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Artur Dmochowski*

Foreign Direct Investment in Central Europe

Central European governments see foreign direct investment (FDI) as one of the main macroeconomic mechanisms for stabilizing the volatile process of economic and political transition. What are the favorite destinations of FDI in Central Europe? What are the motives of Western investors? Why does the amount of FDI vary so much between countries?

In 1994 alone, between $200 billion and $250 billion in international capital was pumped into emerging economies. Sweeping market reforms in Latin America, the embracing of the free market in China, and deep structural changes in Central and Eastern Europe mean increased competition and demand for foreign capital to fuel domestic growth. Capital flow in the form of foreign direct investment (FDI) is becoming one of the major mechanisms of interaction between the West and Central Europe.

Three favorite destinations have emerged for companies serious about exploiting the potential of Central Europe: Hungary, the Czech Republic, and Poland. In all these countries economic reforms accelerated in the years 1989-1990. The response from the West has been slower than the pace of transition, but investors soon recognized that the region presents attractive business opportunities. These include market potential, the valuable production capacity to be acquired, the relatively low cost of investment and a highly skilled work force. However, some difficulties are present as well: industry in Central Europe requires massive investment, capital equipment is ancient and factories overstaffed.

All Central European governments recognize the potential significance FDI could have for their economies. They hope that foreign investment will speed up or significantly ease the process of transition to a market economy. The 45 years of isolation from the world economy have left a deep technological gap between post-communist countries and the industrialized world. The transfer of modern technology and managerial models via FDI is one of the most important objectives for those countries. Others include growth of output, benefits of the balance of payments, and increased market competition to make domestic monopolists more effective.

The next several years will be crucial in the transformation of the previously centrally planned economies of Central Europe. The region has one-fourth of the area and one-fifth of the population of the European Union but a mere 2.4% of the income. This wide discrepancy is a primary reason for high expectations for the region. Central European economies should grow 1.5% to 2% faster than Western Europe, implying annual growth rates in the range of 4% to 5% over the next few years.[1] Therefore, there should be ample opportunities for investment.

While the Central European governments see FDI as one of the main macroeconomic mechanisms for stabilizing the volatile process of economic and political transition, Western investors see their role in a much more conventional way. The main motive for them is probably to gain access to the domestic market in those countries.[2]

Another pull factor for the foreign investors, underscored in many studies, is a highly qualified and, by Western standards, relatively low paid labor force. In general, wages in the former communist bloc are one-tenth or less of those in the West, while skills and education levels are similar to those in Western

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[1] Peter Szopo: Central and Eastern Europe is climbing back, in: Euromoney, June 1994, pp. 130-134.

[2] W. Z. Michalak: Foreign Direct Investment and Joint Ventures in East-Central Europe: A Geographical Perspective, in: Environment and Planing, A 11, November 1993, pp. 1573-91; Maciej Olex-Szczytowski: Predicting the Need for Capital, in: The Warsaw Voice, February 19, 1995.

Table 1
Labor Costs

	Monthly wages (in $)	Additional costs (e.g. social security)
Poland	252	48%
Czech Rep.	222	36%
Hungary	342	53%

Europe. No wonder, then, that manufacturers throughout the West are starting to rely on Central Europe as an alternative manufacturing zone to get around high costs and to compete better against Asian and US rivals.

In many important ways the three countries under analysis here are similar. Foreign capital is needed in all of them to fund the investment required to reinforce all that they have achieved so far and to underpin sustained growth. All have made substantial progress in privatization. They have given high priority to recreating a market-based banking system and the re-creation of financial markets. Governments have moved a substantial distance toward austerity under the combined influence of external disequilibrium, pressure from western aid donors, and ideological commitment to rapid liberalization.[3]

Despite so many similarities, the results could not be more different: Hungary has so far garnered the lion's share of foreign investment, the Czech Republic has been catching up rather slowly, and Poland is lagging behind. What is the reason for this difference? This article will try to move one step further towards a solution of this puzzle.

Flow of Investment

Hungary has attracted around half of all FDI in Central Europe. Both Poland and the Czech Republic received a much smaller amount of capital: Poland attracted 30% and the Czech Republic 20% of the total. The inequality of regional distribution is reflected even more clearly when the per capita amounts of invested capital are examined.

Hungary received quite a few large investments from big multinational corporations (e.g. General Electric, General Motors, Ford, Siemens, Nestlé and Philip Morris). As a result, two-thirds of the FDI in that country involves only one-third of all the registered firms. At the other end of the scale is Poland where the majority of FDI is spread among 80% of the firms. The sectoral distribution in the Czech Republic resembles that of Hungary.[4]

Table 2

Direct Foreign Investment Total
(in millions of US dollars)

	Till the end of 1990	1991	1992	1993	1994	Total
Poland	0.2	0.3	1.1	1.6	1.3	4.5
Czech Rep.	0.1	0.5	1.0	0.6	0.6	2.8
Hungary	1.5	1.7	1.6	2.2	0.8	7.8
Total	1.8	2.5	3.7	4.4	2.7	15.1

The presence of multinationals is emphasized by some authors as an especially important consideration for investors.[5] They literally attract other investors, causing multiplier effects. Investors expect the legal conditions to be improved and stabilized in the wake of the appearance of such corporations, since their bargaining force is a match for most governments (particularly in smaller countries). Multinationals also provide strategic encouragement because to a certain extent they spare the smaller corporations the tiresome work of market research and preparation.

Political Environment

Obviously, the political environment is the key to understanding investors' decisions. For them political unrest translates directly into economic uncertainty, so they are looking for stability, security, clear rules of the game, lack of social tensions, etc.

According to a country risk guide[6] Czechoslovakia was the 36th safest place (just behind Chile), Hungary was 54th and Poland 56th (together with Gambia). This order, in which Czechoslovakia (or later the Czech Republic), was rated as the least risky country of the three, with Hungary and Poland second and third, respectively, but much lower than Czechoslovakia and close to each other, has not changed much since then. During the last quarter of 1993,[7] the risk assessment produced by the

[3] Stephan Haggard, Andrew Moravcsik: The Political Economy of Financial Assistance, in: Robert O. Keohane, Joseph S. Nye, Stanley Hoffmann (eds.): After the Cold War. International Institutions and State Strategies in Europe, 1989-1991, Cambridge, Mass., and London, 1993, p. 177.

[4] W. Z. Michalak, op. cit.

[5] Adam Torak: Why is Hungary still attractive for investors?, in: Hungarian Business Weekly, September 7, 1994, p. 4.

[6] Cf. The Wall Street Journal, September 20, 1991.

[7] Since investment decisions take time, the variables influencing these decisions, which are analyzed here, are considered to the end of 1993. It is assumed that investments in 1994 were the consequence of earlier conditions.

Economist Intelligence Unit[8] classified the Czech Republic as the least risky of the three with the risk grade of 25 (on a scale from 0 = minimum risk, to 100 = maximum). Hungary was rated twice as risky as the Czech Republic, with a grade of 50, and Poland was last with a grade of 60.

It is obvious, then, that the political risk ratings alone do not explain the flow of investment. The Czech Republic, which was permanently rated as the least risky country, did not acquire the largest inflow of foreign investments, whereas Hungary, rated as a much riskier country, did.

In order to look for variables which may have a particularly strong influence on investors' decisions, two areas of potentially special importance will be examined more closely: legislation concerning investment, and privatization. The reasons for choosing these variables are clear: legislation reflects the overall attitude of a given country towards foreign investment. It is a result of the political process, in which diverse political and social forces can influence the final output. It is, then, besides its obvious practical importance for investors, the best indicator of the general political environment for them. Privatization is especially important because it provides opportunities for foreign investors.

Legislation

The transition to democratic and free market systems was reflected in all three countries in constitutional provisions on property rights and in legal frameworks for market activities aimed to improve efficiency and to serve the abolition of the monoparty system. In the following, we will briefly outline the legal environment in those countries with special emphasis on the ability to expatriate earnings, legal protection for private property, and corporate taxation. These factors are ranked by investors as the most important ones.

Only since the enactment of the Act on Companies with Foreign Participation in 1991 have investors in *Poland* been allowed to remit abroad 100% of their share of the joint venture company's profit in hard currency after paying the appropriate tax. Earlier, they could remit 15% of profits.[9] A foreign party may also, pursuant to Article 26 of the Act, export in hard currency the proceeds from the sale of its shares in a Polish company (less any taxes that may be owed). The maximum corporate income tax rate is 45%. Under the Foreign Investment Act of 1988, joint ventures were entitled to an automatic three-year tax holiday. This privilege was eliminated by the new Act, but an income tax exemption is still possible under certain conditions.

Czech foreign exchange regulations and the Act on Enterprises with Foreign Property Participation guarantee the free transfer of profits and capital abroad. When requested by businesses, Czech banks must pay foreign investors the foreign currency equivalent of their return on invested capital in Czech currency. Businesses are subject to a corporate income tax of 45%. The Ministry of Finance may grant tax holidays for a maximum period of two years subject to some conditions.

Act XXIV of 1988 on Investments by Foreigners in *Hungary* made repatriation of profits easier, while still restricting it to an enterprise's hard currency earnings. At that time, it was the most liberal regulation on this issue in all communist countries, and it helped Hungary establish its reputation as the country most open to investment. Later, the remaining restrictions were abolished as well. Until the end of 1993, the corporate tax rate was 40%. Some tax concessions are available.The most generous is the reduction of tax by 60% for the first five years of a company's existence. The foreign investor's share of profits generated by a Hungarian company may be converted and repatriated in the currency of the investor's original investment. Also, any return of capital to a foreign shareholder and the proceeds from the sale of his shares may be paid in convertible currency.

All newly elected governments in Central Europe implemented wholly new and very liberal regulations. With a few exceptions, foreign investors there enjoy a very similar type of legal framework to that usually taken for granted in advanced industrialized countries.

The governments of all countries which wish to attract foreign investment confront the same dilemma: if legislation is restrictive, foreign capital will stay away; if it is too liberal, profits will not stay in the country. Central Europe started from a point at which regulations were more or less highly restrictive (more in the case of Czechoslovakia, less in the case of Hungary), with all sorts of barriers to foreign investment. With the passage of time, the governments decided to ease the restrictions in order

[8] Cf. The Economist, February 19, 1994.

[9] Zbignew Dobosiewicz: Foreign Investment in Eastern Europe, London, New York, 1992.

to encourage investors.This view prevailed first in Hungary, next in Poland, and later in Czechoslovakia, and the most important incentive – the practically unlimited export of profits – was allowed.

Another key problem, investors' fear of nationalization or the expropriation of private assets, was also solved. Although in the current political climate measures like those are difficult to imagine and are not contemplated by any Central European government or significant political group, the governments were nonetheless mindful of their countries' past nationalization policies, so they provided solid assurances to foreign investors that their investment would be free from any danger of expropriation.

In general, all three countries managed to create a very liberal legal framework which appealed to foreign investors. A few remaining restrictions on sectors open for foreign capital make Poland a little bit less advanced in the area of legislation.

Privatization

The biggest deals so far, such as Skoda-Volkswagen, FSM-FIAT and Tungsram-General Electric, were directly connected with the process of the privatization of state-owned enterprises (SOEs). Many investors have expressed their intention to wait until the three countries have fully implemented their privatization programs.

Poland's Privatization Law of 1990 provides for two principal methods of privatization. The first one involves transformation of the SOE into a state-treasury-owned joint-stock company, followed by the disposition of its shares to investors (Polish or foreign). The second method is the liquidation of the SOE. Foreign investors can participate via both methods in the process. To prevent unwanted foreigners from acquiring controlling interests in Polish companies the Law limits the amount of shares that can be bought by a single investor to 10% of the stock. This restriction can be waived on a case-by-case basis.[10] Poland's mass privatization program, which was supposed to start in 1994, has been delayed by the government and is still in the preparation stage. There is still no law concerning restitution of nationalized property.

The *Czech Republic's* privatization process was launched on January 1, 1991. Its three-part privatization strategy includes restitution, small-scale privatization and large-scale privatization. The large-scale privatization has been divided into three waves. The first wave, completed in 1992, included 2,170 enterprises. Most of them (89%) were transformed into joint-stock companies whose shares were then distributed (34% being set aside for foreign investors).

The second wave, currently underway, deals with almost 2,000 companies. As well as sales through vouchers, a process in which foreign investors cannot participate, there will be transactions by public tender and direct sales in which they can. Many approved projects were designed to accommodate foreign investors. The third wave is scheduled for 1996.[11]

The Czech privatization model is a hybrid between the shock therapy approach (that was tried in Poland) and a go-slow negotiated sales model (chosen by Hungary).[12]

Early privatization laws in *Hungary* in 1989 and 1990 created liberal tax breaks and rules on repatriation of profits which attracted much foreign interest. In 1991, privatization represented at least 60% of foreign capital inflow. Privatization in Hungary can be initiated in four ways. First, the State Property Agency can initiate the sale to international investors through the stock exchange, competitive tenders, or employee ownership plans. Second, a state-owned company can initiate the sale as the company seeks a strategic partner. Third, smaller companies can privatize themselves, and fourth, a foreign company can initiate the sale through the SPA.

Since 1990, the State Property Agency has sold more than 600 companies out of almost 2,000 owned by the state, about 40% of the state's property. The government slowed down the pace of privatization in 1993, when data showed that in the first three years of privatization, foreign investors accounted for 80% of the SPA's sales. At this point, officials began to seriously court the domestic investors and in 1993 Hungarians accounted for 70% of sales. In total, about two-thirds of the privatization efforts were linked to foreign direct investments.[13]

In general, the Hungarian privatization was far from successful. Four years into Hungary's transition to a market economy, only 18% of the privatizations announced at the outset of the program have been

[10] Ibid.

[11] Czech Agency for Foreign Investment: Privatisation in the Czech Republic, Prague 1994.

[12] Paul M. Sacks: Privatisation in the Czech Republik, in: Columbia Journal of World Business, Spring 1993, pp. 188-194.

[13] Privatisations on parade, in: Global Finance, No. 8, March 1994, pp. 89-93.

achieved. Recently, privatization seems to have stalled due to political considerations. Some authors argue that the government is to blame for slowing the pace of privatization in an attempt to give Hungarians an edge in competing against foreigners for former state properties.[14]

The Czech Republic has thus so far been the most successful in privatizing its state sector. Not only did the Czechs manage to privatize small enterprises (all three countries did), but they also restored property expropriated by the communists (Poland was unable to do this), and efficiently organized mass privatization (neither Hungary nor Poland did this).

State of the Economy

For most investors the size and growth of a given economy are among the most important factors in making an investment decision. The fundamental problems of the economy have a great influence on the microeconomic performance of a joint venture or foreign subsidiary.

Poland, with 39 million people and a gross domestic product of $90 billion, has Central Europe's largest consumer market. In 1989, it faced the most severe economic crisis in Central Europe. Starting in 1990, the new non-communist government adopted a shock therapy approach to economic reform. Controls on foreign trade and prices were abolished, subsidies and state spending were cut, and tight monetary and wage policies were adopted. The program has largely been followed by the successive Polish governments.

A recent OECD report on the Polish economy summarizes its state after four years of transformations.[15] It indicates that the Polish economy has shown "surprising resilience" to structural reform and the loss of Comecon markets. Industrial labor productivity rose 13% in 1992 and a further 9.6% in 1993. Unemployment reached 16% last year, but the rate of job losses has slowed.

The *Czech Republic's* conservative fiscal policies combined with political stabilization and the quick pace of reforms have produced a reliable investment climate with the lowest level of inflation in the region, strong foreign currency reserves and a balanced budget. Inflation rates, although still high by Western standards, were much lower than in Poland and Hungary.[16] Such economic policies led to improved ratings from Moody's Investors' Service and Standard & Poor's, making it the first post-communist country to be rated (Baa3 and BBB+ respectively).

Even the break-up of Czechoslovakia into the Czech and Slovak Republics on 1 January 1993, which might have caused potential disturbances, actually gave the Czech Republic considerable advantages. It hosted 80%-90% of the foreign investment in former Czechoslovakia. It had two thirds of the former state's population and accounted for about 70% of its gross national product.[17]

This does not mean, however, that the Czechs do not have problems. The GDP was slow to start moving up. It fell constantly until 1993. Although unemployment is the lowest in Europe, it is expected to grow when stricter bankruptcy rules start to eliminate less effective companies.

Although *Hungary* began its transformation with a higher per capita debt than Poland, its external disequilibria imposed fewer binding policy constraints. Moreover, the ideological impetus toward radical macroeconomic adjustment was less strong, because Hungarian communists started gradual reforms in the economy as early as in the late 1960s.[18] That program allowed Hungary to achieve the highest standard of living among the communist countries, but growth was slow and accompanied by high inflation. Besides, the country experienced recurring balance of payments and debt difficulties during the 1980s. By 1987 commercial lenders became apprehensive. The mounting economic crisis triggered the development of a program that included not only stabilization, but accelerated economic reforms as well. As a result, by late 1989 Hungary had reached the stage of economic transformation that was reached in Poland in 1990 and in Czechoslovakia even later.

Yet, that gradual approach was not extremely successful. Hungary's economic reform process has generated, like elsewhere, a mixture of pain and gain, but in general it has been much more sluggish than the Polish or Czech processes. Real GDP began to fall in 1988 and dropped for five consecutive years until 1993. Yet, in the same year the first signs of growth in industrial production began to appear.

One of the most difficult issues has been growing budget deficits, which reached 7% in 1993 and 10%

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[14] Ernest McCrary: Hungary finds pace that suits it best, in: Global Finance, No. 4, April 1993, pp. 75-79.

[15] Cf. Financial Times, January 18, 1995.

[16] Czech Agency for Foreign Investment: Czech Republic Investment Climate, Prague 1994.

[17] David Rudnick: Czechs calculate that division will add up, in: Euromoney, February 1993, p. 86.

[18] Stephan Haggard, Andrew Moravcsik, op. cit.

in 1994, much higher than in Poland (the Czech Republic runs a budget surplus).

Regional Comparison

Five years after the beginning of the historic transformation in Central Europe, there are strong signs that the reforms are beginning to turn the region's economy around and place it on an upward path. After falling about 25% between 1989 and 1993, the region's real GDP grew about 3% in 1994 – and the prospects are for that growth to accelerate rapidly.

Structural reforms and stabilization policies are beginning to show results after several years of difficult restructuring. This new, upward trend started in different countries at different moments, however. Poland was the first to enter a period of economic recovery, with 1.5% growth in 1992 and accelerating growth afterwards. Nevertheless, the economy of Poland, burdened with external and internal debt, must be ranked second to the Czech economy, which started to grow later but had not fallen as deeply as the Polish one in 1989 and 1990. The Hungarian economic environment has been the worst of all three countries: it has been characterized by slow growth and a dangerously high budget deficit.

Foreign Debt

Some studies suggest that the magnitude of the debt service ratio fundamentally influences the chances of economic stability and is therefore of great importance to foreign investors.[19] Poland and Hungary have both incurred substantial levels of debt. Poland, the largest debtor in absolute terms, has a history of debt problems dating to the early 1980s, culminating in a massive restructuring package covering debt coming due between 1987 and 1993. Total Polish debt is currently almost $40 billion. In consequence, raising international money to invest in Poland has become extremely difficult.[20] Successive Polish governments have struggled to improve the debt situation and they have been quite succcessful in this. First, official debt was cut in 1990 as part of an aid package organized by Western countries. Next, in October 1994, after 4 years of negotiations, Poland reached an agreement with commercial banks on the reduction of its $14.4 billion debt by almost half. On that occasion, many analysts expressed the opinion that the debt reduction would enhance foreign investment flows.[21] Yet, it is too early to detect indications of investors' change of heart.

On a per capita basis, Hungary is even more heavily indebted than Poland ($2,150 vs $1,030). However, in absolute terms its debt is much smaller ($22 billion), and what is particularly important for investors, Hungary has never defaulted on its debt. It has continued to pay both the capital and interest on schedule, while Poland ceased to do so in 1990. Czechoslovakia and, successively, the Czech Republic faced a significantly smaller debt burden and did not face any serious external difficulties.

Table 3
Changes in Real GDP
(in %)

	1990	1991	1992	1993
Poland	–12	–8	1.5	4.2
Czech Rep.	–1.2	–14.2	–6.6	–0.3
Hungary	–3	–12	–4.5	1

Table 4
Consumer Price Inflation Rates (%)

	1990	1991	1992	1993
Poland	580	60	43	39
Czech Rep.	10	56.6	11.1	20.8
Hungary	40	36	22	23

Attitudes of Societies

Attitudes of societies towards foreign investment may also influence investors' decisions. Although in the present democratic systems of Central Europe they are voiced through a political and parliamentary process, being finally expressed in the legislation of the given country, it is also possible to trace the social mood directly through public opinion polls. Available data, though rather modest, show that societies in all three countries reacted in a similar way to the inflow of foreign capital. When the transition in Central Europe began, those attitudes were unequivocally positive: foreign investors were welcomed by eight or nine out of ten Poles, Czechs, or Hungarians.[22] Although in every social group and most political parties there were people who took a critical view of foreign capital, their total number was small. However, when the costs of transformation began to lower standards of living for many in those countries, and

[19] Istvan Abel, John P. Bonin: Debt Service, Foreign Direct Investment and Transformation to Market, Centre for Economic Policy Research Discussion Paper, 1992.

[20] Nicholas Kochan: Rough ride ahead as Poland starts to pay off its debts, in: Multinational Business, Winter 1992-1993, pp. 45-53.

[21] Polish Debt Reduced, in: The New York Times, October 14, 1994.

[22] Zbigniew Dobosiewicz, op. cit.

the promised affluence which was supposed to accompany capitalism and foreign investments seemed to be farther away than before, attitudes started to change.

Logic says that Hungary should be the first country where that change emerges because of the large size of investment there. In fact, this has happened. During last year's electoral campaign, a backlash against foreign investors was clearly visible as opposition parties asserted that the government had sold the country's patrimony to outsiders.[23] But the Hungarians' disillusionment with foreign investment in their country could be noticed even earlier. Fear that the large proportion of foreign investment in the country might provoke negative social reactions was one of main reasons that the Hungarian government changed its privatization strategy to try to entice domestic capital into the process.[24]

The same process of abating public support for foreign investment could be traced in Poland. A recent poll shows that only 37% of Poles think that foreign capital will help Polish industry survive, while 35% do not agree. Half of the Poles declare fear of layoffs if their plants are sold to foreign investors, but the majority believes that working conditions in the plants sold will be better.[25]

There are also some signs that a similar process may be taking place in the Czech Republic, where the level of German investments causes various concerns.[26]

Conclusions

Many other variables influencing FDI could be analyzed: trade regulations, currency stability, banking systems, securities markets, labor laws, real property laws etc., but they would not change the general picture. When different variables are operationalized and evaluated for these three countries the result is clear: the Czech Republic is the country with the most favorable environment for foreign investment, easily surpassing both Hungary and Poland, whose scores are similar to each other and much lower than the Czech one.

Surprisingly, however, the actual pattern of FDI in Central Europe indicates that investors consider Hungary the most favored destination. The Czech Republic is only second, and far behind Hungary, which has been receiving constantly the same amount of capital as Poland and the Czech Republic *combined*. In effect then, the actual distribution of the FDI between those countries is almost the reverse of what one could potentially expect on the basis of the quality of the environment for investment that they were able to create. What is the reason for this discrepancy?

There is no single theory that adequately explains foreign investments of enterprises.[27] Besides, most of the existing theories were designed to explain the patterns of industrial investment in highly developed economies. Usually, information biases are thought to be key determinants in the behavior of investors. In fact, the lack of reliable and timely information about the economic and legal environment in Central Europe seems to be one of the most important barriers to FDI in that region. However, there are no indications that the height of this barrier varies between these countries.

In the case of Central European countries, the information bias theories do not explain fully the reversed pattern of investment. Another variable must be introduced: ultimately it is the perception of the economic and political environment which decides whether a given investment will be selected.[28] The key is how the investor perceives the economic and political environment, rather than the reality itself. I would call the perception an intermediate variable as it mediates between the reality of the environment and investors decisions.[29]

Why is Hungary perceived as the best country for investment? The main reason seems to be its significant headstart – the early adoption of market-based laws and regulations at a time when Czechoslovakia was still an oasis of Stalinist orthodoxy, and Poland, in acute crisis, was initiating its transition. This was the beginning of a chain reaction: the first large investments in the then-

[23] Jane Perlez: Hungarians cooling to foreign investment, in: The New York Times, May 3, 1994.

[24] Sheryl Lee: Hungary Looks Homeward for Investors to Partake of Fruits of Privatization, in: The Wall Street Journal, December 11, 1992; Budapest tries to sell Hungarians on capitalism, in: The New York Times, May 6, 1993, p. 13.

[25] Opinia publiczna a inwestycje, in: Nowy Dziennik-Polish Daily News, December 20, 1994.

[26] Dietmar Ostermann, Vlad Lich: Keeping Your German Rivals in Check: Investment Strategies for Czechoslovakia, in: Journal of European Business, No. 2, November/December 1992, pp. 53-56.

[27] W. Z. Michalak, op. cit.

[28] This idea emerged first in W. Z. Miachalak, ibid.

[29] It is rather amazing that where tens or hundreds of millions of dollars are at stake, decisions are not made on a rational basis but, apparently, investors are also human.

existing communist bloc were done in Hungary in 1988-1990, *before* other countries were open for FDI. When they finally established frameworks for foreign investment, it was too late. Some investors were already familiar with Hungary, while others coming to the region saw well-known multinational corporations strongly rooted in Hungary, and did not see any reason not to follow their example.[30] And, since the amount of investment is limited, the latecomers received only leftovers. Later, the separation of the Czech and Slovak Republics introduced an additional element of uncertainty in Czechoslovakia and may have significantly hampered its ability to compete with Hungary.

Perception is closely connected with culture, so it is possible to find evidence to confirm this theory investigating cultural liaisons between Hungary, Poland and the Czech Republic on one side, and potential investors on the other.

Japan is the biggest investor in the world, yet its absence in Central Europe is most notable. The same is true of other big Asian investors, like Taiwan or South Korea. Although Central and Eastern Europe could become a gateway to the European Union for Asians, their investments lag far behind American and European ones. There are only a few, relatively small, Japanese enterprises in Hungary, and one in Poland. The Koreans are the boldest Asian investors in Central Europe. They view the region as the only place left to them because the Japanese dominate the West, but the total value of their investment in the region is also negligible.[31]

On the other hand, it is no accident that the largest investor in Hungary is Austria, since these countries share a strong historical affinity. Austria contributed a 25% share of the total investment there compared with only 9% from Germany. Conversely, Poland received almost one third of its entire FDI from Germany and only 6% from Austria. In the case of Poland, the biggest investor is the United States. This also confirms the theory of cultural perceptions, since close traditional ties exist between these two countries. Also, a significant amount of investment flow to Poland comes from Italy. In this case, there is not even geographic proximity, nor is Italy a big international investor, but, again, close cultural ties exist between them. In the Czech Republic, as could be historically foreseen, the Germans are the biggest contributors. All these data confirm the assumption that the differences in the degree of familiarity with the host country by foreign investors significantly affect their locational choices.[32]

What factors, connected with culture, are responsible for facilitating investors' decisions? Among others, knowledge of language, business culture and business philosophy, similarity of legal regulations, and personal contacts may play a critical part in companies' decisions about investment.[33]

In general, the United States and Germany are the biggest investors in the region, each accounting for about 35% of total investment. Among factors explaining the role of the Germans are proximity, the co-production deals concluded by large West German companies with enterprises in Central Europe in the 1970s, and the historical tradition of German capital expansion in Central Europe.[34] The interest of the American companies can be explained by strategic motives: American corporations want to get a foothold in Central European countries, reckoning with their quickly becoming members of the European Union.

The state of investment in Central Europe also demonstrates the key importance of timing in economic policy. Hungarians were extremely lucky that the first major foreign investors appeared in Hungary in 1989 and 1990, before the war in Yugoslavia. At that time, Hungary had a significant initial advantage in the region as regards the speed and perspectives of transformation, and it seemed reasonable for the multinationals to build up their bases in Hungary. In some cases, this was also supported by the existence of the Soviet Union, where the future was uncertain, but economic opening was clearly visible.[35] And since it is extremely hard for big corporations to withdraw from a country because of huge costs and the threat to the company's prestige and its stockholders' confidence, the multinational corporations remained in Hungary even when war broke out on Hungary's borders and the Soviet Union ceased to exist. This created a powerful magnet in that country resulting in a skewed flow of foreign investment in the region – a good example of the first mover advantage on a national scale.

[30] Marie-France Houde: Foreign investment in Hungary, in: OECD Observer, August/September 1994, pp. 36-38.

[31] Zoher Abdoolcarim: Eastern Europe: The gateway to the EC, in: Asian Business, February 1993, pp. 42-45.

[32] W. Z. Michalak, op. cit.

[33] Dietmar Ostermann, Vlad Lich, op. cit.

[34] Zbigniew Dobosiewicz, op. cit.

[35] Adam Torok, op. cit.