16	2.61	2.91	2.76	3.07	3.26	3.59	4.02	4.41	4.80	5.33
Finland	20.25	20.30	20.40	21.37	22.10	23.59	23.82	24.78	25.34	26.70	27.39
Sweden	23.12	23.79	23.99	25.43	28.56	27.41	28.73	30.43	31.08	31.55	32.16
United Kingdom	14.22	17.69	19.16	20.84	23.71	24.51	25.24	23.56	24.71	24.47	:
Iceland	:	:	:	:	:	:	21.95	23.76	25.22	30.82	32.37
Switzerland	:	:	:	:	30.59	:	34.16	:	32.82	:	:

Source: European commission (2008)
* Break in series: the Netherlands, 1997; Lithuania, 2000; Spain, 2001; Malta, 2003

It can be observed from the tables that labour costs in Bulgaria and Romania are substantially lower than those in the rest of the EU countries. Wages in Bulgaria and Romania are 2-3 times lower even compared with the countries which joint the EU in 2004. In addition, the education level and the quality of labour force in the two countries are competitive relative to rest of the EU countries which can be seen from the next table.

Table 13: Pupils and students (excluding pre-primary education)

	Total (ISCED 1-6) (1 000)		Primary level of education (ISCED 1)		Lower secondary level of education (ISCED 2)		Upper and post-secondary non-tertiary education (ISCED 3-4)		Tertiary education (ISCED 5-6)	
	2000	**2005**	**2000**	**2005**	**2000**	**2005**	**2000**	**2005**	**2000**	**2005**
EU-27	95 840	98 318	32.5	29.3	23.7	23.8	27.2	27.9	16.6	18.8
Euro area	56 682	57 585	31.4	30.4	27.4	26.8	23.2	23.4	17.8	19.3
Belgium	2 235	2 380	34.6	31.0	16.7	18.1	32.8	34.5	15.9	16.4
Bulgaria	1 357	1 226	29.0	23.7	27.0	25.9	24.7	31.0	19.3	19.4
Czech Republic	1 906	1 912	33.8	26.3	27.5	25.9	25.3	30.2	13.3	17.6
Denmark	1 003	1 144	38.3	36.2	20.6	20.5	22.2	23.0	18.9	20.3
Germany	14 549	14 467	25.1	22.9	38.2	37.7	22.0	23.3	14.1	15.7
Estonia	303	289	40.7	29.6	20.2	22.0	21.3	24.9	17.7	23.5
Ireland	990	1 037	45.4	43.8	18.8	16.9	19.6	21.3	16.2	18.0
Greece	1 883	2 053	34.3	31.7	19.5	16.5	23.9	20.4	22.4	31.5
Spain	7 769	7 537	32.7	34.8	26.4	26.3	17.4	:	23.5	24.0
France	11 934	12 315	32.6	32.6	27.7	27.2	22.2	22.3	16.9	17.8
Italy	9 049	9 409	31.3	29.7	20.0	19.5	29.1	29.5	19.6	21.4
Cyprus	138	147	46.3	41.8	23.7	22.2	:	:	7.5	13.7
Latvia	499	491	27.1	17.2	33.1	33.0	21.6	23.2	18.3	26.6
Lithuania	767	805	28.5	19.6	42.1	40.2	13.5	15.9	15.9	24.3
Luxembourg	69	73	47.2	48.1	23.1	24.5	26.1	27.4	3.5	:
Hungary	1 906	1 976	26.3	21.8	26.6	24.9	31.0	31.3	16.1	22.1
Malta	78	80	44.2	37.1	37.2	35.3	10.5	15.7	8.1	11.8
Netherlands	3 171	3 289	40.3	38.9	23.8	24.0	20.5	20.0	15.4	17.2
Austria	1 459	1 462	26.9	24.8	26.1	27.3	29.1	31.2	17.9	16.7
Poland	9 074	8 887	43.7	30.6	6.8	18.7	32.1	26.8	17.4	23.8
Portugal	2 032	1 913	40.2	40.4	20.9	19.9	:	19.8	18.4	19.9
Romania	3 962	3 847	30.0	25.2	33.0	26.7	25.5	28.9	11.4	19.2
Slovenia	389	409	22.3	22.8	26.0	20.3	30.1	29.5	21.5	27.4
Slovakia	1 123	1 101	27.6	22.0	36.4	32.7	23.9	28.8	12.1	16.5
Finland	1 152	1 240	33.7	30.8	17.2	16.2	25.7	28.3	23.4	24.7
Sweden	2 089	2 114	37.1	34.0	17.0	19.8	28.3	26.0	16.6	20.2
United Kingdom	14 955	16 714	31.0	27.7	15.3	14.0	:	:	13.5	13.7
Croatia	:	736	:	26.7	:	28.3	:	:	:	18.3
FYR of Macedonia	386	374	32.8	29.4	33.6	31.7	24.0	25.7	9.6	13.2
Turkey	13 169	16 021	75.3	65.9	:	:	:	:	7.7	13.1
Iceland	73	83	42.6	37.1	16.0	16.5	28.3	28.1	13.2	18.3
Liechtenstein	5	6	46.6	37.1	34.8	26.7	:	27.4	10.8	8.7
Norway	989	1 052	42.4	40.8	16.0	17.7	22.3	21.2	19.3	20.3
Switzerland	:	1 334	:	39.3	:	22.3	:	22.7	:	15.0
Japan	20 583	19 218	36.6	37.6	20.7	19.2	22.0	21.0	19.3	21.0
United States	62 323	66 597	40.1	36.7	19.8	19.8	19.0	17.6	21.2	25.9

Source: European commission (2008)

In addition, throughout the transition process, including present years, the level of unemployment in both countries remained high compared to the countries in Central Europe, not to mention western European economies. This fact shows that labour was relatively abundant in these two countries.

Table 14: Unemployment rate in the EU in %

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EU-27	:	:	:	:	8.7	8.5	8.9	9.0	9.1	8.9	8.2
Euro area	10.7	10.6	10.0	9.1	8.2	7.8	8.3	8.8	8.9	8.9	8.3
Belgium	9.5	9.2	9.3	8.5	6.9	6.6	7.5	8.2	8.4	8.4	8.2
Bulgaria	:	:	:	:	16.4	19.5	18.1	13.7	12.0	10.1	9.0
Czech Republic	:	:	6.4	8.6	8.7	8.0	7.3	7.8	8.3	7.9	7.1
Denmark	6.3	5.2	4.9	5.2	4.3	4.5	4.6	5.4	5.5	4.8	3.9
Germany	8.7	9.3	9.1	8.2	7.5	7.6	8.4	9.3	9.7	10.7	9.8
Estonia	:	9.6	9.2	11.3	12.8	12.4	10.3	10.0	9.7	7.9	5.9
Ireland	11.7	9.9	7.5	5.7	4.2	4.0	4.5	4.7	4.5	4.3	4.4
Greece	9.6	9.8	10.8	12.0	11.2	10.7	10.3	9.7	10.5	9.8	8.9
Spain	17.8	16.7	15.0	12.5	11.1	10.3	11.1	11.1	10.6	9.2	8.5
France	11.6	11.5	11.1	10.5	9.1	8.4	8.7	9.5	9.6	9.7	9.5
Italy	11.2	11.3	11.3	10.9	10.1	9.1	8.6	8.4	8.0	7.7	6.8
Cyprus	:	:	:	:	4.9	3.8	3.6	4.1	4.6	5.2	4.6
Latvia	:	:	14.3	14.0	13.7	12.9	12.2	10.5	10.4	8.9	6.8
Lithuania	:	:	13.2	13.7	16.4	16.5	13.5	12.4	11.4	8.3	5.6
Luxembourg	2.9	2.7	2.7	2.4	2.3	2.0	2.7	3.7	5.1	4.5	4.7
Hungary	9.6	9.0	8.4	6.9	6.4	5.7	5.8	5.9	6.1	7.2	7.5
Malta	:	:	:	:	6.7	7.6	7.5	7.6	7.4	7.3	7.3
Netherlands	6.0	4.9	3.8	3.2	2.8	2.2	2.8	3.7	4.6	4.7	3.9
Austria	4.3	4.4	4.5	3.9	3.6	3.6	4.2	4.3	4.8	5.2	4.7
Poland	:	10.9	10.2	13.4	16.1	18.2	19.9	19.6	19.0	17.7	13.8
Portugal	7.3	6.8	5.1	4.5	4.0	4.0	5.0	6.3	6.7	7.6	7.7
Romania	:	5.3	5.4	6.6	7.2	6.6	8.4	7.0	8.1	7.2	7.3
Slovenia	6.9	6.9	7.4	7.3	6.7	6.2	6.3	6.7	6.3	6.5	6.0
Slovakia	:	:	12.6	16.4	18.8	19.3	18.7	17.6	18.2	16.3	13.4
Finland	14.6	12.7	11.4	10.2	9.8	9.1	9.1	9.0	8.8	8.4	7.7
Sweden (1)	9.6	9.9	8.2	6.7	5.6	4.9	4.9	5.6	6.3	7.4	7.1
United Kingdom	7.9	6.8	6.1	5.9	5.3	5.0	5.1	4.9	4.7	4.8	5.3
Croatia	:	:	:	:	:	:	14.7	14.1	13.6	12.6	11.1
Turkey	:	:	:	:	5.2	6.8	8.9	9.3	9.0	8.8	8.4
Norway	4.7	4.0	3.2	3.2	3.4	3.6	3.9	4.5	4.4	4.6	3.5
Japan	3.4	3.4	4.1	4.7	4.7	5.0	5.4	5.3	4.7	4.4	4.1
United States	5.4	4.9	4.5	4.2	4.0	4.8	5.8	6.0	5.5	5.1	4.6

Source: European commission (2008)

Despite all the facts presented above, a necessary prerequisite for efficiency-seeking investment to take place is that trade costs are sufficiently low in order not to offset low labour costs.

With regard to Bulgaria, integration of the country into the single European market started as early as 1993, when the Europe agreement came into force (European commission, 2005). With this agreement, a gradual decrease and eventual abolishment of all tariff and non-tariff trade restrictions on industrial goods was specified to be achieved over a period of maximum ten years[11]. As of 2003 traditional goods subject to the trade between Bulgaria and EU were free of any trade restrictions and last discussions were taking place in order to further prepare Bulgaria for its EU membership by immediate or gradual abolishment of import duties and export refunds on processed agricultural goods (Commission of the European communities,

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[11] http://europe.bg/en/htmls/page.php?id=533&category=10&page=4

2004). Meanwhile, while removing tariff rates on industrial products, many agricultural goods also became free of tariff rates or quotas (Commission of European communities, 2002, 2003, 2004).

In parallel with negotiations with the EU, Bulgaria became a member of the Central European Free Trade Agreement (CEFTA) in 1999. In the same year, a free-trade agreement with Turkey came into force. Before that, in 1997 a Free Trade Agreement (FTA) between Bulgaria and the European Free Trade Association[12] (EFTA) was implemented (European commission, 1999).

In addition, Romania followed the same timeline of negotiations and agreements with the EU as Bulgaria, since the two countries candidacies had been evaluated and decided on interdependently.

Moreover, the bulk of the FDI flows to Bulgaria and Romania come from a broadly similar list of countries among which one for each country is situated outside the EU. As of the end of 2007 the top ten FDI source countries for Bulgaria are Austria, the Netherlands, Greece, UK, Germany, Cyprus, USA, Ireland, Hungary and Spain in this order, and for Romania – Austria, the Netherlands, Germany, France, Greece, Italy, Switzerland, Cyprus, Turkey and Hungary in this order with USA being out of top 10 direct investors only in 2007. Regarding the direct investment source countries which are not members of the EU – USA is an important strategic investor for the union and Turkey is the largest economy on the Balkan Peninsula, so their presence among the biggest investors in the region is not surprising.

In addition, the value if investment coming from the countries listed above surged during the past four to five years.

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[12] Members of EFTA are Iceland, Liechtenstein, Norway and Switzerland

Table 15: FDI stock in Bulgaria – top ten biggest investors as of the end of 2007

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007*
Total	**2173.8**	**2905.6**	**3342.1**	**3926.6**	**5044.6**	**7420.7**	**11756.5**	**17704.3**	**26874.0**
Austria	122.2	204.1	298.2	580.1	673.0	1505.6	3479.4	4613.5	5341.5
Netherlands	79.9	201.8	310.6	167.7	472.9	632.2	940.7	1882.1	4695.8
Greece	95.7	233.3	273.1	472.4	541.4	637.2	1029.3	1689.8	2406.9
United Kingdom	239.2	220.3	239.7	227.3	300.7	343.7	648.7	1435.2	2105.5
Germany	419.4	353.9	327.0	439.9	439.7	680.7	776.8	1076.1	1509.6
Cyprus	209.1	293.0	292.2	360.1	447.9	470.1	643.0	851.5	1452.6
USA	260.0	281.5	322.1	335.3	374.6	451.3	614.0	825.5	952.1
Ireland	4.9	11.9	3.7	1.1	2.5	19.7	108.2	526.4	858.8
Hungary	8.2	6.4	8.9	18.5	177.8	224.4	311.2	487.9	728.6
Spain	57.2	2.0	7.0	6.8	10.8	18.2	58.7	220.2	724.1

*Preliminary data
Source: Bulgarian National Bank website. Available at
http://www.bnb.bg/bnb/home.nsf/fsWebIndex?OpenFrameset

Table 17: FDI stock in Romania – top ten biggest investors as of the end of 2007

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007*
Total	**2173.8**	**2905.6**	**3342.1**	**3926.6**	**5044.6**	**7420.7**	**11756.5**	**17704.3**	**26874.0**
Austria	122.2	204.1	298.2	580.1	673.0	1505.6	3479.4	4613.5	5341.5
Netherlands	79.9	201.8	310.6	167.7	472.9	632.2	940.7	1882.1	4695.8
Greece	95.7	233.3	273.1	472.4	541.4	637.2	1029.3	1689.8	2406.9
United Kingdom	239.2	220.3	239.7	227.3	300.7	343.7	648.7	1435.2	2105.5
Germany	419.4	353.9	327.0	439.9	439.7	680.7	776.8	1076.1	1509.6
Cyprus	209.1	293.0	292.2	360.1	447.9	470.1	643.0	851.5	1452.6
USA	260.0	281.5	322.1	335.3	374.6	451.3	614.0	825.5	952.1
Ireland	4.9	11.9	3.7	1.1	2.5	19.7	108.2	526.4	858.8
Hungary	8.2	6.4	8.9	18.5	177.8	224.4	311.2	487.9	728.6
Spain	57.2	2.0	7.0	6.8	10.8	18.2	58.7	220.2	724.1

Source: The National Bank of Romania. Available at http://www.bnro.ro/Foreign-direct-investment-3213.aspx

All the information presented in the current subsection backs up the conclusion that Bulgaria and Romania are turning into an attractive cluster for investors who are seeking to minimize their production costs by undertaking efficiency-seeking FDI.

3.3.Reforms related to the EU accession and reforms aiming at creating favourable investment climate

In its 2002 regular report on the progress of Bulgaria towards EU membership issued in October 2002, the European commission concluded that Bulgaria is a functioning market economy (European commission, 2002). According to the definition, used by EU institutions this means the following:

"The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. The performance of a market economy is enhanced by macroeconomic stability and consensus about economic policy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy." (European commission, 1998, p. 16)

The statement is quite convincing regarding the investment climate in Bulgaria. However, despite of the great deal of reforms which were undertaken and finished, the European commission conclusions include further recommendations for improvement.

The main problems, hampering business and creating prerequisites for existence of poor business environment at the opening of the millennium according to the commission of European communities (2000) were corruption, inefficient and slow state administration and judiciary system, barriers to market entry and exit, poor protection of property rights and enforcement of contracts, low level of financial intermediation on the part of banking sector and bad quality of infrastructure. Next, I will deal with reforms in each of these areas of impediments and what was left to be done after the accession of Bulgaria into the EU.

3.3.1. State administration

In 2000 the legal framework for changing Bulgarian state administration and turning it into a modern and efficient one, was enhanced by adopting the most necessary at that moment secondary legislation[13]. In addition in December 2000 the Prime Minister approved a Code of Ethics for Civil Servants which provided guidance about proper personal conduct on duty and in private and public life (European commission, 2001).

In June 2002 a strategy for Modernisation of State Administration was adopted. The strategy was based on the following principles: accountability of the administration, effectiveness of the state policies, coherence of activities, openness to citizens and participation of all groups in society in framing the policy. Particular measures were listed in order to improve civil service through upgrading of working methods and combating corruption and to strengthen the capacity to administer European funds. The Civil Service Law and the Law of State Administration framed the main values followed by the state clerks like loyalty, responsibility, legality, stability, hierarchical subordination and political neutrality. Further

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[13] Unlike laws which are adopted by Bulgarian Parliament, Ministries are in charge of preparing secondary legislation for implementing approved laws and setting the structure of Ministries and other administrative bodies (European Commission, 2000, 2001)

steps were taken in making public information more easily accessible by the citizens (Commission of the European communities, 2002).

In order to precede with the reform of the state administration a programme and an action plan for the implementation of the Strategy for Modernization of State Administration were adopted by the government in January 2003. Following the statements in the program, a Council for the Modernisation of the State Administration was created in March. The Council was set to be responsible for the implementation of the action plan and it reported directly to the Council of Ministers. In the action plan, amendments to the laws of Civil Service and on Administration as well as in the the new law on limiting the Administrative Regulation and Administrative Control of Economic Activity were planed to be adopted (Commission of the European communities, 2003). The Law on Reduction of Administrative Regulation and Administrative Control, which entered into force in December 2003 (Commission of the European communities, 2004), aimed at regulating regimes for obtaining different licences and permits and improving transparency of the process of decision-making on behalf of the state administration (Commission of the European communities, 2003). In addition, in order access to public information to be further improved, amendments to the Law of on Access to Public Information were adopted in May 2003 with which the number of institutions responsible for providing citizens with public information was increased and the definition of the term "public information" was changed in order discretion in judgements of persons responsible for providing of the information to be reduced (Commission of the European communities, 2003).

The proposed amendments to the Law of Civil Service were approved by the parliament in October 2003 and entered into force in January 2004. They concerned the definition of the term "civil servant" which was made more precise and procedures of recruitment, training and subsequent work evaluation. All changes aimed at providing for an independent, efficient and accountable state administration (Commission of the European communities, 2004).

In April 2005, the Council for the Modernization of Public Administration approved a White Paper on the Modernization of the Administration. In the Paper further actions aiming at improving of service delivery, accountability and budgetary control were outlined (European commission, 2005).

In March 2006, the proposed amendments to the Law on Administration and further amendments to the Civil Servant Act were approved. With the Law on Administration a clear

distinction between administrative and political levels of the state administration was outlined; roles and responsibilities were clarified and the involvement of public officials in the management of private companies was regulated. Regarding the Civil Service Act further progress was made concerning recruitment, training and mobility of civil servants. Also in March 2006 the Code of Administrative Procedure was adopted (Commission of the European communities, 2006).

As of May 2006, the Commission of the European communities concluded that "overall, Bulgaria has made good progress in the field of public administration and is on the way to have an efficient state administration provided that the current path of reform is maintained." (Commission of the European communities, 2006, p. 5).

3.3.2. Judicial system

As of 2000 Bulgarian judicial system had suffered many deficiencies. Among the most important had been delays in the administrative processing of cases resulting in a long length of judicial proceedings, large number of cases returned by courts to the public prosecutors because of incomplete investigation, non-equal presentation in cases of seeking justice and poor execution of judgements. A big step towards improving the system was the adoption of a Strategy for Reform of the Judicial System in Bulgaria in October 2001 (European commission, 2001). Accordingly, in March 2002 an action plan for implementation of the strategy was approved and the respective amendments in the Law on the Judicial System, necessary for the implementation of the Strategy were adopted in July 2002. The actions outlined in the Strategy were aimed at improving management, administration and human resource potential of Bulgarian judicial system (Commission of the European communities, 2002).

However, advancement of the reforms was stopped by the declaration of the Constitutional Court stating that certain provisions of the revised Law on the Judiciary were unconstitutional and their followed annulment in December 2002. As a result, a parliamentary commission was established with the purpose to deal with the necessary amendments to the constitution. In parallel, the strategy and the action plan were updated and their scope was expanded to cover constitutional changes, procedural legislation and administrative justice. In order for the court proceedings to be made more efficient amendments to the Civil Procedural Code and the Penal Procedural Code were approved in October 2002 and May 2003 respectively. The

amendments concerned mechanisms for enforcement of judgements and reducing the duration of procedures. In addition, in September 2003 amendments to the constitution regarding the immunity of magistrates and especially abolishment of the absolute immunity were adopted by the parliament which represented a very serious step forward (Commission of the European communities, 2003).

In 2004 some legislative progress was made regarding the pre-trial phase. In addition, rules for appraisal of the work performance concerning activities and workload of judges, prosecutors and investigators were put in place aiming at improvement in managing the workload and subsequent reduction of delay in deciding cases (European commission, 2005).

In December 2005 the Minister of Justice developed and announced an action plan for reforms in the period 2006-2007. Regarding the pre-trial phase, in April 2006 a new Penal Procedure Code entered into force and a mechanism for monitoring its adequacy was established in January in the same year. Amendments to the Law on judiciary concerning random allocation of cases in courts, investigation services and prosecution offices were adopted. In March 2006 both amendments to the constitution establishing the Prosecution Service to be responsible for investigations and new Administrative Procedural Code were adopted (Commission of the European communities, 2006).

Despite of the many reformed and implemented pieces of legislation, the Commission of the European communities concluded as of 2006 that "overall, limited progress has been made both in terms of quality and accountability of justice as well as regarding the institutional relations between the executive and the justice system. Bulgaria needs to complete the reform of the judiciary, ensure tangible results, and take the additional steps to guarantee its independence." (Commission of the European communities, 2006, p. 7).

3.3.3. Corruption

In the year 2000, corruption was one of the main obstacles in front of improvement of the business climate in Bulgaria. As reasons for this were perceived low salaries, imperfect legislation, unreliable judicial system and the lack of administrative control (Commission of the European communities, 2002). Accordingly, in October 2001 a National Strategy for Combating Corruption was adopted by the Council of Ministers. The strategy consisted of four main parts concerning creation of legal and institutional environment which would not favour corrupt activities, fighting corruption in the economy, anti-corruption reform in the

judicial system and anti-corruption cooperation between government, non-governmental institutions and media. It aimed at achieving transparency, clarity and accountability between institutions and citizens. Another step in combating corruption was the enforcement of the new Political Parties Act which contained clear rules regarding financing political parties. In 2001, the government also submitted amendments to twenty-one laws with the many registration and licensing regimes to be either facilitated or eliminated – a step as much pointed to reducing market entry barriers as to fighting corruption. However, much was left to be done with regard to enforcement of provisions in various pieces of legislation aiming at curbing corruption (European commission, 2001).

In February 2001, an Action Plan for Implementation of the Strategy for Combating Corruption for the years 2001-2002 where particular measures, responsible persons and deadlines were outlined, was approved by the Council of Ministers. In addition, a committee was created in order to coordinate activities in the fight against corruption. In 2001, the country's ranking of indices of perceived corruption improved.

Amendments to a number of laws were adopted in 2002. Among them was the Penal Code which introduced more precise provisions on corruption and organised crime.

On the international side, Bulgaria ratified the Criminal law Convention on Corruption and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime in November 2001. The country is also a party to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and is a member of the Council of Europe Group of States against Corruption (GRECO). According to the report of GRECO which was adopted in May 2002, more had been done in improving the legal framework for combating corruption than in its actual implementation and enforcement. The major critics concerned the slowness of the criminal procedure and the lack of many actual sanctions (Commission of the European communities, 2002).

In October 2002, a parliament commission for fight against corruption was created. In 2003 income and property declarations became compulsory for magistrates and their spouses and children and for customs officials. In the same year, the National Association of Court Officials adopted a code of ethics which specified the actions court clerks should undertake in case of being offered a bribe (Commission of the European communities, 2003).

In December 2003, the government adopted updated Action Plan for Implementation of the Strategy for Combating Corruption which covered the period 2003-2005. An inter-ministerial committee responsible for implementation of the strategy and the action plan was set in February 2003. The emphasis was put on preventing corruption and development of control. In February 2004, the Supreme Judicial Court adopted a strategy for the fight against corruption in the judicial system In addition, in March a professional code of ethics for judges was approved.

Special investigation departments were set up by the Supreme Cassation Prosecutor's Office. In addition, in November 2003 a Commission for Prevention and Counteracting Corruption was established under the authority of the Supreme Judicial Council with the purpose to outline the policy for the fight against corruption in the judicial system. Special units in many institutions including police and border guards were created in order to combat corruption. As a result of all undertaken reforms and measures, the number of pre-trial proceedings on corruption charges increased in 2003 (Commission of the European communities, 2004).

In February 2005 the Strategy for Combating Corruption was updated in order high-level corruption, including corruption in the administration of executive power and public procurement, to be addressed. In the same year a new Law on Political Parties was adopted aiming at a further increase in transparency and accountability of funding and thus eliminating corruption practices in this field. In addition, in September 2005 amendments to the Law on Administrative Violations and Sanctions were adopted in order to set the liability of legal persons. The necessary structures to fight with the corruption within judicial system, enforcement agencies and the Ministry of Interior were functioning though with varying effectiveness (European commission, 2005).

Eventually, in December 2005, a Code of ethics regulating the work of government members and politically appointed officials was adopted by the Council of Ministers. According to the code, the persons referred to could not be partners in private entities, were set to be responsible for managing the resources appointed to them and had to take measures to prevent corruption. In January 2006, after consultations with non-governmental organizations, the new Anti-Corruption Strategy for the period 2006-2008 and the Action Plan for its implementation were adopted, both of them aiming at fighting the high-level corruption.

Also in the beginning of 2006, an Ethics committee was established in the parliament. In March, constitutional amendments allowing for lifting the immunity provided that a member of the Parliament had given his written consent for opening of court case were passed. At the same time, a specialised department designed to supervise the pre-trial procedure in cases concerning high-level corruption or organized crime was created at the General Prosecutor's Office (Commission of the European communities, 2006).

As of May 2006, the Commission of the European communities concluded that "overall, certain progress has been made in fighting corruption. Bulgaria needs to present clear evidence of results in its fight against corruption, in particular high-level corruption."(2006, p. 8).

3.3.4. Market entry and exit, protection of property rights and enforcement of contracts, financial intermediation and infrastructure

According to the Commission of the European communities annual progress reports for the period 2001-2006, the progress in these areas was as follows.

Market entry and exit

In 2000, entry and exit of the market place were not working properly. At this time there were more than five hundred licensing regimes, which imposed additional time and money burden on enterprises and created preconditions for corruption due to the lack of transparency in procedures. Regarding market exit, the insolvency procedure was very slow due to the lacking legislative provisions regarding deadlines for debtors to pay their dues to creditors.

Accordingly, during the entire period licensing regimes had been being eliminated or simplified. In parallel, in 2002 a new bank bankruptcy law was adopted whose provisions aimed at speeding up the procedure. In June 2003, in the adopted amendments of the Commercial Code, it was stated that a company which failed to make an outstanding payment in sixty days after it was due should be considered insolvent.

A new Law on Investment Promotion set shortened deadlines for authorization of major investment projects. Also, the long waited Law on Bulstat registry was passed in April 2005 which was to serve as a base for establishment of a central register of legal entities. Following this, in March 2006 a new Commercial Register Law aiming at turning a business registration into a pure administrative procedure and taking it out of courts competencies was adopted.

Amendments to the insolvency legislation were submitted to the Parliament in November 2005 aiming at increasing efficiency and the speed of insolvency procedures.

Protection of property rights and enforcement of contracts

In 2000, contract enforcement had been suffering from the slow and inefficient judiciary system because of which in most cases parties did not file cases in courts when contracts had not been respected. Accordingly, the extent to which contracts were respected was low due to the lack of reliable enforcement. Likewise, the enforcement of property rights was hampered by the insufficient legislative framework. However, large foreign companies were sometimes able to overcome these obstacles by turning directly to political decision-maker but this option was rarely available for smaller or domestic companies.

Unfortunately, as of May 2006 not much had been done with respect to improving property rights and contract enforcement. This was due mainly to the dependence of their effectiveness on the effectiveness of judicial system and to a lesser extent on the effectiveness of the state administration.

Financial intermediation

In 2000, financial intermediation on behalf of banking system was very limited and low. The total amount of credits to the private sector amounted to 14.7 % of GDP. Gradually, the level of financial intermediation improved. At the end of 2001, credit to the private sector increased to 15 % and further to 19 % at the end of 2002 and continued to increase with 50 % pace annually.

Infrastructure

In 2000, many investors stated the low quality of road, railway and port infrastructure as a major obstacle in front of their business. In general, during the entire period the quality of infrastructure remained low and slowly improving. The transport infrastructure had been being upgraded through the joint efforts of Bulgarian government and international organizations, mainly funded wit money from the pre-accession EU funds. The information and telecommunication infrastructures were steadily improving though at a different pace within different areas. The fixed telephone network was making a slow progress, while mobile telephone and internet networks were rapidly improving. Energy infrastructure investment was oriented towards the physical unbundling of the sector, improving the quality for the final consumers and connecting networks with the neighbouring countries.

While it is true that most of the reforms in the present section were undertaken in order Bulgaria to fulfil the criteria for full membership in the EU, it is out of question that they also helped improving business environment in the country immensely. For example, the number of procedures necessary to go through in order to start a business in 2004 had been ten, the entire procedure duration had been thirty days, the costs had amounted to 8.3 % of income per capita and the required minimum capital had amounted to 134.4 % of income per capita (World bank, 2004). To make a comparison, in 2007 the number of procedures was nine and it took thirty-two days and 7.9 % of income per capita to start a new business; the required minimum capital was in the range of 91 % of income per capita (World bank, 2007). These numbers show some progress but as the European commission pointed at the edge of the accession of Bulgaria into the EU, mush had left to be done. However, the advancement in improving business environment and encouraging FDI was visible. Moreover, the efforts and determination of the government and all other institutions which are engaged in the process of reformation influence positively investors' perception about options of undertaking business in Bulgaria.

V. LIMITATIONS AND IMPLICATIONS FOR FURTHER RESEARCH

Many factors could be outlined as determinants of FDI in general and in transition economies in particular. I am not aware of any other research which covers thoroughly FDI determinants in Bulgaria. However, when taking into account the qualitative and descriptive nature of the current thesis, one direction for further research could be the quantitative examination of the impact of the factors referred to in the thesis. While it is true that the factors interact with each other, it would be instructive to examine the influence of which one is the strongest.

In addition, it would be interesting to observe how the investment climate in the country will change in the future, including because of the reforms recommended by the EU at the edge of the accession of Bulgaria. It is unquestionable that resources from the EU funds could assist further development of the country especially with respect to development of infrastructure. It would be worth examining how Bulgaria will manage these resources in order to further improve the investment climate in the country and attract larger amount of FDI flows.

Finally, another direction for further research work is to analyse the process of real income convergence of Bulgaria with the EU countries. It has been shown that wages in Bulgaria are the lowest in the EU. Since FDI is among the major vehicles of economic development and income convergence it is worth investigating the convergence process. More concrete research questions could be approximately when this convergence will take place and what its impact on FDI flows in general and on the efficiency-seeking one in particular will be.

VI. CONCLUSION

In the light of FDI boom at the end of twentieth and the beginning of the twenty-first century, determinants and effects of FDI have been gaining attention and the amount of research work dedicated to them has been rising. Among the most interesting research questions is the one about factors determining FDI flows into transition economies and especially those in the Central and Eastern Europe. Among transition economies in this region, Bulgaria stands out as the one with the fastest growing FDI inflows during the period 2003-2007.

In the current master thesis, considerable attention is paid to several factors determining FDI inflows. Firstly, privatization process is examined. After investigating various aspects of privatization, this paper concludes that while it played a substantial role in attracting FDI in the beginning of the period, when approaching its end, M&A between private companies and especially greenfield investment are gaining larger importance as channels of inward FDI.

Secondly, when compared with Western and even Central European countries regarding factors determining efficiency-seeking FDI, Bulgaria and Romania turn out to have advantage with respect to quality and abundance of labour and labour costs. When combined with removed trade barriers like tariffs and quotas which reduced the overall level of trade cost and more or less equalized it with the one of Western and Central European countries, Bulgaria and Romania clearly have the potential of becoming an attractive geographic cluster for efficiency-seeking FDI and there is no reason to reject this assumption as a factor determining the significant increase of FDI flows to Bulgaria.

Finally, I find out that many of the reforms undertaken by Bulgarian institutions with respect to the upcoming EU accession have had a positive impact on the investment climate in the country. Actually, the conditions for doing business in Bulgaria have improved during the investigating period. Nevertheless there is still much work to be accomplished, the determination of the government increased the credit rating of the country which is proved to influence investors' decision when choosing location for undertaking FDI. Thus reforms launched in Bulgaria during the period 2002-2007 have influenced positively FDI inflows to the country.

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APPENDIX

Appendix 1: FDI inflows, Millions of US $

Country	1990-1995 (annual average)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Bulgaria	57	109	505	537	819	1002	689	905	2097	2488	3923	7507	8429
Check republic	120[a]	516	551	1014	1635	1127	1442	8483	2101	4463	11658	6013	9123
Croatia	947	1428	1300	3718	6324	4986	4916	1126	2042	1076	1788	3423	4925
Estonia	165	150	267	581	305	387	538	284	891	926	2879	1674	2482
Hungary	1 863	2275	2173	2036	1944	1643	2414	2994	2162	4167	7709	6790	5571
Latvia	116[b]	382	521	357	348	408	201	254	300	647	713	1664	2173
Lithuania	36[b]	152	355	926	486	379	446	732	179	773	1032	1840	1934
Poland	1396	4498	4908	6365	7270	9342	8830	4131	4123	6159	10363	19198	17580
Romania	162	263	1215	2031	1041	1025	1137	1144	2213	5174	6483	11366	9774
Serbia and Montenegro	...	...	178[c]	113	112	25	165	137	1360	966	2087	5118	3985
Slovakia	147	251	220	684	390	2075	1475	4094	669	1122	2107	4165	3265
Slovenia	100	194	375	248	181	176	442	1686	337	516	577	645	1426

Source: Annex table B.1., UNCTAD (2002, 2004, 2005, 2008)
[a] Annual average from 1993 to 1995
[b] Annual average from 1992 to 1995
[c] Annual average from 1992 to 1997

Appendix 2: FDI inflows as a percentage share of GDP

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Bulgaria	0.25	1.20	1.21	1.78	2.00	1.28	1.55	3.38	3.70	5.49	9.41	9.81
Check republic	0.37	0.39	0.71	1.11	0.73	0.87	4.93	1.14	2.26	5.59	2.67	3.68
Croatia	4.14	3.46	9.50	16.15	12.06	11.02	2.32	3.95	1.93	3.03	5.32	6.93
Estonia	1.51	2.37	4.86	2.52	2.89	3.71	1.75	4.93	4.66	13.03	6.72	9.09
Hungary	2.35	2.10	1.85	1.68	1.31	1.75	2.01	1.38	2.54	4.51	3.74	2.95
Latvia	2.69	3.33	2.14	1.98	2.14	0.96	1.10	1.21	2.38	2.38	4.88	5.51
Lithuania	0.65	1.37	3.28	1.73	1.26	1.34	2.00	0.43	1.73	2.13	3.44	3.21
Poland	1.44	1.44	1.76	1.90	2.31	2.11	0.93	0.90	1.24	1.97	3.39	2.87
Romania	0.19	0.94	1.63	0.84	0.78	0.77	0.72	1.33	2.72	3.19	4.84	3.60
Serbia and Montenegro	…	…	…	…	…	0.03	0.02	0.22	0.14	0.29	0.64	0.45
Slovakia	0.51	0.42	1.23	0.69	3.51	2.27	5.87	0.91	1.42	2.42	4.29	3.01
Slovenia	0.71	1.28	0.80	0.55	0.51	1.21	4.29	0.83	1.16	1.23	1.29	2.64

Source: Annex table B.1., UNCTAD (2002, 2004, 2005, 2008); http://w3.unece.org/pxweb/Dialog/Saveshow.asp for GDP in Millions of US $ at prices and purchasing power parities (PPPs) of current year; author's calculations