Internationalization of Emerging Economies and Firms

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Foreign Direct Investment in New EU Member States from Central and Eastern Europe: An Investment Development Path Perspective

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Introduction

The interface and interplay between inward and outward foreign direct investment (IFDI and OFDI), coupled with economic development, constitutes the essence of the Investment Development Path (IDP) paradigm, the central theoretical model in this study. In the context of this model, a comparative analysis is conducted of the IDPs of ten Central and Eastern European (CEE) countries, all members of the European Union (EU). They include Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. This group of countries shows relative homogeneity in terms of sharing the same communist heritage, common experience in establishing and developing a market economy, and in acceding to the EU: with eight countries joining the EU in 2004 and two (Bulgaria and Romania) in 2007. All of these countries show relative homogeneity in terms of many socio-economic variables (Niroomand and Nissan, 2007) and have exhibited a tendency to economic convergence over the last two decades (Amplatz, 2003; Matkowski and Próchniak, 2007). At the same time though, there are considerable differences between them in their level of development and in completion of the transition process to the market-led system. In fact, one can distinguish more homogenous subregions in the CEE-10 group (see e.g. Caporale et al., 2009), namely the Central European countries (the CEE-5: the Czech Republic, Hungary, Poland, Slovakia and Slovenia), the Baltic countries (the B-3: Estonia, Latvia and Lithuania), and the two Balkan countries located in south-eastern Europe (the SEE-2: Bulgaria and Romania). Particularly the latter states are handicapped with a considerable development gap separating them from the transition leaders of the CEE-5. Thus in this study we undertake to determine how these

factors of homogeneity in some areas and heterogeneity in other areas influence the individual countries' IDP trajectories.

The main purpose of this chapter is to determine the timing and explore the factors that have influenced the movement of these ten CEE countries through their IDP stages. Thereafter, conclusions and policy recommendations are presented, which are not only applicable to the analysed countries, but which might serve as guidelines or simply be of interest to other CEE states, particularly those that may be or want to be considered as prospective members of the EU.

The datasets used in this study have been derived from the *Handbook of Statistics* (UNCTAD, 2009) and the *Statistical Yearbook of the Republic of Poland* (GUS, 2000–09). The data collected cover the entire period of the ten countries' transition process up to 2008, the last year for which relevant data for all countries were available.

We set out by presenting the IDP model (paradigm) and briefly describing its five stages. We then review the relevant literature, focusing on those studies that applied the IDP model to CEE economies. In the subsequent section, we try to determine the current positioning of the ten countries on the IDP, using a graph depicting the relationship between net outward investment position (NOIP) per capita and GDP per capita, and tables presenting detailed data on IFDI and OFDI stocks and NOIP's absolute values. In doing so, we also highlight the EU accession effects on the countries' move through stages 2 and 3, and the effects of the recent economic and financial crisis on their NOIP dynamics. In a second analytical section, a regression analysis is conducted to verify findings from the previous section. Thereafter, we focus on the CEE-10 countries' OFDI and apply the OFDI performance index in our analysis of that outward investment. The index is used to supplement and enrich the analysis of the countries' IDP positioning conducted in the previous sections. In the concluding section, we summarize our findings and reveal a need to add new theoretical considerations to the IDP original model. We also outline future research avenues in the area of the IDP of CEE countries.

The IDP concept and its application in the studies of CEE countries

The concept of the IDP, which relates to FDI, was first proposed by Dunning in the early 1980s (Dunning, 1981). This was further refined by Dunning (1986, 1997), Dunning and Narula (1994, 1996, 2002) and Narula and Dunning (2000). Several other authors have made significant contributions to the development of the concept, including Lall (1996) and Durán and Úbeda (2001, 2005). According to the basic IDP proposition, the inward and outward foreign investment position of a country is tied with its economic development. Changes in the volume and structure of FDI lead to different

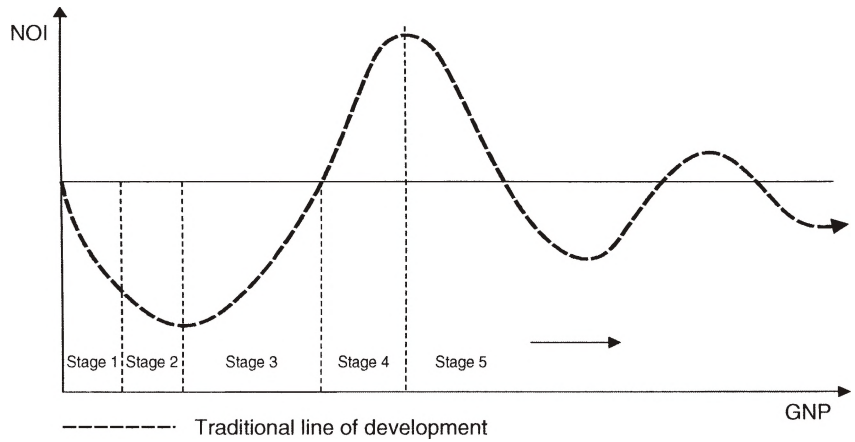

Figure 4.1 The pattern of the Investment Development Path

Note: Not drawn to scale. The IDP curve shown is called by Dunning and Narula (2002) a traditional one. On this traditional curve, they superimposed a curve, parallel to the traditional one but flatter (ibid.:139), that, according to these authors, reflects technological and organizational changes in FDI emerging in the 1990s.

Source: Dunning and Narula (2002:139).

values in the country's net outward investment (NOI) position, defined as the difference between gross outward direct investment stock and gross inward direct investment stock. The changing NOI position passes through five stages intrinsically related to the country's economic development (Dunning and Narula, 2002).[1] A diagrammatic representation of the IDP model is depicted in Figure 4.1

In Stage 1 of the IDP, the NOI position is initially close to zero and subsequently assumes negative, but rather small, values. IFDI is negligible and flowing mostly to take advantage of the country's natural assets. OFDI is also negligible or non-existent, as foreign firms prefer to export and import as well as to enter into non-equity relationships with local firms (Dunning and Narula, 2002:140). As a country develops and improves its L-specific advantages,[2] it experiences an increased inflow of FDI and enters Stage 2 of the IDP. With OFDI remaining still low but larger than in the previous stage, the NOI position continues to decrease, although towards the latter part of Stage 2 the rate of decrease slows down as the growth of OFDI converges with that of IFDI. Stage 3 is reached by a country when it experiences an improving NOI position, although it remains negative, due to an increased rate of growth of OFDI and a gradual slowdown in IFDI, geared in this case more towards efficiency-seeking motives and away from import-substituting production. OFDI is stimulated by domestic firms acquiring new O-specific advantages,[3] which are

increasingly based on intangible assets and which reflect these firms' ability to manage and coordinate assets and activities across national borders (Dunning and Narula, 2002:142). In Stage 4, OFDI stock continues to rise faster than the inward one, and the country's NOI position crosses the zero level and becomes positive. Country L-specific advantages are now mostly derived from created assets and its firms' O-specific advantages develop and lead to their increased international competitiveness, as the indigenous firms seek to maintain their competitiveness by moving their operations to foreign countries. In Stage 5, the NOI position first falls and thereafter demonstrates a tendency to fluctuate around zero but usually with both IFDI and OFDI increasing. This stage is characterized by two main phenomena: (i) the growing propensity of MNEs to internalize their cross-border transactions (as opposed to relying on the market) and to engage in an increasingly complex web of cooperative agreements among themselves; (ii) a convergence of Stage 5 countries' economic structures and their international direct investment positions. Stages 4 and 5 are typical of the most developed countries (ibid.: 143–4).

A conceptual evaluation of the IDP model, as evidenced in developed as well as in developing and newly industrialized countries, is undertaken by Lall (1996). Lall maintains that structural changes in ownership and location factors influence trends in international capital flows, corporate behaviour and government policy. According to one of his suggestions the IDP could be better measured by the international transfer of intangible assets instead of relying only on FDI. His main observation is that countries exhibit long-term deviations from the IDP model, caused mainly by the nature and efficacy of government policy. This might necessitate extending and modifying the model itself to encompass all the identified subpatterns.

A more recent comprehensive evaluation of the IDP concept, its shortcomings and suggestions for its modification are found in the studies of Durán and Úbeda (2001, 2005). In calling for a new approach to the IDP, they draw attention to such methodological problems as the incompleteness of the concept of NOI position as an indicator for analysing the effects of structural changes on IFDI and OFDI, and then the insufficiency of GDP per capita as the indicator of a country's level of economic development. The first dilemma appears in countries where hardly any IFDI and OFDI is made and which are classified as being in Stage 1 of the IDP. Their NOI position will be close to zero, similar to developed countries in Stage 5 of their IDP. To solve this paradox, Durán and Úbeda propose looking at IFDI and OFDI in absolute and relative terms. Suggestions for dealing with the second issue revolve around the inclusion of structural variables, which would reflect not only the degree of economic development but also each country's peculiarities and the nature of its international trade.

Another significant contribution to the debate around the IDP concept made by Durán and Úbeda concerns their redefinition of Stage 4. In

the amended version it is proposed to include developed countries which have: (a) a structural gap due to fewer endowments of created assets; (b) the same levels of IFDI as those in Stage 5 but smaller OFDI compared to those in Stage 5; and (c) a positive or negative NOI position, but in all cases lower than that of countries in Stage 5. All the proposed modifications depend on the availability of additional or more detailed data and offer much wider analytical possibilities.

The IDP model has been used as a framework in numerous empirical studies, which by and large have attempted to validate it by either employing cross-sectional or longitudinal datasets.[4] However, a relatively small number of studies could be identified that directly or indirectly deal with IDPs of CEE countries, of which only four represent a cross-nation comparative analysis.[5]

Boudier-Bensebaa (2008) undertakes a comparative analysis of the IDP in the whole region of CEE (including the former Soviet Republics) and the EU of 15 member states. The 'Eastern' countries concerned are classified into four distinct groups according to their per capita level of GDP and NOI. Their NOI places them in Stages 1 or 2 of the IDP, while that of the EU countries points to Stages 4 or 5. The first most advanced group of the Eastern countries consists of the Czech Republic, Estonia, Slovenia, Hungary, Slovakia, Poland, Latvia, Lithuania and Croatia. The said group is identified as moving towards the end of Stage 2 of their IDPs or even towards the beginning of Stage 3. The NOI of the Eastern countries' groups and subgroups reveals a tendency to converge. But as far as income levels are concerned, no convergence is found either inside the countries or between them and the EU. Finally the author draws attention to the fact that data on FDI stocks and GDP do not cover all the factors affecting FDI and development. In the FDI sphere, left out are the non-equity forms of investment. As for the effect on FDI, besides GDP, elements such as EU accession, globalization and the transformation process per se should be also taken into account. Boudier-Bensebaa focuses on cross-sectional analysis across countries and does not attempt to assess and explain the individual countries' IDP trajectories. This missing element is taken up by us in this study. We argue that individual countries' IDP idiosyncrasies can provide a deeper understanding and a more insightful explanation of the varying IDPs and their convergence or divergence within groups of countries.

In the second cross-nation study focused on CEE, Kottardi et al. (2004) attempt to integrate Dunning's IDP model with Vernon's Product Life Cycle and Hirsch's International Trade and Investment Theory of the Firm. These authors analyse the location determinants of IFDI and the interrelationship between IFDI and imports during the years 1992–2000 in eight new EU member states from CEE and two candidate countries – Bulgaria and Romania. They find evidence of the ten CEE countries going through the second stage of the IDP and gradually moving towards the third stage,

which corroborates the findings of Boudier-Bensebaa (2008) with respect to the most advanced CEE economies, labelled CEECs1.

Studies by Kalotay (2004) and Svietličič and Jaklič (2003) focus on OFDI from CEE. While the former study uses the IDP framework, the latter does not. Kalotay (2004) examines OFDI from most of the 2004 accession CEE countries plus Croatia, placing these countries in Stage 2 of their IDPs. This author predicts that accession of the eight CEE countries to the EU in 2004 should give a major push to both their OFDI and IFDI, with an uncertain net impact of such a development on the IDP. However, based on the experience of Portugal (Buckley and Castro, 1998) and Austria (Bellak, 2001), Kalotay hypothesizes that CEE countries being at the time of accession to the EU on the verge of moving from Stage 2 to 3 will be held back in their transition.

Svietličič and Jaklič (2003), while not using the IDP paradigm as a framework, conduct a comparative analysis of several CEE countries' OFDI (the Czech Republic, Estonia, Hungary, Poland and Slovenia). Their analysis clearly demonstrates that major increases of FDI outflows started in the latter part of the 1990s. This is yet another indication of the CEE countries entering Stage 2 of the IDP during that period. At the same time Svietličič and Jaklič find positive correlation between a country's level of development and its rate of investment abroad, and observe that OFDI of the five countries under study tends to be geographically concentrated in countries with close historical or cultural ties.

Econometric analysis in IDP studies

Many of the IDP studies apply econometric modelling in testing the paradigm. Dunning himself (1981, 1986) and Dunning and Narula (2002) postulated and used a quadratic specification to describe the IDP curve (the formula for this specification is presented later in this chapter). A quadratic function allows for the non-linearity in the relationship. The same function has been used by several other authors analysing IDPs of individual countries or groups of countries (see e.g. Tolentino, 1987; Narula, 1996; Barry et al., 2002; Boudier-Bensebaa, 2008). Other authors (see e.g. Buckley and Castro, 1998; Bellak, 2001) found a cubic specification that fitted their empirical data better.[6]

Some other approaches to econometric analysis of IDP are also noteworthy. Durán and Úbeda (2001, 2005) for example applied factor and cluster analyses to identify the countries reaching specific stages of the IDP. These authors also applied panel data analysis for a number of Stage 4 countries. Similarly Boudier-Bensebaa (2008) applied a quadratic equation to a panel of 27 CEE countries and ran the regression not only for the entire sample but also for two clusters in that group.

Current positioning on the IDP

The last two years under consideration have brought significant changes in the positioning of the ten investigated economies on their respective IDP trajectories. As visualized in Figure 4.2, and further recorded in Table 4.1, five countries in descending order (Hungary, Estonia, Lithuania, Poland and the Czech Republic) were clearly in their IDP Stage 3. Their NOIPs[7] per capita increased in 2008 relative to the previous year (i.e. decreased in absolute values). The smallest increase was curiously recorded for the Czech Republic – the country exhibiting the highest GDP per capita of the above-listed group (US$20,815). Hungary had the highest increase but at a lower GDP per capita of US$15,408. The lowest GDP per capita was that of Poland in the Stage 3 group of countries (US$13,861). Those leaders were with respect to their level of development in the upper middle segment of all the analysed countries. At the least developed end, there was Bulgaria with decreasing (i.e. rising negative) NOIP and GDP per capita of only US$6,573 in 2008.

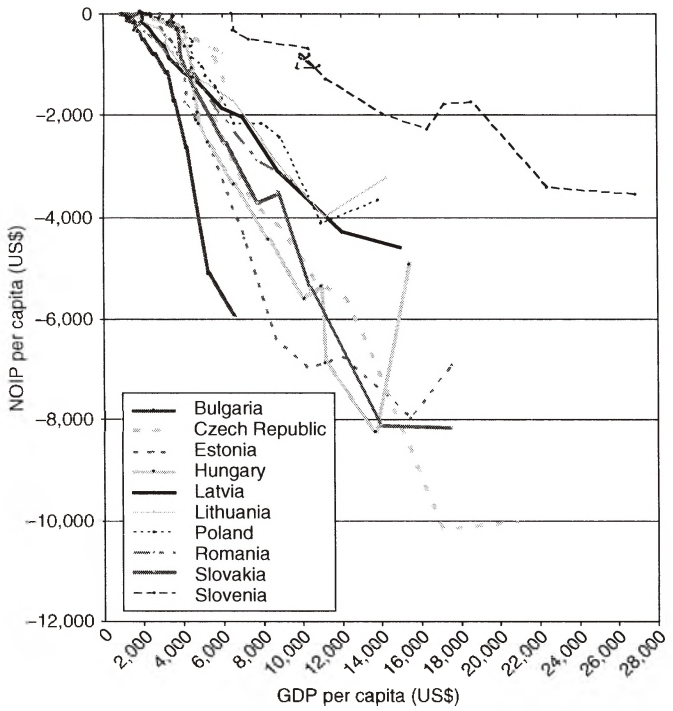

Figure 4.2 NOIP per capita and GDP per capita in US$, 1990–2008, CEE-10 countries
Source: Authors' calculations based on UNCTAD (2009) and (GUS, 2000–09).

At the other end was Slovenia with the top GDP per capita of US$26,905, though its NOIP in 2008 was still slightly decreasing, indicating the forthcoming advent into IDP Stage 3 as well. Bulgaria and Romania were still in the second half of their IDP Stage 2, as well as Latvia, which was closer to the beginning of its IDP Stage 3. Slovakia's NOIP per capita in 2008 was only very slightly higher than in 2007, indicating that the country was at the turning point from Stage 2 to Stage 3 of its IDP.

According to the original model of Dunning, the shift to IDP Stage 3 takes place when the NOIP, and in our case NOIP per capita, starts to rise. In the latest two years for which data are available such shifts in the whole group of countries under investigation has been described above. But it must be stressed that in four countries such shifts were already observed a few years earlier. In the case of Hungary, Slovenia and Slovakia such a shift was visible four years earlier, i.e. in 2004. In that year, all of them became full members of the EU and this accession effect could be held responsible for the said shift in their NOIPs. Also a reinforcing factor was that those three economies were considered to be the most developed in the group of CEE states and the most advanced in the transition process to the market-led economic system. In the case of Estonia, a relatively small Baltic economy, a similar shift occurred in 2005, indicating a somewhat delayed EU accession effect. Thus the closeness to the latest shifts observed in 2008 indicates that final conclusions as to the permanency of passing to IDP Stage 3 require more time for verification.

The underlying causes for the NOIP per capita movements in countries which as of 2008 have been positioned to be in Stage 3 of their IDP require more scrutiny of changes in their stocks of OFDI and IFDI. These changes are recorded in Table 4.2. In two cases, that of Poland and Estonia, the net outcome of a decrease in their NOIPs per capita was due to their OFDI stock increasing for at least two years before and the IFDI stock decreasing from 2007 inclusive. This indicated that as for OFDI expansion and thus competitiveness of their firms these two economies had shown a relatively positive performance in the face of the severe economic downturn which started to afflict the global economy towards the end of 2007. But simultaneously this same business cycle factor may have been responsible for the fall in IFDI stocks. Also it cannot be easily determined whether the continuing outward expansion via FDI from those two countries was due to competitive advantages of domestic firms (the desired expected outcome) or simply indirect FDI, signifying expansion of subsidiaries of foreign MNEs from those countries, thus reflecting their much stronger and sustainable competitive advantage versus their domestic rivals. The retreat of foreign investors in those two cases also demonstrates that the risk associated with recession is not dependent on the size of the internal markets of these two countries, since Poland had the largest market measured by population, whereas Estonia had a much smaller one. Hungary, on the other hand,

Table 4.1 NOIP per capita, GDP per capita in US$ and OFDI Performance Index (OFDIPI) for ten CEE countries, 1990–2008

	1990	1991	1992	1993	1994	1995	1996	1997
Bulgaria								
NOIP per capita	0.001	−0.006	−0.011	−0.016	−0.029	−0.041	−0.058	−0.120
GDP per capita	2,350	873	995	1,267	1,149	1,568	1,197	1,265
OFDIPI	−0.014	−0.093	−0.045	−0.029	0.000	−0.050	−0.223	−0.012
Czech Republic								
NOIP per capita				−0.314	−0.412	−0.679	−0.784	−0.845
GDP per capita				3,603	4,230	5,360	6,022	5,559
OFDIPI				0.257	0.269	0.055	0.188	0.027
Estonia								
NOIP per capita				−0.130	−0.278	−0.422	−0.506	−0.666
GDP per capita			2,859	2,813	2,874	3,114	3,365	3,622
OFDIPI				0.102	0.112	−0.170	0.203	0.275
Hungary								
NOIP per capita	−0.036	−0.182	−0.310	−0.518	−0.657	−1.067	−1.262	−1.683
GDP per capita	3,546	3,319	3,702	3,836	4,125	4,443	4,499	4,564
OFDIPI	0.042	0.093	0.000	0.029	0.110	0.105	−0.007	0.613
Latvia								
NOIP per capita				0.054	−0.055	−0.155	−0.296	−0.431
GDP per capita			2,095	1,854	1,938	1,991	2,310	2,568
OFDIPI				0.102	0.112	−0.170	0.203	0.275
Lithuania								
NOIP per capita				−0.037	−0.088	−0.097	−0.193	−0.284
GDP per capita			2,168	1,867	1,730	1,788	2,271	2,795
OFDIPI				0.102	0.112	−0.170	0.203	0.275
Poland								
NOIP per capita	0.008	−0.001	−0.025	−0.057	−0.086	−0.189	−0.278	−0.361
GDP per capita	1,694	2,189	2,406	2,446	2,813	3,603	4,059	4,073
OFDIPI	0.007	−0.010	0.018	0.020	0.026	0.025	0.026	0.018
Romania								
NOIP per capita	0.003	0.002	−0.002	−0.005	−0.013	−0.031	−0.043	−0.102
GDP per capita	1,659	1,254	854	1,157	1,327	1,575	1,576	1,583
OFDIPI	0.045	0.012	0.026	0.028	0.000	0.005	0.000	−0.016
Slovakia								
NOIP per capita				−0.093	−0.137	−0.216	−0.347	−0.347
GDP per capita				2,550	2,939	3,676	3,977	4,007
OFDIPI				0.102	0.112	−0.170	0.203	0.275
Slovenia								
NOIP per capita				−0.345	−0.511	−0.693	−0.799	−0.886
GDP per capita			6,445	6,496	7,347	10,329	10,393	9,992
OFDIPI				0.102	0.112	−0.170	0.203	0.275

Note: OFDIPI–OFDI performance index reflects the ratio of the share of a country's OFDI from the world's total in a given year to the share of the country's GDP from the world total GDP in a given year.

Source: UNCTAD (2009) and GUS (2000–09).

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
−0.187	−0.297	−0.327	−0.362	−0.506	−0.799	−1.162	−1.728	−2.647	−5.100	−5.914
1,567	1,607	1,574	1,711	1,965	2,546	3,148	3,496	4,160	5,259	6,573
0.000	0.037	0.006	0.025	0.114	0.089	−0.419	0.6100	0.195	0.172	0.481
−1.323	−1.646	−2.046	−2.542	−3.646	−4.217	−5.248	−5.598	−7.106	−10.195	−10.036
6,030	5,880	5,549	6,058	7,379	8,959	10,615	12,165	13,863	17,004	20,815
0.088	0.042	0.019	0.113	0.167	0.149	0.444	−0.008	0.440	0.236	0.287
−1.169	−1.585	−1.742	−1.994	−2.616	−4.419	−6.413	−6.957	−6.754	−7.971	−6.922
4,102	4,152	4,108	4,544	5,385	7,093	8,638	10,230	12,038	15,471	17,538
0.281	−0.504	0.036	0.121	0.027	0.495	−0.024	0.178	0.267	2.126	1.517
−1.943	−2.181	−2.114	−2.537	−3.351	−4.422	−5.593	−5.343	−6.867	−8.249	−4.933
4,708	4,820	4,695	5,233	6,563	8,326	10,101	10,942	11,134	13,660	15,408
0.247	0.142	0.332	0.293	0.254	1.287	0.520	1.131	1.076	0.690	0.351
−0.529	−0.647	−0.866	−0.970	−1.148	−1.358	−1.850	−2.046	−3.095	−4.285	−4.581
2,788	3,041	3,293	3,520	3,972	4,802	5,944	6,969	8,781	12,013	14,956
0.281	−0.504	0.036	0.121	0.027	0.495	−0.024	0.178	0.267	0.310	0.224
−0.453	−0.578	−0.658	−0.752	−1.131	−1.401	−1.734	−2.187	−2.863	−3.980	−3.233
3,147	3,096	3,260	3,487	4,076	5,373	6,543	7,494	8,592	11,133	14,244
0.281	−0.504	0.036	0.121	0.027	0.495	−0.024	0.178	0.267	0.407	0.246
−0.553	−0.651	−0.864	−1.044	−1.222	−1.455	−2.174	−2.180	−2.436	−4.109	−3.662
4,487	4,364	4,458	4,959	5,165	5,655	6,592	7,951	8,916	10,978	13,861
0.078	0.005	0.002	−0.020	0.071	0.093	0.149	0.536	0.508	0.287	0.222
−0.197	−0.248	−0.308	−0.374	−0.349	−0.549	−0.932	−1.187	−1.891	−2.879	−3.299
1,885	1,600	1,673	1,824	2,090	2,726	3,475	4,557	5,684	7,726	9,518
−0.009	0.013	−0.009	−0.017	0.023	0.043	0.044	−0.016	0.012	0.042	−0.044
−0.466	−0.528	−0.811	−0.953	−1.493	−2.553	−3.727	−3.540	−5.391	−8.115	−8.153
4,164	3,825	3,795	3,917	4,552	6,122	7,800	8,804	10,402	13,958	17,566
0.281	−0.504	0.036	0.121	0.027	0.495	−0.024	0.178	0.267	0.129	0.089
−1.083	−1.038	−1.071	−0.808	−1.309	−1.985	−2.286	−1.782	−1.754	−3.422	−3.559
10,640	10,887	9,737	9,950	11,197	14,075	16,323	17,182	18,596	22,379	26,905
0.281	−0.504	0.036	0.121	0.027	0.495	−0.024	0.178	0.267	1.019	0.867

Table 4.2 Outward FDI stock, inward FDI stock and NOIP for CEE-10 countries, 1990–2008 (US$ millions)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Bulgaria									
OFDI Outward	124	118	116	112	113	105	76	74	75
IFDI Inward	112	168	210	250	355	446	555	1059	1597
NOIP	12	-50	-94	-138	-242	-341	-479	-985	-1522
Czech Republic									
OFDI Outward		70	91	181	300	345	498	548	804
IFDI Inward	1363	1886	2889	3423	4547	7350	8572	9234	14375
NOIP		-1816	-2798	-3242	-4247	-7005	-8074	-8686	-13571
Estonia									
OFDI Outward			57	63	65	68	108	215	198
IFDI Inward			96	258	473	675	825	1148	1822
NOIP			-39	-195	-408	-607	-717	-933	-1624
Hungary									
OFDI Outward	197	224	224	226	291	278	265	647	784
IFDI Inward	569	2107	3424	5576	7087	11304	13282	17968	20733
NOIP	-372	-1883	-3200	-5350	-6796	-11026	-13017	-17321	-19949
Latvia									
OFDI Outward			365	361	296	231	209	222	281
IFDI Inward			176	221	436	616	936	1272	1558
NOIP			189	140	-140	-385	-727	-1050	-1277
Lithuania									
OFDI Outward			0	0	0	1	3	26	17
IFDI Inward			107	137	321	352	700	1041	1625
NOIP			-107	-137	-321	-351	-697	-1015	-1608
Poland									
OFDI Outward	408	401	414	432	461	539	735	678	1165
IFDI Inward	109	425	1370	2621	3789	7843	11463	14587	22461
NOIP	299	-24	-956	-2189	-3328	-7304	-10728	-13909	-21296
Romania									
OFDI Outward	66	87	79	103	107	121	120	126	135
IFDI Inward	0	44	122	215	402	821	1097	2417	4527
NOIP	66	43	-43	-112	-295	-700	-977	-2291	-4392
Slovakia									
OFDI Outward		127	136	149	166	139	183	236	408
IFDI Inward	282	363	463	642	897	1297	2046	2103	2920
NOIP		-236	-327	-493	-731	-1158	-1863	-1867	-2512
Slovenia									
OFDI Outward			279	281	365	524	470	459	636
IFDI Inward			841	954	1365	1886	2043	2207	2777
NOIP			-562	-673	-1000	-1362	-1573	-1748	-2141

* According to UNCTAD data OFDI stock for Bulgaria in 2004 was negative, but no exact value is available. Therefore it was assumed that in this case outward FDI stock = 0.
Source: UNCTAD (2009) and GUS (2000–09).

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
11	85	68	81	103	*	181	343	528	1248
2403	2704	2945	4074	6371	9058	13565	20707	39484	46011
−2392	−2619	−2877	−3993	−6268	−9058	−13384	−20364	−38956	−44763
698	738	1136	1473	2284	3760	3610	5058	8557	9913
17552	21644	27092	38669	45287	57259	60662	77460	112408	114369
−16854	−20906	−25956	−37196	−43003	−53499	−57052	−72402	−103851	−104456
281	259	442	676	1028	1419	1940	3613	6174	6686
2467	2645	3160	4226	7002	10064	11290	12664	16815	15962
−2186	−2386	−2718	−3550	−5974	−8645	−9350	−9051	−10641	−9276
924	1280	1556	2166	3509	6018	7993	12693	17596	14179
23260	22870	27407	36224	48340	62585	61886	81760	100335	63671
−22336	−21590	−25851	−34058	−44831	−56567	−53893	−69067	−82739	−49492
244	24	39	59	114	235	284	447	880	1066
1795	2084	2328	2751	3277	4517	4993	7532	10637	11447
−1551	−2060	−2289	−2692	−3163	−4282	−4709	−7085	−9757	−10381
26	29	48	60	120	423	721	1183	1570	1990
2063	2334	2666	3981	4960	6389	8211	10939	15062	12847
−2037	−2305	−2618	−3921	−4840	−5966	−7490	−9756	−13492	−10857
1024	1018	1156	1457	2146	3223	6439	10705	19369	21814
26075	34227	41247	48320	57877	86366	89694	103616	175851	161406
−25051	−33209	−40091	−46863	−55731	−83143	−83255	−92911	−156482	−139592
144	136	117	144	208	273	214	278	1240	912
5671	6951	8350	7799	12188	20523	25894	41001	62961	71864
−5527	−6815	−8233	−7655	−11980	−20250	−25680	−40723	−61721	−70952
346	374	449	485	823	835	705	1282	1509	1901
3188	4746	5582	8530	14576	20910	19775	30327	45251	45933
−2842	−4372	−5133	−8045	−13753	−20075	−19070	−29045	−43742	−44032
626	768	988	1505	2350	3025	3515	3942	7197	8650
2682	2893	2594	4112	6308	7590	7077	7452	14048	15872
−2056	−2125	−1606	−2607	−3958	−4565	−3562	−3510	−6851	−7222

was the only country in the whole group which recorded falls both in IFDI and OFDI stocks, which contributed to the decrease in its NOIP per capita. This of course meant that the OFDI retreat was relatively smaller than the inward one. Thus the country leading in the movement into Stage 3 of its IDP was also the most sensitive to changes in the downturn of the business cycle. The effects of the recession in 2008 were also visible in Lithuania's IFDI stock rising in 2007 and then falling in the following year. At the same time its OFDI continued its unabated rise that had begun in 1998. The Czech Republic, as observed earlier, entered Stage 3 of its IDP, registering the smallest increase in NOIP per capita in the whole group. This was due to its OFDI stock rising slightly faster than its IFDI stock, which was also larger. The remaining countries in the group, i.e. Slovakia, Slovenia, Latvia, Romania and Bulgaria, all displayed slower rising OFDI stocks compared with faster rising IFDI stocks. This trend embraced relatively high GDP per capita countries (the first three) as well as the two least developed ones in the group.

Regression analysis

The above observations and findings based on descriptive analytical tools were subjected to verification using regression analysis. This was applied to the two principal variables of the IDP model: NOI per capita, as the dependent variable, and GDP per capita, as the independent variable. Two non-linear function specifications, quadratic and cubic, were applied.

In the analysis an attempt was made firstly to eliminate 'outliers' – extreme cases – and then to fit the appropriate curve to empirical data. Figure 4.3 shows the plot with country curves according to modelled data. The curves are different because of different data configuration. These regression curves were drawn through points on the scatter plot to summarize the relationship between the variables under investigation. All the curves slope down (from top left to bottom right), indicating an inverse relationship between the variables. Each regression curve represents the regression equation on a scatter plot. The regression equation shows the nature of the relationship between the two variables.

Data description

At first, a regression analysis based on a quadratic equation (in SPSS software) was conducted, related to the said variables. Non-linear regression was appropriate because the relationship between the dependent and independent variables was not intrinsically linear. It has been implemented according to Dunning's (1981) solution, with the idea of regressing NOI on GDP, and thus utilizing a quadratic specification (and further cubic one) in order to allow for the non-linearity in the relationship. As a result, a non-linear relationship was obtained between GDP per capita and NOI per capita.

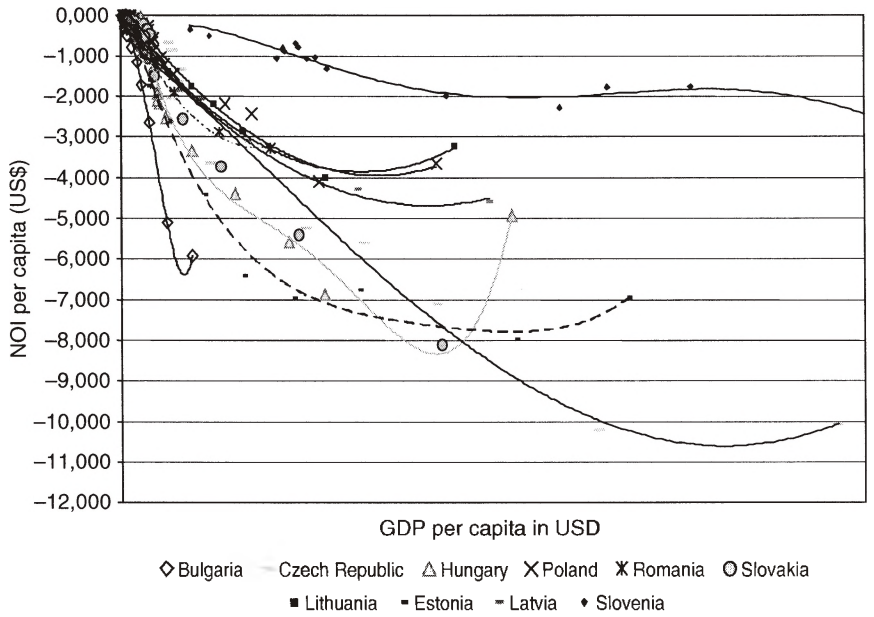

Figure 4.3 Non-linear relationship between NOI and GDP
Source: Authors' calculations.

A regression equation was primarily written as:

$$NOI = \alpha + \beta_1 GDPpc + \beta_2 GDPpc^2 + \mu \quad (1)$$

The equation specified the average magnitude of the expected change in Y given a change in X. In the course of examination according to available time series data the analysis embraced the period from 1990 to 2008 (for the countries Bulgaria, Hungary, Poland and Romania). A shorter period starting from 1993 to 2008 was used for the Czech Republic, Slovakia, Estonia, Latvia, Lithuania and Slovenia, because of the lack of data prior to 1993.

The analysis continued by experimenting with the regression function by allowing in a formula with a cubic equation, which was written in the following way:

$$NOI = \alpha + \beta_1 GDPpc + \beta_2 GDPpc^2 + \beta_3 GDPpc^3 + \mu \quad (2)$$

Where:

NOI – outward investment position of a country in a given year or at a given value of GDP per capita (NOI can be positive or negative) measured in US$ or EURO

GDPpc – gross domestic product per capita of a country in a given year measured in US$ or EURO
α, β, β and μ – coefficients depending on conditions in the countries for which NOI is calculated

Obviously the starting point of regression analysis was at first to fit a line to a number of points (crossing NOIP and GDP) in order to see at least the shape of the data on the plot. This is presented in Figure 4.3.

In proceeding further with the analysis based on quadratic and cubic formulas it was detected that regression coefficient values and fit of the models for quadratic assumptions were slightly lower than in the cubic ones. In some cases cubic formulas showed a much better fit of the variability being estimated. The relationship between the model and the dependent variable was quite strong. One can consider for example the R score as a multiple correlation coefficient.

The obtained R^2 values[8] were ranked in descending order (according to the non-linear regression quadratic function) of variability within the observed values. As a result, the variability of models could be explained for the investigated countries in the following descending order: (1) Latvia, (2) Romania, (3) Slovakia, (4) Czech Republic, (5) Bulgaria, (6) Poland, (7) Slovenia, (8) Lithuania, (9) Estonia and (10) Hungary. And as far as R^2 values were concerned, based on cubic calculations, the following descending order of countries was obtained: (1) Latvia, (2) Romania, (3) Slovakia, (4) Czech Republic, (5) Bulgaria, (6) Lithuania, (7) Poland, (8) Slovenia, (9) Estonia and (10) Hungary (see Table 4.3).

Having thus compared both types of analysis, one may infer that different characteristics in formulas result in only minor alterations (changes) in each country model's variability explanation. In some countries the R^2 values remain actually on the same level – no matter whether the quadratic or cubic equation is selected. This specific situation refers to countries such as Slovakia, Romania, Poland and Latvia. The biggest change appears in Bulgaria, Hungary and Lithuania.

The independent variable denotes NOI per capita and the dependent variable GDP per capita. The non-linear model provided very strong results for all parameters, which are highly significant in the overall model (F statistic at 5 per cent level).

Interpretation of findings

Based on the results of the regression analysis as shown in Figure 4.3, certain amendments to the findings based on the more descriptive analysis presented on pp. 000–000 need to be considered in this section. Firstly, Slovakia appears as the leader in the whole group, being the most

Table 4.3 Non-linear regression statistics for quadratic and cubic equations

	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Estonia	Latvia	Lithuania	Slovenia
Quadratic models GDPpc^2										
R – [Multiple R]	0.973	0.979	0.912	0.963	0.994	0.983	0.939	0.994	0.956	0.958
R^2 – [R – square]	0.946	0.959	0.831	0.927	0.987	0.967	0.881	0.988	0.913	0.917
Cubic models GDPpc^3										
R – [Multiple R]	0.979	0.981	0.928	0.964	0.994	0.983	0.941	0.994	0.964	0.960
R^2 – [R – square]	0.958	0.963	0.862	0.929	0.988	0.967	0.885	0.989	0.930	0.921

Source: Authors' calculations based on SPSS software.

advanced in Stage 3 of its IDP. In the descriptive approach it was positioned at the turning point from Stage 2 to Stage 3. Hungary, Lithuania and Estonia generally exhibit the same level of advancement to Stage 3 of their IDPs, whereas in the previous approach they were visibly differentiated, although they were also well into that stage. Poland, Latvia and the Czech Republic all are positioned at the beginning of Stage 3 of their respective IDPs, whereas earlier Latvia was described as being still positioned in Stage 2 of its IDP. In the regression analysis, Poland as the largest economy enters Stage 3 at a smaller GDP per capita than Latvia, and Latvia enters the same stage at a GDP per capita level still smaller than that of the Czech Republic.

Then there is the curious case of Slovenia. This country's positioning seems to show a fluctuation pattern around the turning point from Stage 2 to Stage 3 of its IDP. In the descriptive approach it was edging towards the end of Stage 2, with the highest GDP per capita of all the countries of the group positioned still in Stage 2 of their IDPs.

Romania and Bulgaria in the descriptive analysis were said to be somewhere in the second half of Stage 2 of their IDPs. But according to the regression analysis, Romania seems to be at the turning point from Stage 2 to Stage 3 of its IDP. However, the largest discrepancy concerns the positioning of Bulgaria. At first glance, Figure 3.3 suggests that Bulgaria is already in Stage 3 of its IDP, whereas descriptive analysis positioned its economy in the last place among the group of ten countries analysed, both with respect to the GDP per capita and the movement along its IDP. However, one cannot help noticing an atypical regression curve in the case of Bulgaria, which does not have the same shape as the curves of the Stage 3 countries. Bulgaria's curve first slopes to the left, which is an indication of a country going through the first part of Stage 2, and then it suddenly turns up at the end of the analysed period. Therefore it could be interpreted as a 'more dramatic' passage to the second part of Stage 2 rather than to Stage 3. Indeed, a closer look at the OFDI and IFDI stock statistics for Bulgaria (Table 4.2) confirms this assertion, i.e. that the country's OFDI remained negligible until 2006, when it started to grow rapidly and continued to do so over the next two years. However, even in 2008, when OFDI stock doubled compared to the previous year, it was still seven times lower than that of Slovenia, which incidentally recorded only a third of Bulgaria's IFDI stock in the same year. All of this seems to confirm Bulgaria's progress through Stage 2 but not yet passing to Stage 3.

Nevertheless both analytical approaches (the descriptive as well as the regressive) yield results confirming the undisputed leading role in the advancement of the IDP and a firm positioning in Stage 3 of Hungary, a medium sized advanced CEE economy. Lithuania and Estonia, the two Baltic states, and Poland, the largest country in the group, can also be classified in this leading category.

The outward FDI performance index

The analysis of the OFDI performance index (OFDIPI) provides an indication as to magnitude of OFDI which a country generates relative to the size of its economic potential, thus indirectly pointing out which country has the capacity to move to Stage 3 of its IDP or, being in that stage, to continue moving towards Stage 4. The values of the index that are less than 1 signify that OFDI is less than proportional to the size of the home country's economy as measured by its participation in the global economy as such. If, on the other hand, the values of the index are higher than 1 then the OFDI generated is more than proportional relative to the aforementioned size of the home economy. From the point of view of positioning on the IDP, the closer the index is to 1 or higher than 1 the more predisposed a given country is to advance on its IDP trajectory or in this case reach Stage 3 of its IDP, or to continue moving within Stage 3 faster than others.

In this context the values of the index as applied to the ten countries in this study are presented in Table 4.1. Among those countries Hungary was the unquestioned leader, recording the highest OPI values in 1991, 1995, 1997 and from 1999 onwards, surpassing in 2003, 2005 and 2006 the threshold value of 1, reflecting the highest relative effectiveness in OFDI expansion, which in turn was perceived to be the key factor in upgrading the country's international competitiveness. Until the end of 2006 no other country in the group recorded OFDIPI values higher than 1. At that moment Hungary showed the greatest propensity to be capable of being the first to move into its IDP Stage 3.

In the two ensuing years of 2007 and 2008, however, a radical change occurred in the OFDIPI values of certain countries. Estonia's value jumped from 0.267 in 2006 to the highest recorded value in the whole group so far of 2.126, thus succeeding Hungary as the new leader. The reason for that outstanding turnaround of Estonia was due to a sudden surge in OFDI, even in the face of rising IFDI stock. On the other hand Hungary's index fell to 0.69 indicating a substantial worsening of its international competitive position. Then in 2008, when the recession became prevalent, Estonia's index somewhat deteriorated, though still maintaining an impressive level of 1.51, showing sustained outward competitiveness in a difficult external environment. Hungary suffered more with its index going down to a mere 0.351.

A trend similar to that of Estonia was seen in the case of Slovenia's OFDIPI. In 2007, its value rose from 0.267 to a high of 1.019 in 2007, only to fall back to 0.867 in 2008. This also can be considered as evidence of a relatively small but well developed economy demonstrating a sustained capacity to maintain its competitiveness on foreign markets.

Then there is the case of the five countries of Latvia, Lithuania, Poland, Romania and Slovakia exhibiting a decline in their OFDIPI in 2007 and 2008. The first three registered in 2008 a similar level ranging from 0.222

for Poland to 0.246 for Lithuania, thus revealing that these economies (one with a large market and two with small internal markets) were underperforming in their OFDI relative to their economic potential, mainly as a result of recession. Thereafter is Slovakia, another small country, with its OFDIPI plunging down to 0.089 in 2008. And the lowest level of this index (–0.044) was recorded by Romania, confirming that also in this dimension the performance of this Balkan economy was in line with the second lowest GDP per capita level for the whole group, which in essence attested to its companies' paucity of significant competitive advantages that could be successfully exploited via FDI in foreign markets in addition to the negatively reinforcing effect of economic slowdown.

Bulgaria and the Czech Republic differentiated themselves from the rest by recording increased values of OFDIPI in 2007 and 2008, although both had higher values in 2006. Also worth noting is the fact that Bulgaria, the least developed in the group of all the ten countries, had a much higher OFDIPI of 0.481 in 2008 than the Czech Republic, the second most developed in the whole group with an OFDIPI of 0.287. This can be interpreted as evidence of rising international competitiveness of Bulgarian firms, stemming from an economy in the second half of Stage 2 of its IDP or, according to the regression analysis, even in Stage 3, especially when compared with their Czech competitors in foreign markets having behind them and being supported by a much more developed economic potential of an economy positioned at the beginning of its IDP Stage 3. Only these two countries, although being at opposing ends of the economic development scale, were able to withstand the onslaught of recession and improve in these challenging years their OFDIPI values.

Conclusions

The negative thrust of the last global recession exerted a surprising and paradoxical effect of pushing seven of the investigated CEE-10 economies well into Stage 3 of their IDPs. This provided a new theoretical consideration which could be added to the general IDP model in that exogenous macroeconomic factors, such as in this case a downturn in the business cycle which was not directly connected to and/or affecting changes in the NOIP construct, as envisaged originally by Dunning, could expedite the movement of an economy from one stage to another (in this case from Stage 2 to Stage 3). Moreover, in the case of two Balkan economies with a considerable development gap towards the rest (Romania and Bulgaria), this same factor accelerated movement along their IDP Stage 2 trajectory. This so far short-term effect, observed in a time frame of two years, has still to be proven to be sustainable since evidence from the past shows that in some cases such movement into Stage 3 can be reversible. This reversibility was observed previously as a consequence of accession to the EU: for Hungary in 2004, for

Slovenia and Slovakia one year later, and for Estonia two years later. Thus external factors or influences may exert a considerable impact on the IDPs of the former transition economies.

Evidence provided by the analysis of the OFDIPI also confirmed that the investigated countries weathered with different strengths and success the negative consequences for their international competitiveness and the sustainability of their competitive advantages in foreign markets brought about by the last global recession. Only a minority of the CEE-10 countries was able to improve its OFDIPI values. This of course brings into focus the necessity of all the remaining countries in the group to institute economic policy measures addressed to remedy and eliminate the existing unfavourable situation. From the point of view of the IDP paradigm, the key thrust lies in sustaining and promoting OFDI, especially by domestic MNCs and/or national firms, since subsidiaries of foreign based MNCs usually wield so much economic power that they are fully capable of re-exporting capital without additional host country assistance, encouragement or support. Of course the economic recovery underway in Western EU countries should lead to a resurgence of increased FDI flows to the CEE economies, and it remains to be seen how these increases will compare with increases anticipated in OFDI from the CEE region.

The analysis of the IDPs of the group of ten CEE countries leads to a general conclusion that, in their economic development viewed from a time perspective of 19 years from the start of the transition process, they have all followed the basic premises and trajectories as set forth in the original IDP model. The regression analysis showed that all of the investigated CEE economies, except those of Bulgaria, Slovenia and Romania, were well into Stage 3 of their IDPs. This observation can be construed as an indirect confirmation of the success of the transition process to a market led system, which those countries had implemented almost two decades ago, and of the role which FDI has been playing in this process and generally in the economic development of these economies. The Stage 2 economies were also in a specific positioning regarding IDP. Slovenia, much more developed than Bulgaria and Romania, showed a tendency to fluctuate around the border of IDP Stage 3, whereas Romania, according to the regression analysis, was about to enter its IDP Stage 3.

All the above country specificities can be attributed to external factors such as the effect of a downturn in the business cycle and to the idiosyncratic nature of development per se. The first effect is relatively short term, whereas the second effect is more long term; but both are prone to possible reversals. Thus all of those conclusions must undergo a further extensive verification process in the coming years since definite/sustainable patterns and trends are clearly visible only in a long-term approach. Also a comparative dimension is advisable with the remaining members of the EU and/or selected CEE countries, which are currently outside the EU.

Notes

An earlier version of this chapter was presented at the 36th Annual Conference of the European International Business Academy in Porto, Portugal, 9–11 December 2010.

1. In its original version (Dunning, 1981), the path had four stages. The fifth stage was added later (Dunning and Narula, 1996).
2. L-specific advantages denote a country's advantages as a locus for investment vis-à-vis other countries. Such advantages may include large markets, low input costs, tax and financial incentives or strategic geographic location.
3. O-specific advantages denote ownership advantages of firms, such as brand name, ownership of proprietary technology or lower costs due to economies of scale.
4. A succinct review of the two types of IDP empirical studies, cross-sectional and longitudinal, can be found in Gorynia et al. (2006).
5. Several studies focus on individual CEE countries' IDP. They either explicitly use the IDP framework or focus on some of its elements, typically on OFDI. A review of these studies is presented in Gorynia et al. (2008).
6. A cubic specification is as follows: $NOI = \alpha + \beta_1 GDPpc^3 + \beta_2 GDPpc^5 + \mu$.
7. The abbreviations NOI and NOIP are used interchangeably in this chapter but in both cases denote net outward investment position.
8. In linear regression models the quality of fit of a model is expressed in terms of the coefficient of determination, also known as theR^2. In non-linear regression, such a measure is, unfortunately, not readily defined. One of the problems with the R^2 definition is that it requires the presence of an intercept, which most non-linear models do not have. A measure relatively closely corresponding to R^2 in the non-linear case is $R^2 = 1 - SS(Residual)/SS(Total_{Corrected})$. The degree to which the predictor (independent variable) is related to the dependent variable is expressed in the R^2, which can assume values between 0 and 1.

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