

Christie, Edward

Working Paper

Foreign Direct Investment in Southeast Europe

wiiw Working Paper, No. 24

Provided in Cooperation with:

The Vienna Institute for International Economic Studies (wiiw) - Wiener Institut für Internationale
Wirtschaftsvergleiche (wiiw)

Suggested Citation: Christie, Edward (2003) : Foreign Direct Investment in Southeast Europe, wiiw
Working Paper, No. 24, The Vienna Institute for International Economic Studies (wiiw), Vienna

This Version is available at:

<https://hdl.handle.net/10419/203889>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen
Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle
Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich
machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen
(insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten,
gelten abweichend von diesen Nutzungsbedingungen die in der dort
genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

*Documents in EconStor may be saved and copied for your personal
and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to
exhibit the documents publicly, to make them publicly available on the
internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content
Licence (especially Creative Commons Licences), you may exercise
further usage rights as specified in the indicated licence.*

wiiw Working Papers

No. 24

March 2003

Edward Christie

**Foreign Direct
Investment in
Southeast Europe**

Edward Christie is research associate at wiiw.

Research was financed by the Jubiläumsfonds
of the Oesterreichische Nationalbank, Project
No. 9957.

Edward Christie

**Foreign Direct
Investment in
Southeast Europe**

Contents

| | |
|---|----|
| Abstract..... | i |
| Introduction | 1 |
| The concentration-proximity trade-off..... | 1 |
| The gravity model..... | 4 |
| Pooling across country pairs | 6 |
| FDI and exports: complements or substitutes?..... | 8 |
| Data and methodological issues | 9 |
| Empirical results..... | 11 |
| The classical equation..... | 14 |
| Conclusion..... | 18 |
| References | 20 |
| Appendix..... | 21 |

Abstract

This paper applies a gravity model to foreign direct investment (FDI) stocks in five countries of Southeast Europe from nine selected Western European source countries, using five countries of Central Europe as a control group. Basic elements of the economic theory on FDI are shortly reviewed, then the discussion shifts to recent empirical work and the various issues surrounding estimates using the gravity equation.

FDI to Central Europe is mainly of the horizontal, market-seeking type. The evidence for Southeast Europe is less clear. Both types co-exist and, if we exclude Croatia, we are led to conclude that neither the vertical, efficiency-seeking type nor the horizontal type dominates. The countries of Southeast Europe overall are found, unsurprisingly, to have lower than normal stocks of FDI in relation to the countries of the control group, GDPs and geographical distances to investing countries accounted for. Through the estimation of a gravity equation for trade using the residuals of the FDI gravity equation, evidence is found in favour of complementarity, rather than substitutability, between trade and FDI for the control group. No conclusive evidence is found in favour of either for the countries of Southeast Europe.

Keywords: foreign direct investment, gravity model, Southeast Europe, proximity-concentration trade-off, economic geography

JEL classification: F21, F23, P17

Foreign Direct Investment in Southeast Europe

Introduction

Why do some firms choose to set up a foreign affiliate, thereby generating foreign direct investment (FDI), rather than exporting to the corresponding foreign market or licensing a local firm?

The traditional approach to analysing which factors drive FDI, the Ownership-Location-Internalization (OLI) framework, was introduced by Dunning (1977) and considers three types of advantages for firms that opt for FDI:

- ownership advantages: assets such as patents, trade secrets, reputation and so on mean that the firm has a competitive advantage over foreign producers (without which the firm would not consider the foreign market at all);
- location advantages: through its affiliate, the firm has easier customer access, saves on transport costs and avoids tariffs and other barriers (FDI rather than exporting);
- internalization advantages: owning an affiliate is preferable to licensing another firm so as to keep the firm's knowledge assets inside the firm. Otherwise, a licensee, once it has learned all the firm's technology, may defect and become a direct competitor (FDI rather than licensing/franchising).

In this paper we leave the issues of licensing/franchising aside and focus on the two most important channels through which a firm can sell its goods in a foreign market: exports and FDI.

The OLI framework indicates that choosing between these two channels comes down to assessing the location advantages to see whether they are large enough to motivate FDI. Against this the firm must consider the cost of setting up the affiliate. Furthermore, if one assumes increasing returns to scale, there is a loss due to the fragmentation of production linked to FDI.

The concentration-proximity trade-off

Brainard (1993) exposes a theoretical model that gives rise to the concentration-proximity trade-off. Brainard (1997) is an empirical paper that summarizes the model and expands it, leading to an empirically testable modified gravity model. We first present a brief summary of his model's main features and then compare his approach to Brenton, Di Mauro and Luecke (1999) and Di Mauro (2000), which both use gravity models.

Brainard's model presents features that are familiar from economic geography:

- There are two countries A and B at a geographical distance D from each other
- Factors and consumers are immobile between countries
- There is symmetry in factor endowments and consumer distribution across countries
- There are two types of goods: Homogeneous (say, agricultural), and Differentiated (say, manufactured)
- Wages are determined in the homogeneous goods sector
- In the differentiated goods sector there are increasing returns to scale
- There are strictly positive per-unit transport costs for the differentiated goods, increasing in distance

These two last assumptions are the key as they cause, depending on the values of the model's parameters, firms from a given country either to concentrate production or, on the contrary, to expand across the border.

We refer the reader to Brainard (1993) for the details of the model. Familiar features from economic geography are found, notably the Dixit-Stiglitz type CES sub-utility and monopolistic competition in the differentiated goods sector.

The main point is that firms should expand horizontally across the border ('horizontal FDI') when the advantages of direct access to the foreign market's consumers (which are to avoid the additional variable transport costs, though the firm must pay fixed set-up costs for its affiliate) outweigh the advantages of concentrating production in a single plant in the home country, which are due to increasing returns to scale.

In this case, the firm becomes a Multinational Corporation (MNC) and it accesses the consumers in the foreign market through affiliate sales. When not, it keeps production concentrated and exports to the foreign market.

The overall result of the model is that there are three types of equilibria:

- (1) All firms operate as multinationals (multinational equilibrium)
- (2) All firms have single-plant production and export (trade equilibrium)
- (3) Some firms are multinationals, others export (mixed equilibrium)

In the mixed equilibrium (the most relevant case) a proportion α of firms are single-plant, single-country, the remaining firms are MNCs.

This proportion α is greater the greater are the fixed cost of setting up the foreign affiliate, and it is greater the smaller are transport costs, trade barriers and the size of each market. Brainard (1997) then proceeds to complement this with Helpman's (1984) older, vertical, factor-proportions model:

If relative factor endowments are sufficiently different across countries, factor prices will not equalize through trade. This, firms will wish to exploit. If corporate activity and production have different factor intensities, then 'vertical' multinational firms will arise, with their corporate headquarters in one country and their production in the other.

The main results of the model are as follows:

- FDI is driven only by factor-proportions differences
- FDI flows only arise in a single geographical direction (all flows are either from country A into country B or from country B into country A) for a given industry
- All firms have a single production plant
- FDI only happens between countries that have large factor-proportions differences
- When there is FDI, the firm splits production from management, each in a different country
- However, there is two-way trade in the differentiated goods sector
- And one-way trade in the homogeneous goods sector, according to factor proportions differences

Brainard (1997) combines the two models, allowing both horizontal and vertical types of FDI. When factor proportions differ sufficiently, vertical single-plant MNCs emerge, especially when the proximity-concentration trade-off would lead to a pure trade equilibrium.

This attempt at model combination is desirable, as both types of FDI are known to exist. Di Mauro (2000) also advocates a synthesis of both types of models. She points out, however, that most FDI actually takes place between developed countries (e.g. the car industry) and so is of the horizontal (or market-seeking) type, rather than between developed and less developed countries (vertical, or efficiency-seeking FDI). More than 90% of world FDI is 'North-North'.

When it comes to empirics, Brainard (1997), Di Mauro (2000) and Brenton, Di Mauro and Luecke (1999) all estimate some version of a gravity model on FDI data. We therefore discuss the gravity model in the next section.

The gravity model

The gravity model explains aggregate trade or FDI flows between two countries as a log-linear function of the countries' GDPs and of the geographical distance between the countries' capitals. This model has been used extensively in recent years, both for FDI flows and trade flows, in particular in order to simulate potential trade or FDI flows between Central and Eastern European countries (CEECs) and Western economies. The aim has been to evaluate the (remaining) scope for trade and investment flows following the simultaneous disintegration of the CMEA and the gradual lowering of barriers between East and West (Hamilton and Winters, 1992 is just one example).

The preferred form of the gravity model in this paper is taken from Fidrmuc and Fidrmuc (2000):

$$M = k \cdot GDP_M^b \cdot GDP_X^g \cdot D^d \quad (1)$$

where M is the flow of FDI or imports into country M from country X , and D is the geographical distance between the countries' capitals. β and γ are expected to be positive and in the region of 1, δ is expected to be negative and is generally estimated between -0.7 and -1.5 .

This model provides a benchmark as to what FDI or trade flows are in the chosen sample, but one expects deviations from that benchmark due to country-pair or country-group specifics. Some countries may, for instance, be parties to agreements on preferentially lower barriers to trade and FDI (typically, Regional Integration Agreements such as the EU, NAFTA, CEFTA etc.). Other specific effects may include having a common land border, or cultural affinities such as a common language. Negative deviations also exist, for example because of military conflicts or economic sanctions.

To test for p different effects, one expands the model with dummy variables G_1, \dots, G_p :

$$\ln(M) = \mathbf{a} + \mathbf{b} \ln(GDP_M) + \mathbf{g} \ln(GDP_X) + \mathbf{d} \ln(D) + \sum_{s=1}^p \mathbf{I}_s G_s \quad (2)$$

which is equivalent to:

$$M = \exp(\mathbf{a}) \cdot GDP_M^b \cdot GDP_X^g \cdot D^d \cdot \prod_{s=1}^p \exp(\mathbf{I}_s G_s) \quad (3)$$

In many instances the two countries' populations are included as independent variables alongside the GDPs, or the countries' GDP per capita and their populations, which is equivalent.

Hamilton and Winters (1992) suggest one possible rationale: one needs to proxy for countries' openness to trade, remarking that small countries (say, Belgium) are much more open to trade, as measured by the sum of imports and exports over GDP, than large countries (say, the US). This is broadly true in a world sample. This relationship may break down in restricted samples however. For instance, in Europe, Germany (with a population of 82 million) is more open to trade in goods than the UK or France (both at 59 million), and Greece and Portugal are much less open to trade than Belgium (though all have around 10 million inhabitants). Of course one would want to look at the supply side in more detail to explain this, but it remains that, as in Christie (2002), the population variables within a gravity model (where both supply and demand are modelled using just GDP) are often not significant in comprehensive European samples¹. Fidrmuc and Fidrmuc (2000) also exclude populations from their chosen specification.

A more important modification to the classical gravity model is presented in Di Mauro (2000), which is to look at the similarity of GDP between partner countries, rather than the individual values of GDP. We present her model (4) below. She argues that, as predicted by the Helpman-Krugman theory of increasing returns, countries of a more similar size should trade more. This should apply to FDI as well. So instead of using the countries' GDPs, she introduces a variable SIMSIZE that ranges from minus infinity (for 'infinitely different' GDPs, i.e. when one of them is zero) to $\ln(1/2)$ when they are identical. Of course, the size effect still applies, so she introduces the sum of GDPs as an explanatory variable as well. Finally, to proxy for differences in relative factor endowments, she introduces the log of the ratio of the countries' GDP per capita. This variable is zero if the GDP per capita are identical and is greater in absolute value the greater the difference between the two countries.

$$\ln(M_{ij}) = \mathbf{a} + \mathbf{b}_1 \text{SIMSIZE}_{ij} + \mathbf{b}_2 \text{TGDP}_{ij} + \mathbf{b}_3 \text{RELEND}_{ij} + \mathbf{b}_4 \ln(D_{ij}) + \sum_{s=1}^p \mathbf{I}_s G_s \quad (4)$$

$$\text{SIMSIZE}_{ij} = \ln \left(1 - \left(\frac{\text{GDP}_i}{\text{GDP}_i + \text{GDP}_j} \right)^2 - \left(\frac{\text{GDP}_j}{\text{GDP}_i + \text{GDP}_j} \right)^2 \right) \quad (5)$$

$$\text{TGDP}_{ij} = \ln(\text{GDP}_i + \text{GDP}_j) \quad (6)$$

¹ Some European samples yield significant population effects, others do not. It depends exactly on which set of countries one includes. The presence of certain dummy variables may also influence the significance of the population variables. GDP and distance are much more robust.

$$RELEND_{ij} = \ln\left(\frac{GDP_i}{POP_i}\right) - \ln\left(\frac{GDP_j}{POP_j}\right) \quad (7)$$

The idea is as follows: vertical FDI, in this sense analogous to inter-industry trade, emerges when countries differ more strongly in their factor composition. This may refer to a fragmentation by production stages that is advantageous for a multinational corporation to put in place (e.g. management in the Netherlands, production in Bulgaria). If we mainly have vertical FDI in our sample, we should see a positive correlation with the absolute value of that variable. Horizontal FDI (analogous to intra-industry trade) of the type envisaged by the proximity-concentration trade-off theory emerges more between similar countries. In this case, the multinational corporation is investing because it is interested in a new market. It will in part duplicate in the new country what it was already doing in its home market, rather than specifically split the production process according to factor intensities. We would expect a negative correlation with the RELEND variable if horizontal FDI is more prevalent. As Di Mauro points out, this is only a proxy for relative factor endowments. A slightly better alternative would be to use GDP per worker, which is what I do in the empirical part.

Pooling across country pairs

Brenton et al. (1999) use the classical specification of the gravity equation, however, they opt for a different estimation procedure. A major issue about the econometrics of gravity equations is that of data pooling, i.e. whether one should estimate a single equation for a set of country-pair flows, or whether one should do separate estimations by source or destination country. The latter is what Brenton does.

In fact, separating the estimations is a way around the invalidity of pooling across country pairs. The classical paper cited by Brenton is Matyas (1997).

What Matyas suggested was to 'go back to' the full specification (8), i.e. a triple-indexed model (source country, destination country and time) where there are individual intercepts for each source country (\mathbf{a}_i), for each destination country (\mathbf{g}_j) as well as for each time period (time effects) (\mathbf{f}_t). The gravity model (when modelling flows) should always be applied to a panel data set. Then, once country-specific effects (both as source and as destination countries) and time-specific effects (to account for the business cycle) have been stripped out, one can test additional effects with dummy variables, such as membership of a trade agreement.

$$\ln(M_{ijt}) = \mathbf{a}_i + \mathbf{g}_j + \mathbf{f}_t + \mathbf{b}_1 \ln(GDP_{it}) + \mathbf{b}_2 \ln(GDP_{jt}) + \mathbf{b}_3 \ln(D_{ij}) + \mathbf{e}_{ijt} \quad (8)$$

(With dummy variables as appropriate)

The economic rationale for this specification is as follows: the source and destination country effects account for how open countries are in exports and in imports in turn, with regard to all other countries in the sample. The idea is to capture effects such as competitiveness of the export sector on the supply side (source country side) and general openness to trade and investment (such as lower barriers to trade in the case of a trade flows model, or lower corporate tax in the case of an FDI model) on the demand side (destination country side). This is a refinement compared to only using GDP as it allows countries' overall effective supply and demand of traded goods to depart from GDP. This may then provide very interesting results provided one works with a full world sample or, failing that, if a fictitious country representing the rest of the world is introduced.

What Brenton et al. do in their paper is to estimate equations separately by source country, thus getting around the pitfall of pooling revealed by Matyas. In fact, it is a matter of arbitrary choice whether to split the estimations along source or destination countries, whereas doing both at the same time is equivalent to the full fixed-effects approach of Cheng and Howard (1990).

However, Brenton's choice is not equivalent to Matyas: by estimating separate equations for each source country he not only allows different intercepts for each source country but also different coefficients for GDP and distance.

Matyas says that in effect he opts for fixed effects rather than random effects, since his specification labels the effects as additional intercepts to be estimated.

Real fixed effects however is not about having source country and destination country effects, but about having two-way country-pair effects, i.e. having a separate effect for each 'individual', so two effects (one for each direction) for each country-pair. This difference can be seen by bearing in mind that (8) implies $2N+T$ effects (if one has N countries over T periods in a balanced set) whereas the full fixed effects specification implies N^2-N effects (fixed effects including time effects would have N^2-N+T effects).

If one were to do this, the gravity equation would lose most of its meaning, as is shown in Cheng and Howard (1999). The point is that these country-pair effects catch all the information contained by the distance variable, since it is time invariant. As for GDPs, their only role is then to account for the departure of flows from the base level through time.

It rather depends on what one is trying to do: if one wants to focus on a few selected country-pairs through time and if one is rather more interested in forecasting capabilities, then dropping distance through an all-purpose intercept is probably the way forward. But if one is trying to identify and explain patterns in trade flows, that is if one wants to answer

the question 'why do some countries trade more with each other than with others at a given point in time?', it is completely useless.

Cheng and Howard's methodology, however, underlines the serious problem of heterogeneity. Trade flow estimates from a pooled OLS estimated equation are too often far below or far above the true values, i.e. the remaining variance is still high. An interesting paper on this is Breuss and Egger (1999) which computes confidence intervals around flow estimates from a single-year cross-section gravity equation estimated with OLS. They find confidence intervals that are so large that they make interpretations about 'untapped' trade potential between East and West statistically impossible.

A final comment should be made on zero flows. A full world sample (as advocated by Matyas) would contain a very large number of flows that are nil (typically when countries are small and far away from each other, say Guatemala importing from Latvia). In practice, samples are restricted and country pairs with zero flows are excluded. Is this econometrically valid? The problem is that the gravity equation is by nature misspecified, since the functional form does not enable zero flows between countries unless one of the GDPs is zero or the distance between the countries is infinite. However, an empirical model does not necessarily have to cover the full range of possible values to be useful. The point is that the specification of the gravity model requires a jump from the very small to zero but it is not that region of the range of possible values that is of interest, so that in effect this is a non-issue. Indeed, this problem is not mentioned at all by most researchers.

FDI and exports: complements or substitutes?

One of the major issues about FDI and trade is whether they are complements or substitutes. Brainard's framework seems to imply substitutability, FDI being used to 'jump over' barriers to trade (his model is easily expanded beyond transport costs to include tariffs and non-tariff barriers), thus reducing trade. However, in practice FDI is also trade-creating because of the demand for intermediate goods by the affiliate firms.² In effect, the overall effect of FDI on trade is unclear and so the question becomes an empirical one.

As Di Mauro points out, there are basically two ways to address this question, a direct one and an indirect one. The direct way is to look at how the export share of total foreign sales is related to barriers to trade, which is what Brainard does in his empirical paper, as he has access to data on affiliate sales since he looks at US firms.

² Another trade creating effect which is not discussed in this paper – because it concerns imports instead of exports - is that of trade reversal, i.e. when a firm relocates production to another country and then exports back to its country of origin. However in this case trade creation as exports in intermediate goods from the source country of FDI is also possible.

In the framework of this paper, as with Di Mauro (2000) and Brenton et al. (1998) this is not possible so we use the indirect method, which is to estimate separate gravity equations for FDI and for exports. Di Mauro advocates regressing the residuals of each equation against each other, whereas Brenton uses the residuals of the FDI equation as an additional variable in the exports equation. We apply Brenton's methodology in this paper. If the correlation is positive, we have evidence of complementarity, and the opposite if the correlation is negative. However, as Di Mauro explains, this is an aggregate result, and more detailed sectoral analysis should be made if possible.

One further issue is that in this paper we look at the FDI stock at a single point in time, so that this concept of complementarity / substitutability is tested across countries for a given year, saying in essence that a positive correlation means that generally when FDI is high (respectively low) then so are exports. The additional test one should do would be to look through time at fixed country-pairs' exports and FDI stocks. But even if one were to do this, one should bear in mind how difficult it is to decode from aggregate trade what is really happening. Ideally, one would have access not only to affiliate sales but also to affiliate purchases from their home countries and contrast the latter with export levels of the final goods before the foreign investment happened.

Data and methodological issues

Southeast Europe poses a challenge in that up-to-date and reliable data are not always easy to find. Given the limited resources of national institutions in the region, certain series either do not exist or are rather poor. For these reasons, we have been forced to leave out Serbia and Montenegro (at that time, the Federal Republic of Yugoslavia) and Albania.

Given the nature of the data, and following Di Mauro (2000), we opt for using the FDI end-of-year 1998 stock levels, rather than FDI inflows over several years. For Bosnia-Herzegovina the stock refers to July 1998. More recent FDI stock data were available for Romania, Bulgaria and Croatia but not for Macedonia, which is why we chose December 1998 as the reference date, assuming no big changes for Bosnia in the remaining six-month period.

A proper testing of the proximity-concentration trade-off would in fact require data on affiliate sales. In practice such data are only available for the US and Sweden. In consequence we follow Di Mauro's idea that FDI stock can be seen as a proxy for foreign affiliate sales since the FDI stock is a basis for affiliate production.

There are practical objections to the use of FDI flows as well. Except for very 'stable' investor countries, yearly country-to-country FDI flows vary quite strongly through time in a way that is not explainable using the economic theory referred to in this paper. This is

especially the case for small recipient countries with secondary source countries. One large investment may take place in one particular year, and then one can have a few years during which FDI is nil.

Looking at the stock level (which in practice for all transition economies is the cumulative value of inflows between 1990 and 1998) has the advantage of stripping out the business cycle and any other 'time anomalies'.

Another justification for this choice is linked to the functional form of the gravity equation. FDI inflows can be nil or even negative, which is something that the gravity equation cannot account for. Stocks at least can never be negative. Zero stocks do persist even after ten years between countries that are simultaneously small and remote from each other, but in practice they are not included in the sample, which is not a problem as discussed in the section on the gravity model.

A difficult issue is that of identifying the source countries of FDI. Although this is not unheard of elsewhere, FDI data for Southeast Europe display large flows from 'exotic countries' (tax havens) such as Cyprus, Liechtenstein, Cayman Islands etc. Greek firms are keen to save money by going through Cyprus (Panagiotou, 2000) and Yugoslav firms used tax havens (in particular Cyprus and Liechtenstein) especially in 1999 in order to get around international sanctions. Russian businesses are also rumoured to like this kind of practice. Finally, even certain domestic investors may choose to use tax havens to invest in their own countries (e.g. money-laundering).

It pays to do some detective work in order to reallocate some flows back to their original source countries, preferably with some help from regional sources who know 'where the money really came from'. We did manage to find out some bits of information concerning the most problematic data. We assume that some correction is better than none at all, as the tax havens themselves are not selected source countries, so that reallocating part of their stocks to some of the chosen source countries should not generate a bias.

In particular, for Macedonia, the two largest investing countries in 1998 were Cyprus and Liechtenstein. In reality it was a Greek-Swiss consortium formed by Titan Cement and Holderbank registered in Cyprus that bought an 84% stake (half each) of the USJE cement factory (Skopje) and a Serbian multinational, Balkan Steel, registered in Liechtenstein, that bought Skopje Steel Mill.

Balkanbrew Holding of Greece bought Pivara Skopje³, but it was unclear how, if at all, this was recorded in FDI data.⁴ It was not in the flows from Greece, so we added it there.

Another investment from Liechtenstein by Duferco Ltd⁵ was rather difficult to decompose by original source country so we ignored it.

Finally, Romania has a large FDI stock from Cyprus. This, we were told, is from several different countries and also includes Romanian equity. Simultaneously, Russia's Lukoil buying a 51% stake in Romania's refinery Petrotel seems to have gone unrecorded in the FDI data we had, but we were unable to conclusively link the two so we ignored it (in any case Russia is not a selected source country in this paper).

Concerning data sources, we took GDPs (nominal at current prices in billions of USD) from the OECD for western countries and from wiiw for transition countries. Export data came from the IMF-DOT database (trade in goods, nominal prices in millions of USD) and from wiiw, FDI stocks from wiiw. Employment data came from wiiw and the OECD.

Empirical results

We decided to focus on nine key European source countries: Germany, Italy, Greece, Austria, Belgium, The Netherlands, Switzerland, the UK and France. For the reasons explained above, there remained only five Southeast European destination countries (Romania, Bulgaria, Macedonia, Bosnia-Herzegovina and Croatia). In order to assess whether the FDI levels in those countries were at their potential values at the end of 1998, we selected the five more advanced Central European economies of Hungary, Poland, the Czech Republic, Slovakia and Slovenia to serve as a control group. We tested two specifications of the gravity equation, Di Mauro's and a modification of the classical equation that includes source country effects (dummy variables not stated).

$$\ln(FDI_{ij}) = \mathbf{a} + \mathbf{b}_1 SIMSIZE_{ij} + \mathbf{b}_2 TGDP_{ij} + \mathbf{b}_3 RELEND_{ij} + \mathbf{b}_4 \ln(D_{ij}) + \mathbf{e}_{ij} \quad (9)$$

$$\ln(FDI_{ij}) = \mathbf{a}_i + \mathbf{b}_1 \ln(GDP_i) + \mathbf{b}_2 \ln(GDP_j) + \mathbf{b}_3 \ln(D_{ij}) + \mathbf{e}_{ij} \quad (10)$$

³ Source: Privatization Agency of the Republic of Macedonia. <http://www.mpa.org.mk/fdi2.htm>

⁴ The FDI data used were compiled by The Vienna Institute for International Economic Studies (WIIW) using national sources. In other words there are discrepancies between the privatization agency and the national statistical office and national bank.

⁵ Duferco Ltd started off as an independent exporter of Brazilian steel, then rapidly expanded into the Pacific Rim area, and later started activities in Europe. Its headquarters are now in Switzerland.

We chose (10) as our main workhorse for measuring the regional effect as we believe that it is econometrically more solid (Matyas, 1997). However, we present the conclusions from the Di Mauro equation (9) first. Here the fit is slightly better than that of the classical specification without source country effects. The RELEND variable is not significant, so that there is no evidence of dominance from vertical FDI.

Dependent Variable: LOG(STOCK1298)

Method: Least Squares

Sample: 1 90

Included observations: 76

Excluded observations: 14

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| C | 2.841338 | 1.439317 | 1.974088 | 0.0523 |
| SIMSIZE | 1.496988 | 0.123986 | 12.07383 | 0.0000 |
| TGDP | 1.599871 | 0.181966 | 8.792135 | 0.0000 |
| RELEND | 0.181224 | 0.257153 | 0.704732 | 0.4833 |
| LOG(DIST) | -0.645772 | 0.228522 | -2.825858 | 0.0061 |
| R-squared | 0.701747 | Mean dependent var | | 5.000337 |
| Adjusted R-squared | 0.684944 | S.D. dependent var | | 1.825566 |
| S.E. of regression | 1.024688 | Akaike info criterion | | 2.950179 |
| Sum squared resid | 74.54895 | Schwarz criterion | | 3.103516 |
| Log likelihood | -107.1068 | F-statistic | | 41.76315 |
| Durbin-Watson stat | 1.877398 | Prob(F-statistic) | | 0.000000 |

However, if one estimates the same equation separately for the two country groups a different picture emerges. For Southeast Europe:

Dependent Variable: LOG(SEE5*STOCK1298)

Method: Least Squares

Sample(adjusted): 1 72

Included observations: 38

Excluded observations: 34 after adjusting endpoints

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| C | 3.942369 | 2.299357 | 1.714553 | 0.0958 |
| SIMSIZE | 1.268538 | 0.184625 | 6.870893 | 0.0000 |
| TGDP | 1.124427 | 0.268269 | 4.191423 | 0.0002 |
| RELEND | 0.756450 | 0.362284 | 2.088006 | 0.0446 |
| LOG(DIST) | -0.670607 | 0.403896 | -1.660346 | 0.1063 |
| R-squared | 0.600885 | Mean dependent var | | 3.849437 |
| Adjusted R-squared | 0.552507 | S.D. dependent var | | 1.471309 |
| S.E. of regression | 0.984231 | Akaike info criterion | | 2.928168 |
| Sum squared resid | 31.96747 | Schwarz criterion | | 3.143639 |
| Log likelihood | -50.63518 | F-statistic | | 12.42071 |
| Durbin-Watson stat | 2.336530 | Prob(F-statistic) | | 0.000003 |

We see that RELEND is significant at the 5% level and positive, indicating evidence in favour of vertical (efficiency-seeking) FDI.

For the control group countries, things are very different:

Dependent Variable: LOG(CEC5*STOCK1298)

Method: Least Squares

Sample(adjusted): 19 90

Included observations: 38

Excluded observations: 34 after adjusting endpoints

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| C | 2.910113 | 1.701860 | 1.709960 | 0.0967 |
| SIMSIZE | 1.775103 | 0.256712 | 6.914765 | 0.0000 |
| TGDP | 2.099749 | 0.301625 | 6.961443 | 0.0000 |
| RELEND | -0.976562 | 0.486234 | -2.008417 | 0.0528 |
| LOG(DIST) | -0.762730 | 0.256720 | -2.971063 | 0.0055 |
| R-squared | 0.626150 | Mean dependent var | | 6.151236 |
| Adjusted R-squared | 0.580834 | S.D. dependent var | | 1.367466 |
| S.E. of regression | 0.885338 | Akaike info criterion | | 2.716385 |
| Sum squared resid | 25.86618 | Schwarz criterion | | 2.931857 |
| Log likelihood | -46.61132 | F-statistic | | 13.81766 |
| Durbin-Watson stat | 2.381604 | Prob(F-statistic) | | 0.000001 |

Here on the contrary RELEND is negative and the p-value is only a touch above 5%. In effect, the two regions are symmetrical when it comes to the RELEND variable which explains its non-significance in the joint estimation.

If one considers RELEND here to be significant and negative, we conclude that FDI is higher when GDPs per worker are closer, i.e. there is more FDI the more similarity there is between countries and so this points to a domination of horizontal, market-seeking FDI.

What about the evidence of vertical FDI in Southeast Europe?

Prima facie we should conclude that FDI to that region is mainly efficiency-seeking, given our positive and significant result for the RELEND variable. However Croatia is an anomaly in the region, having a very high GDP per worker and being geographically close to Western countries but attracting only modest levels of FDI. This is changing today but in 1998 there was still some way to go and there were clearly some political factors at play.

We re-estimated the same equation on a reduced sample, taking each country out of the sample in turn, and indeed it is Croatia that is responsible for our result. We give below the successive lines corresponding to the RELEND variable only:

| Excluded Country | RELEND Coefficient | RELEND Std Err | RELEND T-Stat | RELEND P-Value |
|------------------|--------------------|----------------|---------------|----------------|
| Croatia | 0.413377 | 0.826636 | 0.500071 | 0.6214 |
| Romania | 0.875528 | 0.407432 | 2.148891 | 0.0419 |
| Bulgaria | 0.617241 | 0.376677 | 1.638649 | 0.1143 |
| Bosnia | 0.891664 | 0.372764 | 2.392035 | 0.0235 |
| Macedonia | 0.741239 | 0.402432 | 1.841901 | 0.0774 |

We see that excluding Croatia yields a non-significant RELEND variable. All in all, the evidence is mixed. Clearly, both types of FDI are well represented in Southeast Europe (as regional sources confirm), and if we accept the exclusion of Croatia, we conclude that neither type dominates.

The classical equation

The estimation of the classical equation was done using OLS and by allowing separate intercepts for each source country on the FDI stock. In this way, time effects are stripped out, while source country effects are also taken care of. Naturally, the GDP of the source country is no longer included since there is only one time period and therefore the source country effects include the source country GDP effect.

This specification is therefore correct according to the Matyas methodology and follows Di Mauro's reasoning as to the choice of stocks instead of flows.

Dependent Variable: LOG(STOCK1298)

Method: Least Squares

Sample: 1 90

Included observations: 76

Excluded observations: 14

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| SOURCEDE | 4.931927 | 1.561860 | 3.157728 | 0.0024 |
| SOURCEAT | 4.203806 | 1.407994 | 2.985671 | 0.0040 |
| SOURCEIT | 3.360582 | 1.555664 | 2.160223 | 0.0344 |
| SOURCENL | 4.667952 | 1.650390 | 2.828393 | 0.0062 |
| SOURCEBE | 3.363512 | 1.666746 | 2.018012 | 0.0477 |
| SOURCECH | 3.508772 | 1.581258 | 2.218976 | 0.0300 |
| SOURCEUK | 4.322837 | 1.697957 | 2.545905 | 0.0133 |
| SOURCEFR | 3.981032 | 1.658556 | 2.400300 | 0.0193 |
| SOURCEGR | 4.181053 | 1.583608 | 2.640207 | 0.0104 |
| LOG(YM98) | 1.397134 | 0.103640 | 13.48067 | 0.0000 |
| LOG(DIST) | -0.501319 | 0.215441 | -2.326937 | 0.0231 |
| R-squared | 0.772039 | Mean dependent var | | 5.000337 |
| Adjusted R-squared | 0.736968 | S.D. dependent var | | 1.825566 |
| S.E. of regression | 0.936272 | Akaike info criterion | | 2.839307 |
| Sum squared resid | 56.97937 | Schwarz criterion | | 3.176650 |
| Log likelihood | -96.89365 | Durbin-Watson stat | | 1.533658 |

It is then possible to test with the SEE5 dummy variable whether, overall, the countries of Southeast Europe have 'abnormally low' levels of FDI stock. Unsurprisingly, the SEE5 dummy is negative and significant, meaning that FDI stocks in the SEE-5 countries are lower than what they should be with regard to the countries of the control group, destination country GDP and geographical distance accounted for.

One should note the effect of the introduction of that dummy variable on the distance variable which is then no longer significant. The issue here is that there is some correlation between distance and the SEE5 dummy variable because overall the countries of that region are further away from the source countries than those of the control group.

Regarding both equations, one cannot comment on the differences between the source country effects because the differences in the coefficients are too small compared to the standard errors (i.e. none of the country effects are significantly different from any other).

The SEE5 dummy variable estimate indicates that the distortion to the SEE countries' FDI stocks was $\exp(-0.757603)=0.468789$. In other words, these results indicate that the FDI stocks in the region were 46.88% of what they 'should have been'. We use the inverted commas here as we are limited to a bare-bones gravity model that accounts only for GDP and distance.

Dependent Variable: LOG(STOCK1298)

Method: Least Squares

Sample: 1 90

Included observations: 76

Excluded observations: 14

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| SOURCEDE | 3.755255 | 1.577136 | 2.381060 | 0.0202 |
| SOURCEAT | 3.263183 | 1.407887 | 2.317787 | 0.0237 |
| SOURCEIT | 2.193372 | 1.570297 | 1.396788 | 0.1673 |
| SOURCENL | 3.364888 | 1.673965 | 2.010130 | 0.0486 |
| SOURCEBE | 2.122140 | 1.681312 | 1.262193 | 0.2115 |
| SOURCECH | 2.311487 | 1.597457 | 1.446979 | 0.1528 |
| SOURCEUK | 2.947213 | 1.726715 | 1.706833 | 0.0927 |
| SOURCEFR | 2.657063 | 1.684095 | 1.577739 | 0.1196 |
| SOURCEGR | 3.309031 | 1.564873 | 2.114569 | 0.0384 |
| LOG(YM98) | 1.200009 | 0.127685 | 9.398173 | 0.0000 |
| LOG(DIST) | -0.185379 | 0.243574 | -0.761080 | 0.4494 |
| SEE5 | -0.757603 | 0.306184 | -2.474336 | 0.0160 |
| R-squared | 0.791942 | Mean dependent var | | 5.000337 |
| Adjusted R-squared | 0.756182 | S.D. dependent var | | 1.825566 |
| S.E. of regression | 0.901427 | Akaike info criterion | | 2.774264 |
| Sum squared resid | 52.00453 | Schwarz criterion | | 3.142275 |
| Log likelihood | -93.42204 | Durbin-Watson stat | | 1.752025 |

It may be possible to find other variables that explain in whole or in part the observed distortion, which is why, in keeping with Brenton's paper, we also experimented with the Index for Economic Freedom of the Heritage Foundation. This index is the average of scores from 1 (very free) to 5 (very restricted) attributed to countries on ten key aspects⁶ of 'business and investment climate'. Ultimately, the lower the index the better for foreign investors. It was necessary to exclude Macedonia from the sample for lack of availability.

The result is that although the index is significant and of the expected negative sign, the SEE5 dummy is a superior variable. The two are of course correlated, but when estimating the same equation with each in turn, the equation with the SEE5 dummy yields a slightly higher R-squared. This result reinforces the idea that the countries of Southeast Europe are similar and have similar problems. They have similar scores for economic freedom, but it turns out it is more accurate to lump them together in the same category rather than use the index. Having said that, at least we do have an economic variable that explains in part the region's shortfall in FDI.

Now as to the issue of complementarity between FDI and trade, we use the same approach as Brenton: estimating a gravity model on exports including the residuals of the equation on FDI as an additional dependent variable. Contrary to Brenton however, we choose to estimate the equation on exports for the year 1999, with the GDP of 1999. We agree with Brenton on the consistency issue, from the point of view of the variables in the model (his point is that the remaining dependent variables should be the same). However, our argument is that the FDI stock proxies affiliate production after December 1998 so that the interaction between the FDI stock and exports is played out in 1999.

The FDI RESIDUAL variable used here is the difference between the log of the FDI stock and the estimate of that same quantity from the first equation in this section.

Dependent Variable: LOG(IMP99)
Method: Least Squares
Sample: 1 90
Included observations: 76
Excluded observations: 14

(continued)

⁶ Trade policy, Fiscal burden of government, Government intervention in the economy, Monetary policy, Capital flows and foreign investment, Banking and finance, Wages and prices, Property rights, Regulation, Black market (1: none, 5: enormous).

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| SOURCEDE | 7.991297 | 0.597793 | 13.36800 | 0.0000 |
| SOURCEAT | 6.111266 | 0.539105 | 11.33595 | 0.0000 |
| SOURCEIT | 7.238909 | 0.595430 | 12.15745 | 0.0000 |
| SOURCENL | 5.953698 | 0.631512 | 9.427684 | 0.0000 |
| SOURCEBE | 5.771423 | 0.637582 | 9.052041 | 0.0000 |
| SOURCECH | 5.401565 | 0.605138 | 8.926173 | 0.0000 |
| SOURCEUK | 6.332847 | 0.649659 | 9.747951 | 0.0000 |
| SOURCEFR | 6.769826 | 0.634677 | 10.66658 | 0.0000 |
| SOURCEGR | 6.312559 | 0.605112 | 10.43206 | 0.0000 |
| LOG(YM99) | 0.986890 | 0.040472 | 24.38433 | 0.0000 |
| LOG(DIST) | -0.496487 | 0.082203 | -6.039750 | 0.0000 |
| FDI-RESIDUAL | 0.213695 | 0.047288 | 4.518956 | 0.0000 |
| R-squared | 0.941640 | Mean dependent var | | 6.122242 |
| Adjusted R-squared | 0.931609 | S.D. dependent var | | 1.364739 |
| S.E. of regression | 0.356901 | Akaike info criterion | | 0.921225 |
| Sum squared resid | 8.152234 | Schwarz criterion | | 1.289236 |
| Log likelihood | -23.00656 | Durbin-Watson stat | | 1.718029 |

As we can see, the FDI RESIDUAL variable is positive and significant. This indicates evidence of complementarity between exports and FDI stocks. In other words, where FDI stocks are lower than the estimate, exports are generally also lower than the estimate, and when FDI stocks are higher than the estimate, then so are exports.

However this applies to the whole sample. It may be that most of that effect is a 'between' rather than a 'within' effect, so it is necessary to repeat the estimation on the two country groups separately. The full tables are available in the annex. The estimates are:

For the CEC-5 sub-sample:

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------|-------------|------------|-------------|--------|
| | | | | |
| FDI-RESIDUAL | 0.364462 | 0.069525 | 5.242136 | 0.0000 |

For the SEE-5 sub-sample:

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------|-------------|------------|-------------|--------|
| | | | | |
| FDI-RESIDUAL | 0.044346 | 0.099650 | 0.445011 | 0.6599 |

In other words we see evidence of complementarity in the control group of Central European economies but no evidence in favour of complementarity or substitutability for the SEE group.

Conclusion

FDI stocks (at the end of 1998) in the more advanced economies of Central Europe are mainly of the horizontal, market-seeking type. For Southeast Europe we conclude that both market-seeking FDI and efficiency-seeking FDI co-exist, with neither type dominating.

Unsurprisingly, Southeast Europe is found to attract somewhat lower levels of FDI than gravity variables would indicate. The index for economic freedom is found to be a significant economic variable in explaining the shortfall. The case of Croatia is particularly striking, given its relatively high GDP and (from a gravity model point of view) favourable geographic location. One should add at this stage that recent figures show a marked increase in Croatia's FDI stock. This recent development is thus compatible with the spirit of the gravity model.

Whereas evidence is found in favour of complementarity between trade and FDI for the countries of the control group (Central Europe), meaning that FDI and trade are positively correlated across country pairs, neither complementarity or substitutability were found for Southeast Europe. In other words, high FDI stocks in the sample are not significantly often coupled with either high or low trade volumes. This could mean that both effects co-exist, depending on which country pair one looks at.

Generally speaking FDI into Southeast Europe is such that it is only a weak trade creator in the relevant intermediate goods, so that the extra trade thus generated is small when compared to total exports. Technology matters at this stage. FDI to the region is mainly 'bricks and mortar', i.e. rather low-tech, as we saw with the examples quoted for Macedonia such as cement factories or breweries. Therefore the corresponding demand for intermediate goods from the investor countries is low, as the small number of varieties of goods used can mostly be found at a cheaper price in the destination country. This does not exclude trade creation effects completely though, as we did not investigate possible increases to recipient countries' export capacity brought on by foreign investment. The case of Bulgaria for the textile and clothing industry is a clear example. Analysing this type of trade creation constitutes a separate area of research interest.

One should note here that the technological level of investments has already changed as the economies of the region have progressed and as more high-technology sectors have developed and have been targeted by investors. Deutsche Telekom's acquisitions in Croatia in 2001 are one example, though acquisitions in the telecommunications sector subsequently experienced a clear slowdown across transition countries.

Regarding future prospects for FDI into the region, the index for economic freedom should give a good indication of which problems should be dealt with from an institutional and economic policy point of view. The fact that the regional dummy actually had more explanatory power than the index is quite stunning. However more recent and more complete data, including FDI for Albania and Serbia and Montenegro, both still very low, would show a different picture. In effect, according to the most recent data, the region may be split in two: a 'periphery', made up of Croatia, Romania and Bulgaria, which are relatively more advanced and whose FDI stocks have substantially increased since 1998, and a 'core', made up of Bosnia-Herzegovina, Serbia and Montenegro, and Albania, which are only just beginning to attract substantial interest from strategic investors.

Regarding future investigations, it would be most interesting to have access to firm-level data to determine to what extent affiliates of western multinational corporations import goods from their country of origin ('affiliate purchases'). This would constitute a direct method that would refine the empirics on trade creation effects and the debate on complementarity versus substitutability.

References

- Brainard, S.L. (1993), 'A Simple Theory of Multinational Corporations and Trade with a Trade-Off between Proximity and Concentration', *NBER Working Paper* 4269.
- Brainard, S.L. (1997), 'An Empirical Assessment of the Proximity-Concentration Trade-Off Between Multinational Sales and Trade', *The American Economic Review*, Vol. 87, Issue 4, pp. 520-544.
- Brenton, P., F. Di Mauro and M. Luecke (1999), 'Economic Integration and FDI: An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe', *Empirica*, Vol. 26, pp. 95-121
- Breuss, F. and P. Egger (1999), 'How Reliable are Estimations of East-West Trade Potentials Based on Cross-Section Gravity Analyses?', *Empirica*, Vol. 26, pp. 81-94.
- Christie, E. (2002), 'Potential Trade in Southeast Europe: A Gravity Model Approach', *wiiw Working Papers*, No.21, March.
- Cheng, Hui and J.W. Howard (1999), 'Controlling for Heterogeneity in Gravity Models of Trade', *FRBSL Working Paper* No. 99-010A, Federal Reserve Bank of St. Louis.
- Di Mauro, F. (2000), 'The Impact of Economic Integration on FDI and Exports: A Gravity Approach', *CEPS Working Document* 156.
- Dunning, J. (1977), 'Trade, location of economic activity and the MNE: a search for an eclectic approach', in B. Ohlin, P. Hesselborn and P. Wijkman (eds), *The International Allocation of Economic Activity*, Macmillan, London.
- Fidrmuc, Jan and Jarko Fidrmuc (2000), 'Disintegration and Trade', *CEPS Discussion Paper* 2641.
- Hamilton, C.B. and L.A. Winters (1992), 'Trade with Eastern Europe', *Economic Policy* (European Forum), April, pp. 77-116.
- Hunya, G. (2000), 'Recent FDI Trends, Policies and Challenges in South-East European Countries', *wiiw Research Reports*, No. 273.
- Helpman, E. (1984), 'A Simple Theory of International Trade with Multinational Corporations', *Journal of Political Economy*, Vol. 92, Issue 3, pp. 451-471
- Markusen, R.M. and K.E. Maskus (1999), 'Discriminating Among Alternative Theories of the Multinational Enterprise', *NBER Working Paper* 7164.
- Matyas, L. (1997), 'Proper Econometric Specification of the Gravity Model', *The World Economy*, Vol. 20, No. 3, pp. 363-368.
- Maurel, M. (1998), *Régionalisme et désintégration en Europe centrale et orientale – Une approche gravitationnelle*, CNRS Economie, Paris.
- Panagiotou, R. (2000), 'Foreign Direct Investment in Southeast Europe', *wiiw 'Countdown' Project, Regionalism and Balkan Integration Project Paper*.
- Papanastassiou, M. and G. Zanas (2000), 'Greek Foreign Direct Investment in Southeast Europe', *wiiw 'Countdown' Project, Regionalism and Balkan Integration Project Paper*.

APPENDIX

Exports equation on CEC-5 sub-sample

Dependent Variable: LOG(CEC5*IMP99)

Method: Least Squares

Sample(adjusted): 19 90

Included observations: 38

Excluded observations: 34 after adjusting endpoints

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| SOURCEDE | 8.273694 | 0.824059 | 10.04018 | 0.0000 |
| SOURCEAT | 6.237140 | 0.684845 | 9.107367 | 0.0000 |
| SOURCEIT | 7.365311 | 0.857609 | 8.588193 | 0.0000 |
| SOURCENL | 6.180367 | 0.889703 | 6.946553 | 0.0000 |
| SOURCEBE | 6.315947 | 0.894315 | 7.062329 | 0.0000 |
| SOURCECH | 5.814282 | 0.843402 | 6.893848 | 0.0000 |
| SOURCEUK | 6.635675 | 0.927061 | 7.157752 | 0.0000 |
| SOURCEFR | 7.034418 | 0.909568 | 7.733800 | 0.0000 |
| LOG(YM99) | 0.945486 | 0.074093 | 12.76078 | 0.0000 |
| LOG(DIST) | -0.510825 | 0.144599 | -3.532700 | 0.0015 |
| FDI-RESIDUAL | 0.364462 | 0.069525 | 5.242136 | 0.0000 |
| R-squared | 0.955674 | Mean dependent var | | 6.924044 |
| Adjusted R-squared | 0.939257 | S.D. dependent var | | 1.103984 |
| S.E. of regression | 0.272089 | Akaike info criterion | | 0.471825 |
| Sum squared resid | 1.998879 | Schwarz criterion | | 0.945863 |
| Log likelihood | 2.035333 | Durbin-Watson stat | | 1.715695 |

Exports equation on SEE-5 sub-sample

Dependent Variable: LOG(SEE5*IMP99)

Method: Least Squares

Sample(adjusted): 1 72

Included observations: 38

Excluded observations: 34 after adjusting endpoints

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| SOURCEDE | 1.376850 | 0.420529 | 3.274095 | 0.0029 |
| SOURCEAT | 0.177312 | 0.398639 | 0.444793 | 0.6600 |
| SOURCEIT | 1.152049 | 0.405314 | 2.842359 | 0.0084 |
| SOURCENL | -0.862104 | 0.448895 | -1.920501 | 0.0654 |
| SOURCEBE | -1.173559 | 0.475172 | -2.469754 | 0.0201 |
| SOURCECH | -1.123263 | 0.434350 | -2.586080 | 0.0154 |
| SOURCEUK | -0.716354 | 0.455115 | -1.574004 | 0.1271 |
| SOURCEFR | -0.154628 | 0.436049 | -0.354611 | 0.7256 |
| LOG(YM99) | 0.946858 | 0.111168 | 8.517367 | 0.0000 |
| LOG(DIST) | 0.418446 | 0.061247 | 6.832164 | 0.0000 |
| FDI-RESIDUAL | 0.044346 | 0.099650 | 0.445011 | 0.6599 |
| R-squared | 0.817286 | Mean dependent var | | 5.320439 |
| Adjusted R-squared | 0.749614 | S.D. dependent var | | 1.111780 |
| S.E. of regression | 0.556319 | Akaike info criterion | | 1.902249 |
| Sum squared resid | 8.356260 | Schwarz criterion | | 2.376287 |
| Log likelihood | -25.14273 | Durbin-Watson stat | | 2.146802 |

Short list of the most recent wiiw publications

(as of March 2003)

For current updates and summaries see also wiiw's website at www.wiiw.at

Foreign Direct Investment in Southeast Europe

by Edward Christie

wiiw Working Papers, No. 24, March 2003

22 pages, EUR 8.00 (PDF: free download from wiiw's website)

The Vienna Institute Monthly Report 2003/3

edited by Leon Podkaminer

- Iraq crisis, oil price and economies in transition
- Iraq and the Balkans
- Structural change and productivity growth in Central and Eastern Europe
- Poland's macro policy under a critical reassessment
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2003
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, March 2003

27 pages including 13 Tables

(exclusively for subscribers to the wiiw Service Package)

The Russian Oil and Gas Sector: Facing the New Challenges

by Vasily Astrov

wiiw Research Reports, No. 294, February 2003

29 pages including 4 Tables and 2 Figures, EUR 22.00 (PDF: EUR 20.00)

wiiw-wifo Database. Foreign Direct Investment in CEECs and the Former Soviet Union – with Special Attention to Austrian FDI Activities

by Gábor Hunya and Jan Stankovsky

wiiw and wifo, Vienna, 14th edition, February 2003

53 pages including 35 Tables, EUR 47.00

Transition Countries Resist Global Slowdown: Productivity Gains Offset Effects of Appreciation

by Leon Podkaminer et al.

wiiw Research Reports, No. 293 (Special issue on transition economies), February 2003

106 pages including 37 Tables, 10 Figures and 4 Panels, EUR 70.00 (PDF: EUR 65.00)

The Vienna Institute Monthly Report 2003/2

edited by Leon Podkaminer

- Poland's debt: history and outlook
- Income inequality in the Czech Republic
- Factors affecting T-bond yields in Poland
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, February 2003

37 pages including 29 Tables and 7 Figures

(exclusively for subscribers to the wiiw Service Package)

The Vienna Institute Monthly Report 2003/1

edited by Leon Podkaminer

- The Copenhagen Summit: enlargement comes cheaply
- Agriculture in transition countries: stagnation in the CEECs, growth in Russia and Ukraine
- Kosovo: a protectorate's economy
- Privatization, FDI and corporate governance in Bulgaria
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, January 2003

39 pages including 19 Tables and 1 Figure

(exclusively for subscribers to the wiiw Service Package)

Comparison of Tax Burdens

by Markus Leibrecht and Roman Römisch

wiiw Research Reports, No. 292, December 2002

80 pages including 8 Tables and 3 Figures, EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 2002/12

edited by Leon Podkaminer

- Hungarian manufacturing – the shooting star in Central and Eastern Europe
- The 2002 Regular Reports on the EU candidate countries
- The Baltic countries: from the rouble to the euro
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, December 2002

29 pages including 14 Tables and 2 Figures

(exclusively for subscribers to the wiiw Service Package)

Industrial Diversity, Trade Patterns and Productivity Convergence

by Robert Stehrer and Julia Wörz

wiiw Working Papers, No. 23, November 2002

29 pages including 7 Tables, EUR 8.00 (PDF: free download from wiiw's website)

Competitive Economic Performance: USA versus EU

by Karl Aiginger and Michael Landesmann

wiiw Research Reports, No. 291, November 2002

76 pages including 14 Tables and 23 Figures, EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 2002/11

edited by Leon Podkaminer

- From ERM to ERM2 – from one crisis to another?
- Structural militarization in post-communist Russia
- Neoliberal economic policy hampers integration of Central and Eastern Europe
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, November 2002

29 pages including 14 Tables

(exclusively for subscribers to the wiiw Service Package)

EU Enlargement: Economic Impacts on Austria and the Five Acceding Central European Countries

by Peter Havlik

wiiw Research Reports, No. 290, October 2002

38 pages including 19 Tables and 1 Figure, EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 2002/10

edited by Leon Podkaminer

- Bulgaria: steady growth
- Croatia: trade deficit high again
- Czech Republic: after the flood
- Hungary: growth driven by domestic demand
- Macedonia: landmark elections
- Poland: changes in fiscal policy may make a difference
- Romania: export-led growth
- Russia: mixed results in 2002
- Slovakia: election encourages GDP growth
- Slovenia: record FDI inflow
- Ukraine: budget and inflation targets jeopardized
- Yugoslavia: making up its mind
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, October 2002

41 pages including 22 Tables

(exclusively for subscribers to the wiiw Service Package)

Countries in Transition 2002: wiiw Handbook of Statistics

covers twelve transition countries (Bulgaria, Croatia, Czech Republic, Hungary, Poland, Macedonia, Romania, Russia, Slovakia, Slovenia, Ukraine, Yugoslavia), 1990 to August 2001

wiiw, Vienna, October 2002

545 pages, EUR 90.00 (ISBN 3-85209-007-5)

The Services Sectors in Central and Eastern Europe

by Hermine Vidovic

wiiw Research Reports, No. 289, September 2002

88 pages including 17 Tables, 7 Figures and 5 Maps, EUR 22.00 (EUR 20.00)

Macroeconomic and Sectoral Aspects of Hungary's International Competitiveness and Trade Performance on EU Markets

by Gábor Oblath and Sándor Richter

wiiw Research Reports, No. 288, September 2002

37 pages including 14 Tables and 14 Figures, EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 2002/8-9

edited by Leon Podkaminer

- Agriculture in transition countries: robust expansion backed by investment and bumper harvests
- Average effective tax rates in CEE and EU countries
- Selected monthly data on the economic situation in ten transition countries, 2001 to 2002
- Guide to wiiw statistical services on Central and Eastern Europe, Russia and Ukraine

wiiw, August - September 2002

31 pages including 15 Tables and 1 Figure

(exclusively for subscribers to the wiiw Service Package)

Restructuring Through FDI in Romanian Manufacturing

by Gábor Hunya

wiiw Research Reports, No. 287, August 2002

27 pages including 4 Tables and 8 Figures, EUR 22.00 (PDF: EUR 20.00)

The CEECs in the Enlarged Europe: Convergence Patterns, Specialization and Labour Market Implications

by Michael Landesmann and Robert Stehrer

wiiw Research Reports, No. 286, July 2002

51 pages including 11 Tables and 14 Figures, EUR 22.00 (PDF: EUR 20.00)

wiiw Service Package

The Vienna Institute offers to firms and institutions interested in unbiased and up-to-date information on Central and East European markets a package of exclusive services and preferential access to its publications and research findings, on the basis of a subscription at an annual fee of EUR 2,000.

This subscription fee entitles to the following package of **Special Services**:

- A free invitation to the Vienna Institute's **Spring Seminar**, a whole-day event at the end of March, devoted to compelling topics in the economic transformation of the Central and East European region (for subscribers to the wiiw Service Package only).
- Copies of, or online access to, **The Vienna Institute Monthly Report**, a periodical consisting of timely articles summarizing and interpreting the latest economic developments in Central and Eastern Europe and the former Soviet Union. The statistical annex to each *Monthly Report* contains tables of the latest monthly country data. This periodical is not for sale, it can only be obtained in the framework of the wiiw Service Package.
- Free copies of the Institute's **Research Reports** (including **Reprints**), **Analytical Forecasts** and **Current Analyses and Country Profiles**
- A free copy of the **wiiw Handbook of Statistics, Countries in Transition** (published in October each year and containing more than 200 tables and 100 figures on the economies of Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia, Russia and Ukraine)
- Free online access to the **wiiw Monthly Database**, containing more than 1000 leading indicators monitoring the latest key economic developments in ten Central and East European countries.
- **Consulting**. The Vienna Institute is pleased to advise subscribers on questions concerning the East European economies or East-West economic relations if the required background research has already been undertaken by the Institute. We regret we have to charge extra for *ad hoc* research.
- Free access to the Institute's specialized economics library and documentation facilities.

Subscribers who wish to purchase wiiw data sets **on diskette** or special publications not included in the wiiw Service Package are granted considerable **price reductions**.

**For detailed information about the wiiw Service Package
please visit wiiw's website at www.wiiw.at**

To
The Vienna Institute
for International Economic Studies
Oppolzergasse 6
A-1010 Vienna

- Please forward more detailed information about the Vienna Institute's Service Package
- Please forward a complete list of the Vienna Institute's publications to the following address

Please enter me for

- 1 yearly subscription of *Research Reports* (including *Reprints*)
at a price of EUR 225.00 (within Austria), EUR 250.00 (Europe) and EUR 265.00 (overseas) respectively

Please forward

- the following issue of *Research Reports*
- the following issue of *Analytical Forecasts*
- the following issue of *Current Analyses and Country Profiles*
- the following issue of *Working Papers*
- the following issue of *Research Papers in German language*
- the following issue of *China Reports*
- the following issue of *Industry Studies*
- the following issue of *Structural Reports*
- the following issue of *wiiw-wifo Data on Foreign Direct Investment*
- the following issue of *COUNTRIES IN TRANSITION: wiiw Handbook of Statistics*

.....
Name

.....
Address

.....
Telephone

Fax

e-mail

.....
Date

.....
Signature

Herausgeber, Verleger, Eigentümer und Hersteller:

Verein "Wiener Institut für Internationale Wirtschaftsvergleiche" (wiiw),
Wien 1, Oppolzergasse 6

Postanschrift: A-1010 Wien, Oppolzergasse 6, Tel: [431] 533 66 10, Telefax: [431] 533 66 10 50

Internet Homepage: www.wiiw.at

Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.

P.b.b. Verlagspostamt 1010 Wien