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**COMPETING LOCATIONS? MARKET POTENTIAL AND FDI IN CENTRAL AND
EASTERN EUROPE VS THE MEDITERRANEAN**

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COMPETING LOCATIONS? MARKET POTENTIAL AND FDI IN CENTRAL AND EASTERN EUROPE VS THE MEDITERRANEAN

by Carlo ALTOMONTE ^{a, (*)} and Claudia GUAGLIANO ^b

ABSTRACT

The issue of the location of Foreign Direct Investment is receiving a renewed interest in the literature since developing countries have now started to compete for the attraction of foreign capital. In particular, the European Union is at the centre of a region where strong integration dynamics are in place, and where the “peripheries”, i.e. Central and Eastern Europe and the South Mediterranean shore, are taking advantage of an increasing presence of European multinationals.

The full implications of such dynamics, for both the European Union and the bordering countries, are yet to be fully understood given the complex issues behind the determinants of FDI location.

At this purpose, we will exploit two unique databases, constructing a panel probit model of FDI determinants of more than 3,500 European multinationals having invested in Central and Eastern Europe and the Mediterranean over the 1990-1997 period in 48 NACE-3 different industries.

We will then discuss the policy implications for the European Union and for its neighbouring countries of those FDI determinants.

JEL classification: C23, F21, P20

Keywords: panel data, FDI, transition economies

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1. Introduction

The integration process of the European Union (EU) has been characterised in the last decade by a twofold dimension: an internal one, devoted to the creation of a truly single market operating with a single currency, the euro, and a renovated attention to the external dimension of such an integration process, at least as far as its neighbouring borders are concerned.

Lacking at present an effective capacity in the implementation of its foreign policy decisions, the EU has in fact tried to build an area of peace and stability around its Member States through a progressive participation of the bordering countries in its integration process, of course at different stages and speed according to the internal and international political and economic evolutions.

At this purpose, specific agreements have been signed with ten Central and Eastern European countries (CEECs) in the early nineties, then followed between 1998 and 1999 by the official opening of negotiations for the actual accession of these countries to the EU; an historic partnership has been developed since 1995 with all the South Mediterranean (MED) countries (the so-called Barcelona process), while specific programmes, ultimately leading to similar outcomes, have just been set up for the Balkan countries¹.

After lengthy political negotiations also within current Member States, significant human and financial resources have been devoted to sustain this political goal and should lead at the start of the next decade to the full EU membership of the CEECs and to the creation of a free trade area between such an enlarged EU and the MED partners. And yet, given the size of the economies at stake, all these efforts are pointless if market forces will not endogenously sustain such an outcome.

In other words, the success of these political operations is linked to the ability and willingness of economic agents to support, with appropriate levels of productive investments the (broadly defined) transition of these countries from a status of developing or socially-planned economies to the one of members of an unified European space. It comes then at no surprise the emphasis put in all the European Commission programmes on the capacity of these countries to attract foreign direct investments (FDI), especially from European multinational enterprises (MNEs).

The importance of structural reforms leading to a stable and working market economy, the implementation of an appropriate and transparent legal framework for the business environment, the restructuring of the industrial base through privatisation programmes are all issues stressed by the European political counterparts, since these factors are all likely to lead to an increased volume of foreign investments in the CEE and MED region, and hence to their solid and rapid integration within an area of peace and prosperity².

¹ The ten CEECs are Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovakia. Malta and Cyprus, belonging to the MED group, have also started official negotiations for accession. Turkey, another MED country, is currently discussing with the EU the opportunity of starting a similar process. Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian National Authority (PNA), Syria, Tunisia all have signed a special Association Agreement with the Union or are currently negotiating it. See Annex 1 for more specific details.

² Needless to say, apart from the proactive role played by FDI in determining the outcome of the transition process, the set up of strong European economic interests in these countries is also the best way for EU politicians to secure internal support for their outward looking plans.

The object of this paper is therefore to provide an assessment of the capacity of these two regions to attract Foreign Direct Investment since the start of their integration processes. Section 2 of the paper tries to understand, combining macroeconomic evidence with an analysis of firm-level data on MNEs, whether the two areas have been both able to attract multinational corporations, or whether instead one area crowded out the other. Section 3 explores through an econometric exercise the determinants of the registered FDI dynamics. Section 4 concludes with some policy implications and further lines of research.

2. Overview of FDI inflows to Central and Eastern Europe and Mediterranean Countries

A fairly extensive academic literature³ offers a conceptual and empirical evidence on the role and the economics of foreign investments. FDI can play an important role in the development process. Capitals transferred from the parent firms add to local stock and contribute to increase the host country's production base and productivity through a more efficient use of existing resources. Foreign investments promote the diffusion of new technologies, know how and managerial and marketing skills through direct linkages or spillovers to domestic firms. Finally foreign firms may also contribute to improve external imbalances due to their greater propensity to export than domestic firms. Needless to say, foreign firms are the first beneficiaries of their investments that contribute in different ways in expanding their profits, market shares and their competitiveness.

Notwithstanding these widely acknowledged benefits, the two regions object of our study, Central and Eastern European Countries (CEECs) and Mediterranean (MED) Countries both have only recently welcomed foreign investments, seeking their contribution to industrial restructuring and modernisation and, hence, economic development and growth.

In fact, the last decade has been characterised by a relevant increase of FDI flows in both areas (Table 2.1), although the regional trends are different. In the CEECs, since the beginning of transition FDI inflows have increased significantly. The process of liberalisation undertaken by these countries and the removal of restrictions on capital movements allowed western firms to enter a market of 400 million potential consumers. In addition, the effects of socially planned economic system left the region with an urgent necessity for capital and western technical and managerial capabilities in order to restructure the productive side of the economy.

[Table 2.1 about here]

Also the MED region benefited from the rise in FDI flows that characterised the period 1990-98, but to a much lesser extent than CEECs. In term of location of FDI, the MED region seems to

³ See Dunning (1992 and 1998) for a general presentation of the theory of Multinational Enterprises, Caves (1996) for an application to developing countries, and Markusen (1995) and Markusen and Maskus (1999) for some hints on the relationships between the theory of MNEs and the new international trade theory. Altomonte (2000) provides a survey

be in a weaker competitive position. The difference between the two regions is clear when analysing FDI flows as a percentage of developing countries (see Table 2.2).

Foreign investments to the CEE area have significantly gained in importance, with an average of 8.3 per cent in the last five years and a peak of 10.7 per cent in 1995, in line with the world-wide up-surge in FDI operations in that year as a consequence of intense merger and acquisition activity, vast privatisation programs implemented in the economies in transition and a continuously improving regulatory framework (Alessandrini, 2000). Conversely, FDI into the Mediterranean area, as a percentage of flows to developing countries have significantly lost in importance. Political and economic instability and a non transparent, on average, government attitude towards foreign investors were major obstacles to FDI inflows, further hampered by a weak enabling environment for privatisation-related FDI and a lack of effective investment promotion activities (Reiffers, 1997).

[Table 2.2 about here]

As far as the FDI destination is concerned both regions show the formation of different groups of recipient countries (see Table 2.3). In the CEECs the core group is represented by the former "Visegrad" countries (i.e. Poland, Hungary and the Czech Republic), with cumulated flows of 65 billion euro (79 per cent). The second group encompasses, in decreasing order, Romania (6.6 per cent), Bulgaria (2.7 per cent), Latvia, Lithuania, Slovak Republic Estonia and Slovenia which together account for 21 per cent of the cumulative value.

In the MED area it is generally possible to distinguish at least four different groups of recipient countries. The core group encompasses Egypt, Turkey and Israel. These countries represent the most important recipient countries in the area. In particular, Israel's share of FDI steadily grows over time, while Egypt and Turkey have lost positions. Middle recipient countries encompasses Algeria, Morocco and Tunisia. Among small recipient countries, Jordan and Lebanon, emerge as the most dynamic, because of the impressive growth rates recorded by FDI flows in several years of the decade. FDI flows into the other economies of the region remain low, indicating a poor attractiveness, at least at marginal levels.

[Table 2.3 about here]

The increased FDI inflows of the two areas over the last decade are also dependent from the European Union strategy aimed at deepening and intensifying its economic relationships with the neighbouring countries (see Annex 1). The subscription of several agreements represented the basis for a wider integration process involving both the Central and Eastern Europe and Mediterranean areas and paving the way to structural economic reforms in the two regions. The location of FDI had a key role in this process.

of the literature on MNEs in the CEECs, while Reiffers (1997) and Alessandrini and Resmini (2001) do the same for the MED region.

Over the period 1994 to 1998, EU FDI to the CEECs amounted to euro 28.4 billion, i.e. around 70 per cent of the total value of the investments recorded (or 7% of extra EU flows during the period). EU FDI outflows to CEECs increased threefold from 2,824 million euro in 1994 to 9,416 million in 1998 (see Table 2.4). Germany alone contributed for 40 per cent of the total initial value of European initiatives, with total estimated outflows of 11.7 billion euro. France came second, with 10.4 per cent of the cumulative value, followed by Austria and the Netherlands with 9.8 per cent. The position of United States is also very important with a total contribution of 9 billion Euros, invested mainly in Poland, Hungary and the Czech Republic. These three countries together absorb almost 90 per cent of the American investments in the region.

The EU is the most important investor also in the MED region, even though the Mediterranean countries do not seem to be on top of the European firms' preferences as a location for production plants. In 1998, in fact, the MED region represented only 2 per cent of total EU FDI outflows. This share showed a decline since 1994, when the region collected about 11 per cent of total European FDI outflows. Within the EU, only five countries seem to be steadily involved as investors in the MED region, even though with different paces and patterns: France, Germany, Italy, Netherlands and United Kingdom. It is worth noting that in 1997 Swedish investors entered in the area (Morocco) and that in 1998 Spain and Portugal have more than doubled their FDI share.

[Table 2.4 about here]

Aggregated data on FDI flows and stocks allow however only a limited analysis of the pace and modalities at which the process of economic integration between the European Union and the CEECs and the MED countries is taking place.

A more micro level approach is deemed necessary for deriving some insights on the FDI determinants in these areas and the role of EU firms with respect to this process. The analysis can be carried out exploiting two firm-specific databases registering almost 4,400 FDI operations in the CEECs and 1,800 operations in the MED region⁴.

In the Central and Eastern European area (Figure 2.1), considering only EU investments, Poland is, over the entire period, the most important destination with 750 reported operations (27 per cent), followed by Czech Republic (24 per cent) and Hungary (21 per cent). Three country attract 72 per cent of EU FDI initiatives in the region.

[Figure 2.1 about here]

⁴ The two databases PECODB and DBMEDA have been developed by prof. Alessandrini at ISLA-Bocconi, Milan. We recall that, being based on sample observations, statistical data for the multinational initiatives are not fully comparable with official statistics derived from balance of payments data or special surveys of FDI. Hence, only general comparison can be made among the two data sources.

From the home country perspective, in terms of number of operations, German (26 per cent), Italian (16 per cent) and Austrian (12 per cent) entrepreneurs have been the most active investors, followed by France, the Netherlands, the UK, Sweden, Switzerland and Finland.

A different picture appears, though, when looking at the number of FDI initiatives in the MED region. Figure 2.2 shows that the number of European initiatives is much lower, around 50 per cent, increasing therefore the role of the American initiatives to 30 per cent. The European countries that seem to be mainly involved as investors are France (30 per cent of EU initiatives), Italy (25 per cent of EU initiatives) and Germany (15 per cent of EU initiatives).

[Figure 2.2 about here]

Generally speaking, the economic literature previously mentioned has highlighted how FDI decisions can be traced back also to industry characteristics such as labour costs or production cost differentials, the exploitation of economies of scale and scope, the availability of a qualified labour force and the opportunities for upgrading production techniques and product quality⁵. Thus, at the micro-economic level, an analysis of sectors is crucial for a better understanding of the FDI dynamics in the CEECs and in the MED area.

As illustrated in Figure 2.3a, the manufacturing sector in the CEECs accounted for 62 per cent of foreign initiatives, while the wholesale and retail trade sector and the financial sector accounted for, respectively, 10 and 8 per cent of the total number of initiatives. A minor role has been played by agriculture and mining activities.

In the MED area, as Figure 2.3b shows, the main sector of activity in which MNEs are engaged in the Mediterranean region are related to manufacturing, which accounts for more than 60 per cent of the total number of operations recorded in the area. Financial intermediation comes second, with 12.2 per cent of initiatives, followed by oil-related activities and tourism, with 5.3 per cent each. A significant presence, given the strategic and financial value of each initiative, is also displayed by the telecommunications sector, accounting for 3.5 per cent of total investments in the area.

[Figure 2.3 about here]

More in detail, Figures 2.4a and 2.4b show the main branches of activities within the manufacturing sector in which MNEs are engaged in the CEECs and in the Mediterranean region.

In the CEEC countries, Figure 2.4a shows that production of food, chemical, motor vehicles, machinery, textiles (NACE 17 and 18) and high-tech (NACE 30 to 32) attracted the greatest number of investments. These six sectors accounted for roughly 55 per cent of the total number of recorded initiatives in the manufacturing sector. In some of those sectors, especially in food and beverages,

⁵ See Resmini (2000) for a discussion of sector-level FDI determinants in transition countries.

the strategy chosen for penetration by Western firms often relied on the acquisition, via the privatisation process, of leading local firms.

In the MED countries, it is clear the prevalence of the chemical (NACE 24) and food (NACE 15) sectors, with 21 and 18 per cent of total MNEs investments, followed by the high-tech (NACE 30 to 32), textiles (NACE 17 and 18) and motor vehicles (NACE 34) industries, all around 10 per cent of initiatives.

[Figure 2.4 about here]

3. The econometric analysis

a) The model

The proposed econometric model rests on a set of panel data recording the number of investments in each industry i over host country j at time t (cross-sectional, time-series model). The theoretical total number of observations is 6,912, covering 48 industries i , over 8 years t (1990-1997), in 10 Mediterranean (MED) and 8 Central and East European (CEE) host countries j ⁶. As a result, the panel data set is balanced.

The dependent variable INV_{ijt} , measures the number of investments undertaken by a MNE in industry i at time t for each host country j . However, given the relevant number cells where there is no or just one FDI project⁷, the underlying Poisson theoretical distribution of observations is strongly biased. Since a probit model is a better fit, a binary formulation of the dependent variable is used in which INV_{ijt} takes the following values:

$$INV_{ijt} = \begin{cases} 1 & \text{if an FDI operation is registered in industry } i \text{ of country } j \text{ in year } t; \\ 0 & \text{otherwise.} \end{cases}$$

As a result, a random-effects probit model on the specified panel will be estimated. The estimation technique is based on a generalised maximum-likelihood estimating equation (GEE) approach applied to a generalised linear model (GLM)⁸.

The independent variables of the model derive from the traditional literature on FDI location determinants in developing countries (e.g. Caves, 1996), with appropriate modifications in order to take into account the peculiar experience of transition economies. In particular, we include in the estimation three general determinants of the attractiveness of an host economy for MNEs.

⁶ See Annex Table for a precise classification of countries and industries.

⁷ The fact that in a given industry/country in a given year there are no investments is in any case a significant piece of information.

⁸ The GEE approach used follows in particular Liang and Zeger (1986).

The volume of the local demand, proxied by the size of the population (pop_{jt}) or by different GDP-related measures for a country j , is a traditional determinant of the choices of MNEs, especially market-seeking ones (Dunning, 1992). Following some of the intuitions developed in the most recent location theories, which combine comparative advantages with agglomeration forces, we also include a measure of market access ($mktacc_{jt}$) as a proxy for local demand (Davis and Weinstein, 1998), discounting GDP of a country j by its average distance from the “core” European regions (Frankfurt). The intuition behind this variable is that the further a region is localised from a centre of economic activity, the larger has to be its local demand, in order to compensate for lower pecuniary externalities MNEs can possibly take advantage from.

We control for efficiency-seeking strategies of multinationals, i.e. the de-localisation of production plants abroad in order to exploit cost advantages, especially in terms of cost/skill of the labour force. We proxy that through the level of education, $educ_{jt}$, of the population, assuming that average higher education implies average higher wages and hence labour costs.

Specifically for countries in transition, a whole literature has developed on the relationships between the quality of business environment / legal framework and the attractiveness of a country for MNEs⁹. We control in the estimation for these effects in two alternative ways: first, we employ a subjective index of the perceptions of the business environment, ORI_{jt} , computed by a consultancy agency (BERI S.A.) through a panel of experts. Second, we assess the completeness of the local legal framework through an appropriate index, LAW_{jt} , developed by the World Bank.

Given the differentiated nature of FDI in different sectors of activity, in order to minimise the potential bias deriving from unobservable, heterogeneous fixed-effects, a full set of *time* and *industry*-specific dummy variables has been introduced in every estimation. In this way, the error component should only contain country-specific fixed effects appearing in the constant term.

Finally, a structural dummy MED is included in order to control, in the pooled estimating equations, for structural heterogeneity deriving from the two different areas considered.

b) The results

Table 3.1 to 3.3 report the results of the econometric analysis relative to the use of the ORI subjective index of business environment, while Tables from 3.4 to 3.6 report the same results using the institutional World Bank index LEG. In particular, Table 3.1 and 3.4 report the estimations for the pooled sample of 48 industries; Table 3.2 and 3.5 for manufacturing and services industry separately; Table 3.3 and 3.6 for the economies of scale vs. traditional Pavitt classification of manufacturing industries (Pavitt, 1984). All models under Column A refer to the analysis employing the market access proxy for local demand, while Columns B perform the same exercise using the traditional proxy of local population. In all tables, Column 1 refers to the joint CEE and MED sample, Column 2 performs the analysis only on CEE countries, while Column 3 does the same for the MED area. All equations include a full set of industry and time-specific dummy variables, in general always significant, and for all equations the joint parameters are significant at

⁹ See Altomonte, 2000 for a survey and some results applied to the case of CEE countries.

the 1 per cent level, as indicated by the reported Wald tests. A comparison across these different specifications does not reveal striking differences in terms of the overall sign and significance of the reported coefficients, thus allowing us to consider the results relatively robust.

For every sub-sector specification, the local demand affects significantly (at the 1 per cent level) and positively the probability of undertaking an investment in a given region/industry; the coefficients reported using the market access proxy are slightly lower than the ones reported using the population variable, albeit the pattern of the coefficients stays the same over the different sector/country specifications. The MED area reports, in all model specifications, a coefficient around 50 per cent lower than the CEE one (the difference is even slightly bigger if using the population rather than the market access indicator).

In line with theoretical predictions, the education of the labour force is significant with a negative sign in all estimations relative to the entire sample of country and regions (Columns 1A and 1B of Table 3.1 and Table 3.4). It does not seem to be, instead, a significant FDI determinant for the pooled country estimation in the services sector (Column 1A and 1B of Table 3.2 and Table 3.5, Services), where probably only local demand conditions are relevant, as it is the case for the European Union (Hallet, 2000). Again, we find here a difference between CEE and MED countries: while in the former labour costs enter with a significant and negative sign in all the sector specifications, for the latter the education of the work force is (slightly) significant with a negative sign only in the case of traditional industries (Columns 3A and 3B of Table 3.3 and Table 3.6, Traditional industries), while it is a positive and (slightly) significant determinant for FDI in the services sector (Columns 3A and 3B of Table 3.2 – Table 3.5, Services). In other words, after controlling for sector-specific effects, efficiency-seeking strategies related to the exploitation of cheap labour costs are, again, less characterising the MED region with respect to the CEE countries.

In terms of business environment and legal framework, the coefficients are in general significant with a positive sign, as expected. There are however some technical considerations to take into account. In particular, the coefficient of the legal environment (LAW) indicator is on average larger and more significant than the one reporting the subjective impressions on the business environment (ORI); the ORI coefficient seems in fact to be more affected, especially in the CEE sub-samples, by the alternative specifications of the two indexes proxying local demand (Columns B in Tables 3.1 to 3.3 yielded higher and on average more significant coefficients with respect to the models using market access reported in Columns A, for all sub-sample specifications; this effect is not present in Tables 3.4 to 3.6). We can therefore conclude that the LAW indicator is possibly more robust to alternative model specifications¹⁰, and limit ourselves to its discussion.

In fact, the indicator of legal framework performs consistently with our theoretical priors in the CEE case: it is significant with a positive sign in the manufacturing industries and not in services, and among manufacturing in economies of scale industries and not in traditional ones (Tables 3.5 and 3.6, columns 2A), thus reflecting the fact that investment with higher sunk costs

¹⁰ This can be due to the fact that proxying local demand with the population leaves unexplained a greater portion of variance, an unobserved heterogeneity more easily captured by the business environment (subjective) indicator rather than by the legal framework variable.

(higher proportion of physical capital committed, or larger dimensions) tend to react more to the quality of the local legal environment (Altomonte, 2000; Lankes and Venables, 1996). On the contrary, no similar clear-cut conclusions can be drawn in the case of MED countries, due to the higher instability of the index, more sensible to different model specifications.

Finally, and more formally, the evident differences between the CEE and the MED countries are picked by the strong significance of the MED dummy in every model specification (Columns 1A and 1B).

4. Conclusions and further lines of research

When trying to understand what explains the differences in the capacity of FDI attraction between the two areas, we have seen that even after controlling for sector-specific effects, the CEE area structurally displays a greater potential in the attraction of FDI flows with respect to the MED one, both in terms of market and efficiency-seeking MNEs strategies. Neither the MED region seems to be specifically conditioned in its capacity of FDI attraction only from factors related to its legal framework, at least judging from the level of significance of this variable.

Rather, the unobserved underlying characteristic responsible for the different performance of the two areas is probably related to the presence of stronger pecuniary externalities for European MNEs in the CEE countries with respect to the ones currently existing in the MED region: in other words, from stronger agglomeration economies in the former area or, better, from a lower market potential of the latter region (in the spirit of Harris, 1954).

In fact, while it is likely that MNEs evaluate the local demand, measured at the country-level, in their investment decisions, however they are also likely to consider the demand of neighbouring locations, because as long as there is some trade, part of the total demand addressed to MNEs will come from consumers located just outside the boundaries of the host country chosen as their foreign production base (Head and Mayer, 2001). Therefore, the higher segmentation of regional markets in the MED, also in terms of non-tariff barriers, could be responsible for this lower attraction capacity of the area when competing on equal grounds with the CEE. The evolution of the growth rates and share of European FDI in the two areas, displayed in Figure 3.1 and 3.2, is in line with this non-linear behaviour of the attraction capacity of the considered regions.

[Figure 3.1 and 3.2 about here]

The good news, from an economic policy point of view, is that the start of the Barcelona process in 1995, which has raised the prospects of regional integration for the MED countries, together with a drastic improvement in their legal framework (see Figure 3.3), seem to have re-balanced the drain of FDI from the MED region towards the CEE area, yielding virtually no widening differences in the last two years (see Figure 3.1), but a structural and permanent gap in terms of share of EU foreign direct investment (Figure 3.2).

[Figure 3.3 about here]

Clearly, these findings leave ample room for further lines of research in the direction of a more stringent application of the concept of market potential when modelling the location choices of multinationals in the two areas, with a more thorough interaction between international flows of capital and international trade.

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Annex 1. Status of European Union Agreements

CEECs

Soon after the fall of the Berlin Wall in 1989, the European Community quickly established diplomatic relations with the CEECs. It removed the standing import quotas on a number of products, extended to these countries the Generalised System of trade Preferences (GSP) and, over the next few years, concluded Trade and Cooperation Agreements with Bulgaria, the former Czechoslovakia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovenia. During the 1990s, the EU and its member states progressively concluded the so called "Europe Agreements" with ten countries of the CEECs. The EU had already established similar Association Agreement with three Mediterranean Countries: Turkey (1963), Malta (1970) and Cyprus (1972) On 31 March 1998, accession negotiations were started with six applicant countries: Hungary, Poland, Estonia, Czech Republic, Slovenia and Cyprus. On 12 December 1999, accession negotiations were started also with Romania, Slovakia, Latvia, Lithuania, Bulgaria and Malta. The accession negotiations determine the conditions under which each applicant country will enter the EU. The applicants are expected to accept the so called *acquis communautaire*, whose ratification is divided in different sectors or chapters.

<i>Country</i>	<i>Association Agreement signed on</i>	<i>Accession application submitted on</i>	<i>Number of chapters closed</i>
Bulgaria	1-3-1993	14-12-1995	10
Cyprus	19-12-1972	3-07-1990	22
Czech Republic	6-10-1993	17-1-1996	19
Estonia	12-6-1995	24-11-1995	19
Hungary	16-12-1991	31-3-1994	22
Latvia	12-6-1995	13-10-1995	15
Lithuania	12-6-1995	8-12-1995	17
Malta	5-12-1970	3-7-1990	16
Poland	16-12-1991	5-4-1994	16
Romania	8-2-1993	22-6-1995	6
Slovakia	6-10-1993	27-6-1995	17
Slovenia	10-6-1996	10-6-1996	20
Turkey	12-9-1973	14-4-1987	-

MED

After 20 years of increasingly intensive bilateral trade and development cooperation between the EU, the 15 member states and the 12 Mediterranean Countries, the Conference of EU and Mediterranean Foreign Ministers in Barcelona (27-28 November 1995) opened a new phase in the regional dialogue based on three pillars: political and security partnership, economic and financial partnership; social, cultural and human partnership. For the implementation of the Euro-Mediterranean Partnership it is necessary the negotiation of Association Agreements between the EU and nine of its Mediterranean Partners to replace the 1970s Cooperation agreements.

<i>Country</i>	<i>Association Agreement</i>
Algeria	In negotiation
Egypt	Negotiations concluded in 1999. Under signature
Israel	Ratified, 1995
Jordan	Signed, 1997. Under ratification
Lebanon	In negotiation
PNA	Ratified, 1997
Morocco	Ratified, 1996
Syria	In negotiation
Tunisia	Ratified, 1995

Annex 2. The dataset

Country Classification

Central and Eastern European (CEE) countries: Bulgaria, Czech Republic, Hungary, Estonia, Poland, Romania, Slovakia and Slovenia

Mediterranean (MED) countries: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, Turkey

Industry classification - NACE 4 Rev. 1, 1993

a) 1 Mining industry

10-11-12-13 and 14 (mining of coal, metals and stone; extraction of petroleum and natural gas).

b) 39 Manufacturing industries (Pavitt, 1984 - 2 and 3 digits classification of sunk costs adapted to NACE Rev. 1)

Economies of scale industries

21 (paper and pulp); 22 (publishing and press); 241 and 242 (basic chemicals and agro-chemicals); 245 (soaps and detergents); 246 and 247 (other chemical products and synthetic fibres); 251 (rubber products); 26 (other non-metallic products); 27 (metallurgy); 297 (domestic appliances); 31 (electrical appliances, excluding domestic); 321 (electronics); 322 and 323 (communication equipment); 341 (car production); 343 (car components); 351 (ship building); 352 and 354 (railways; motorcycles).

Traditional industries

151 and 152 (production and transformation of meat and fish); 153 and 155 (vegetables, milk and dairy products); 156 and 157 (grains and pet food); 158 and 159 (fabrication of bread, tea, coffee and other alimentary products including drink and beverages); 16 (tobacco); 17 (textiles); 18 (clothing); 19 (leather); 20 (wood); 28 (metals); 361 and 362 (furniture); 363 and 365 (musical instruments and toys); 366 (other general manufacturing).

Specialised industries

243 (paintings); 252 (plastic products); 291 (mechanical machinery); 292 (general machinery); 293 (agricultural machines); 294 and 295 (machine tools); 334 and 335 (optics, photography, clocks).

High Tech industries

244 (pharmaceuticals); 30 (office machines and computers); 331 and 332 (medical and precision instruments).

c) 8 Services industries

401 and 402 (electricity and gas); 45 (construction); 55 (hotels and restaurants); 642 (telecommunications); 65 and 66 (financial intermediation and insurance); 72 (computer and related activities); 73 (research and development); 92 (cultural and sporting activities).

Table 2.1 - FDI inflows into the CEECs and the MED countries (Millions of dollar)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
CEECs	1849	2508	5359	5168	12008	9698	11772	16349	17853
MED	2258	3225	2867	3927	4019	4151	5873	5940	7212

Source: UNCTAD-DTCI, FDI database based on IMF, Balance of Payment Statistics

Table 2.2 - Share of FDI flows in percentage of total developing countries inflows

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
CEECs	0.9	0.9	5.9	7.4	6.8	4.9	10.7	6.7	6.4	8.9	8.9
MED	8.7	5.9	4.4	6.2	3.6	3.7	3.5	2.8	3.1	3.2	3.4

Source: UNCTAD-DTCI, FDI database based on IMF, Balance of Payment Statistics

Table 2.3 - FDI inflows into the CEECs and the MED countries, US\$ million

	1993	1994	1995	1996	1997	1998	1999
CEECs							
Bulgaria	40	105	90	109	505	537	770
Czech Rep.	653	868	2561	1429	1301	2720	5108
Estonia	162	214	201	151	267	581	306
Hungary	2339	1146	4453	2275	2173	2036	1944
Latvia	45	214	180	382	521	357	366
Lithuania	30	31	73	152	355	926	486
Poland	1715	1875	3659	4498	4908	6365	7500
Romania	94	342	420	265	1215	2031	961
Slovak Rep.	168	245	195	251	206	631	322
Slovenia	113	128	176	186	321	165	90
MED							
Algeria	-59	22	5	4	7	5	6
Cyprus	83	75	80	50	68	56	65
Egypt	493	1256	596	636	888	1077	1500
Israel	429	355	1306	1389	1822	1850	2256
Jordan	-34	3	13	16	361	310	151
Lebanon	3	7	35	80	150	200	250
Libya	31	79	107	135	82	150	100
Malta	56	152	182	325	165	273	811
Morocco	491	551	332	354	1079	329	847
Syria	176	251	100	89	80	80	75
Tunisia	562	568	378	351	366	670	368
Turkey	636	608	885	722	805	940	783

Source: UNCTAD-DTCI, FDI database based on IMF, Balance of Payment Statistics

Table 2.4 - EU FDI to the CEECs and MED Countries, 1994-98, €million

	1994	1995	1996	1997	1998
CEECs	2824	3705	5483	6975	9416
% of extra EU flows	11%	8%	11%	7%	5%
MED	2827	2779	2943	4804	4679
% of extra EU flows	11%	6%	6%	5%	2%

Source: Eurostat European Union direct investment yearbook 1999

Table 3.1 - Pooled sectors and ORI index

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.016*** (.001)	-	.020*** (.001)	-	.012*** (.001)	-
pop	-	.019*** (.001)	-	.035*** (.002)	-	.014*** (.002)
educ	-.019*** (.003)	-.019*** (.003)	-.035*** (.004)	-.035*** (.004)	-.001 (.005)	.007 (.005)
ori	.010** (.004)	.035*** (.004)	-.001 (.006)	.055*** (.007)	.019*** (.007)	.027*** (.007)
<i>industry</i>	9900.22***	10226.85***	6645.29***	7088.77***	4138.62***	3901.89***
<i>time</i>	145.01***	164.19***	192.32***	227.67***	14.40**	11.86*
MED	-1.43*** (.060)	-1.86*** (.071)	-	-	-	-
const	-.865*** (.206)	-1.68*** (.229)	-.905*** (.309)	-3.22*** (.369)	-1.99*** (.328)	-2.54*** (.348)
n. obs.	5606	5606	2735	2735	2871	2871
Wald chi2	23166.25***	24533.92***	10609.93***	10934.50***	5037.86***	4838.81***

Table 3.2 – Manufacturing vs. Services industries and ORI index

Manufacturing

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.017*** (.001)	-	.021*** (.001)	-	.012*** (.002)	-
pop	-	.020*** (.001)	-	.036*** (.003)	-	.015*** (.002)
educ	-.023*** (.003)	-.024*** (.004)	-.037*** (.005)	-.036*** (.005)	-.007 (.006)	.002 (.006)
ori	.010** (.005)	.036*** (.005)	.002 (.001)	.062*** (.008)	.018** (.008)	.025*** (.008)
<i>industry</i>	<i>7909.12***</i>	<i>8243.25***</i>	<i>4879.66***</i>	<i>5199.63***</i>	<i>3449.41***</i>	<i>3195.37***</i>
<i>time</i>	<i>125.06***</i>	<i>141.81***</i>	<i>169.34***</i>	<i>199.03***</i>	<i>12.61**</i>	<i>10.7*</i>
MED	-1.45*** (.067)	-1.91*** (.080)	-	-	-	-
const	-.762*** (.228)	-1.62*** (.254)	-1.01*** (.339)	-3.43*** (.405)	-1.77*** (.361)	-2.34*** (.384)
n. obs	4671	4671	2280	2280	2391	2391
Wald chi2	18266.38***	19985.81***	7716.19***	7968.13***	4278.20***	4048.1***

Services

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.013*** (.002)	-	.017*** (.003)	-	.009** (.005)	-
pop	-	.014*** (.003)	-	.028*** (.007)	-	.009* (.005)
educ	-.003 (.007)	-.002 (.007)	-.032*** (.011)	-.032*** (.011)	.019 (.012)	.026** (.013)
ori	.010 (.011)	.029*** (.011)	-.022 (.017)	.023 (.018)	.027 (.018)	.033* (.018)
<i>industry</i>	<i>1382.47***</i>	<i>1400.79***</i>	<i>1033.66***</i>	<i>1079.11***</i>	<i>262.43***</i>	<i>269.49***</i>
<i>time</i>	<i>27.08***</i>	<i>29.43***</i>	<i>32.86***</i>	<i>37.89***</i>	<i>5.57</i>	<i>5.02</i>
MED	-1.45*** (.142)	-1.75*** (.159)	-	-	-	-
const	-1.85*** (.493)	-2.53*** (.543)	.177 (.758)	-1.68* (.907)	-8.06 (16.07)	-7.77* (3.97)
n. obs	935	935	455	455	480	480
Wald chi2	2201.57***	2220.47***	1428.52***	1457.34***	275.71***	283.74***

Table 3.3 – Economy of scale vs. traditional industries and ORI index*Economy of scale industries*

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.019*** (.001)	-	.023*** (.002)	-	.014*** (.003)	-
pop	-	.022*** (.002)	-	.040*** (.005)	-	.019*** (.003)
educ	-.026*** (.006)	-.026*** (.006)	-.046*** (.008)	-.045*** (.008)	.001 (.009)	.014 (.010)
ori	.019** (.008)	.047*** (.008)	.024** (.012)	.090*** (.013)	.012 (.012)	.019 (.012)
<i>industry</i>	<i>2790.27***</i>	<i>788.46***</i>	<i>1426.52***</i>	<i>1504.17***</i>	<i>930.74***</i>	<i>851.48***</i>
<i>time</i>	<i>59.63***</i>	<i>65.08***</i>	<i>86.24***</i>	<i>99.13***</i>	<i>8.78</i>	<i>7.96</i>
MED	-1.49*** (.105)	-1.98*** (.126)	-	-	-	-
const	-1.80*** (.357)	-2.74*** (.407)	-1.64*** (.538)	-4.35*** (.649)	-3.63*** (.554)	-4.34*** (.602)
n. obs	1872	1872	912	912	960	960
Wald chi2	4819.08***	806.91***	1854.79***	1924.67***	1036.04***	972.72***

Traditional industries

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.017*** (.001)	-	.022*** (.002)	-	.011*** (.003)	-
pop	-	.021*** (.002)	-	.036*** (.004)	-	.014*** (.003)
educ	-.023*** (.006)	-.024*** (.006)	-.029*** (.008)	-.029*** (.008)	-.024** (.010)	-.016 (.011)
ori	-.001 (.007)	.024*** (.008)	-.028** (.012)	.031** (.013)	.032** (.013)	.040*** (.014)
<i>industry</i>	<i>3080.06***</i>	<i>3192.76***</i>	<i>1681.01***</i>	<i>1838.77***</i>	<i>1268.19***</i>	<i>1182.83***</i>
<i>time</i>	<i>61.89***</i>	<i>69.72***</i>	<i>84.79***</i>	<i>96.69***</i>	<i>7.25</i>	<i>6.93</i>
MED	-1.44*** (.105)	-1.91*** (.125)	-	-	-	-
const	-.301 (.352)	-1.13*** (.392)	-.045 (.531)	-2.44*** (.635)	-1.98*** (.610)	-2.52*** (.653)
n. obs	1863	1863	912	912	951	951
Wald chi2	6956.57***	7186.06***	2419.27***	2555.07***	1756.34***	1697.33***

Table 3.4 - Pooled sectors and LAW index

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.016*** (.001)	-	.020*** (.001)	-	.013*** (.001)	-
pop	-	.017*** (.001)	-	.032*** (.003)	-	.016*** (.002)
educ	-.015*** (.003)	-.013*** (.003)	-.038*** (.006)	-.046*** (.006)	.001 (.005)	.012** (.005)
law	.147*** (.032)	.253*** (.033)	.200*** (.050)	.465*** (.052)	.109* (.057)	.174*** (.059)
<i>industry</i>	7223.49***	7572.46***	5051.54***	5608.78***	4153.90***	3866.12***
<i>time</i>	42.45***	31.20***	74.65***	50.68***	11.69*	11.22*
MED	-1.23*** (.073)	-1.36*** (.074)	-	-	-	-
const	-.823*** (.172)	-1.13*** (.186)	-1.47*** (.258)	-2.50*** (.287)	-1.46*** (.192)	-1.89*** (.219)
n. obs.	4742	4742	1871	1871	2871	2871
Wald chi2	15954.01***	16589.38***	7217.43***	7614.63***	4959.80***	4699.26***

Table 3.5 – Manufacturing vs. Services industries and LAW index*Manufacturing*

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.017*** (.001)	-	.021*** (.001)	-	.013*** (.002)	-
pop	-	.018*** (.001)	-	.031*** (.003)	-	.016*** (.002)
educ	-.019*** (.004)	-.017*** (.004)	-.038*** (.006)	-.045*** (.006)	-.003 (.006)	.007 (.006)
law	.143*** (.036)	.255*** (.037)	.208*** (.054)	.476*** (.056)	.071 (.063)	.138** (.065)
<i>industry</i>	5824.83***	6123.06***	3954.21***	4407.48***	3497.54***	3214.67***
<i>time</i>	34.20***	23.95***	63.21***	39.71***	10.14	9.29
MED	-1.24*** (.081)	-1.39*** (.083)	-	-	-	-
const	-.703 (.189)	-1.03*** (.204)	-1.47*** (.280)	-2.49*** (.312)	-1.22*** (.211)	-1.67*** (.240)
n. obs	3951	3951	1560	1560	2391	2391
Wald chi2	12810.25***	13554.26***	5364.50***	5677.09***	4212.88***	3941.57***

Services

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.013*** (.002)	-	.018*** (.004)	-	.011** (.004)	-
pop	-	.013*** (.003)	-	.033*** (.008)	-	.013** (.005)
educ	-.001 (.008)	.002 (.008)	-.040*** (.015)	-.049*** (.015)	.021* (.011)	.031** (.012)
law	.176** (.080)	.256*** (.082)	.152 (.128)	.407*** (.133)	.269* (.149)	.321** (.153)
<i>industry</i>	980.73***	1020.92***	700.1***7	727.02***	256.29***	270.20***
<i>time</i>	14.58**	13.29**	18.78***	17.85***	6.49	6.46
MED	-1.24*** (.174)	-1.33*** (.172)	-	-	-	-
const	-2.11*** (.438)	-2.35*** (.474)	-1.08* (.646)	-2.13*** (.726)	-6.65* (2.58)	-7.17* (3.95)
n. obs	791	791	311	311	480	480
Wald chi2	1460.67***	1507.14***	945.38***	969.89***	271.25***	288.51***

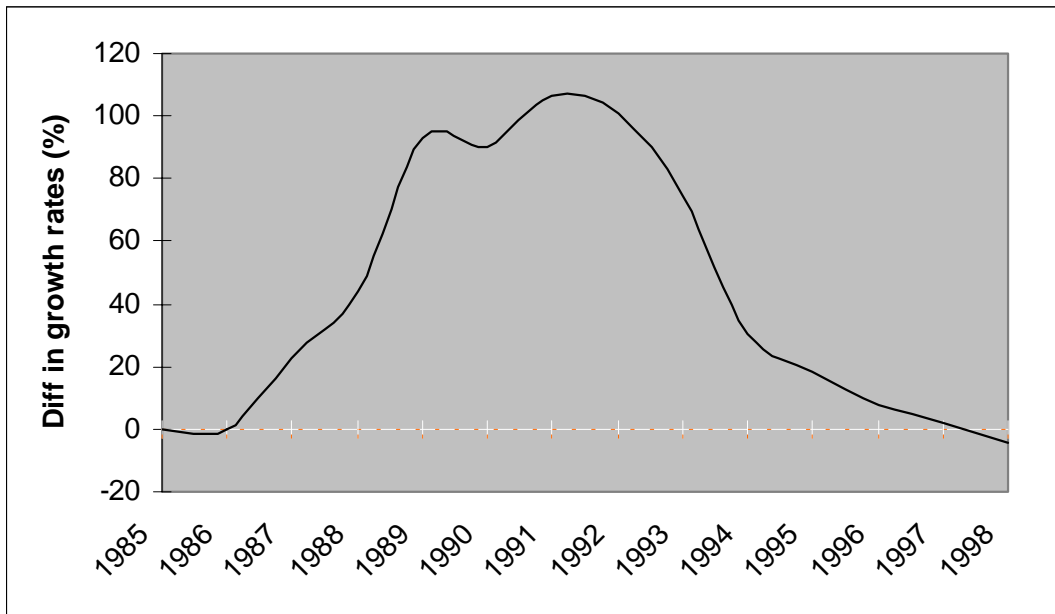
Table 3.6 – Economy of scale vs. traditional industries and LAW index*Economy of scale industries*

Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.018*** (.001)	-	.023*** (.002)	-	.015*** (.003)	-
pop	-	.019*** (.002)	-	.033*** (.005)	-	.020*** (.003)
educ	-.019*** (.006)	-.017** (.006)	-.051*** (.011)	-.058*** (.010)	.003 (.008)	.018 (.009)
law	.158*** (.055)	.278*** (.057)	.317*** (.088)	.609*** (.092)	-.019 (.096)	.066 (.102)
<i>industry</i>	<i>2030.92***</i>	<i>2168.88***</i>	<i>1037.05***</i>	<i>1147.71***</i>	<i>904.00***</i>	<i>818.38***</i>
<i>time</i>	<i>23.42***</i>	<i>18.02***</i>	<i>37.64***</i>	<i>25.34***</i>	<i>8.89</i>	<i>7.95</i>
MED	-1.22*** (.125)	-1.37*** (.126)	-	-	-	-
const	-1.82*** (.297)	-2.14*** (.323)	-2.06*** (.462)	-3.17*** (.517)	-3.13*** (.346)	-3.71*** (.403)
n. obs	1584	1584	624	624	960	960
Wald chi2	3255.24***	3477.89***	1219.46***	1311.18***	992.43***	916.40***

Traditional industries

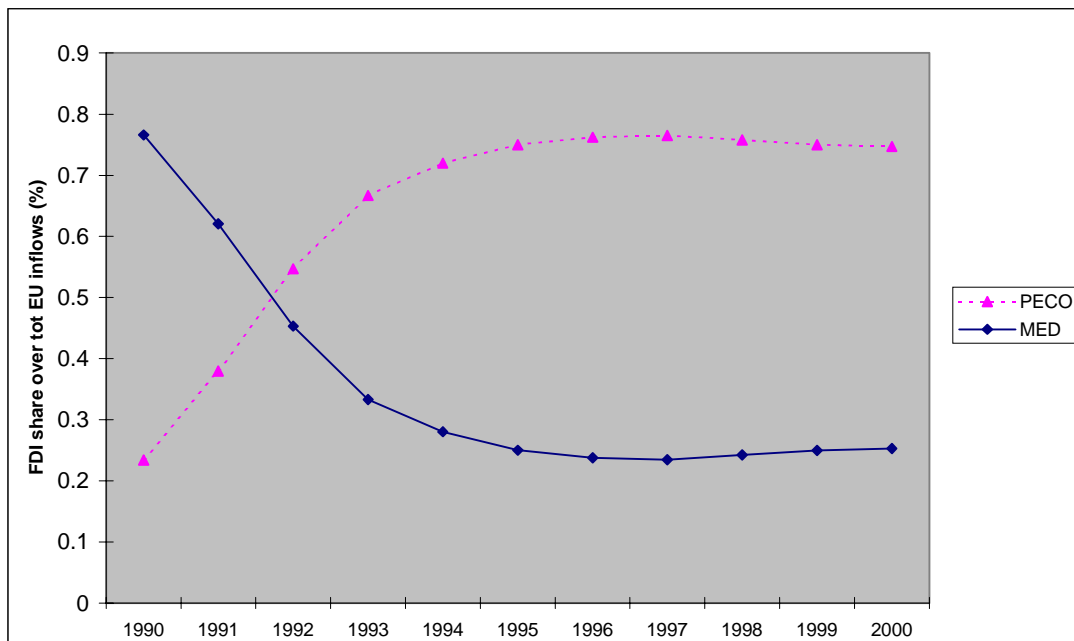
Variable	1A Pool	1B Pool	2A CEE	2B CEE	3A MED	3B MED
mktacc	.017*** (.001)	-	.023*** (.002)	-	.013*** (.003)	-
pop	-	.021*** (.002)	-	.038*** (.005)	-	.016*** (.003)
educ	-.022*** (.007)	-.021*** (.007)	-.029*** (.010)	-.038*** (.010)	-.019* (.010)	-.009 (.011)
law	.111** (.056)	.233*** (.058)	.072 (.084)	.378** (.087)	.172* (.098)	.233** (.102)
<i>industry</i>	<i>2219.88***</i>	<i>2324.24***</i>	<i>1373.47***</i>	<i>1514.18***</i>	<i>1349.04***</i>	<i>1265.88***</i>
<i>time</i>	<i>19.52***</i>	<i>15.38**</i>	<i>41.31***</i>	<i>28.54***</i>	<i>6.16</i>	<i>7.10</i>
MED	-1.34*** (.131)	-1.52*** (.135)	-	-	-	-
const	-.454 (.296)	-.838*** (.321)	-1.13 (.426)	-2.36*** (.482)	-1.08*** (.335)	-1.47*** (.380)
n. obs	1575	1575	624	624	951	951
Wald chi2	5247.17***	5570.18***	1793.89***	1910.76***	1751.62***	1692.88***

Graph 3.1 – The growth rates differential of FDI inflows between CEE and MED countries
 (difference in yearly growth rates of the total number of FDI)



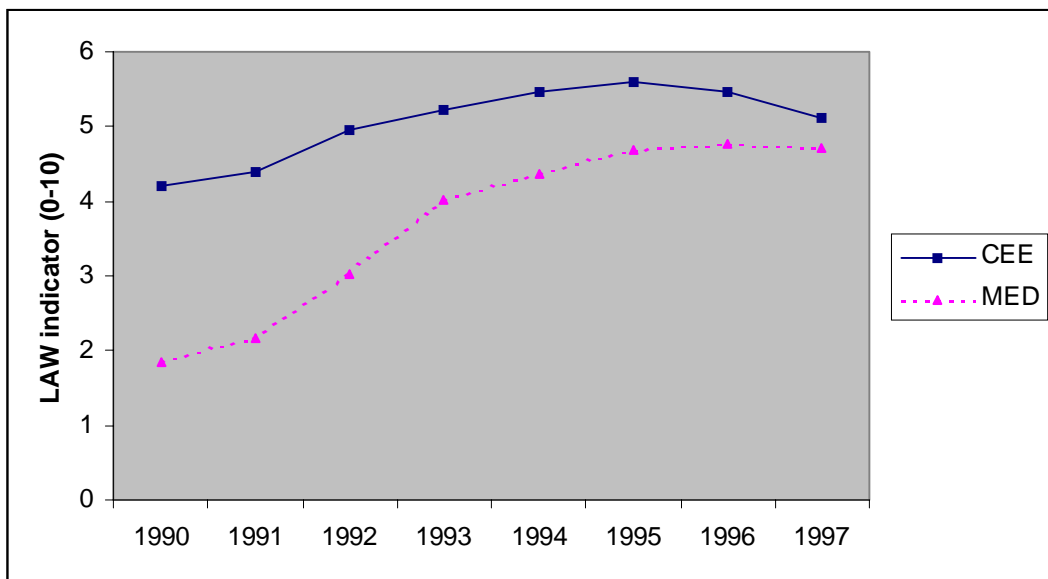
Source: Author's calculations from PECODB database

Graph 3.2 – The evolution of the shares of European FDI inflows in CEE and MED countries
 (percentages over total number of FDI attracted in a given year)



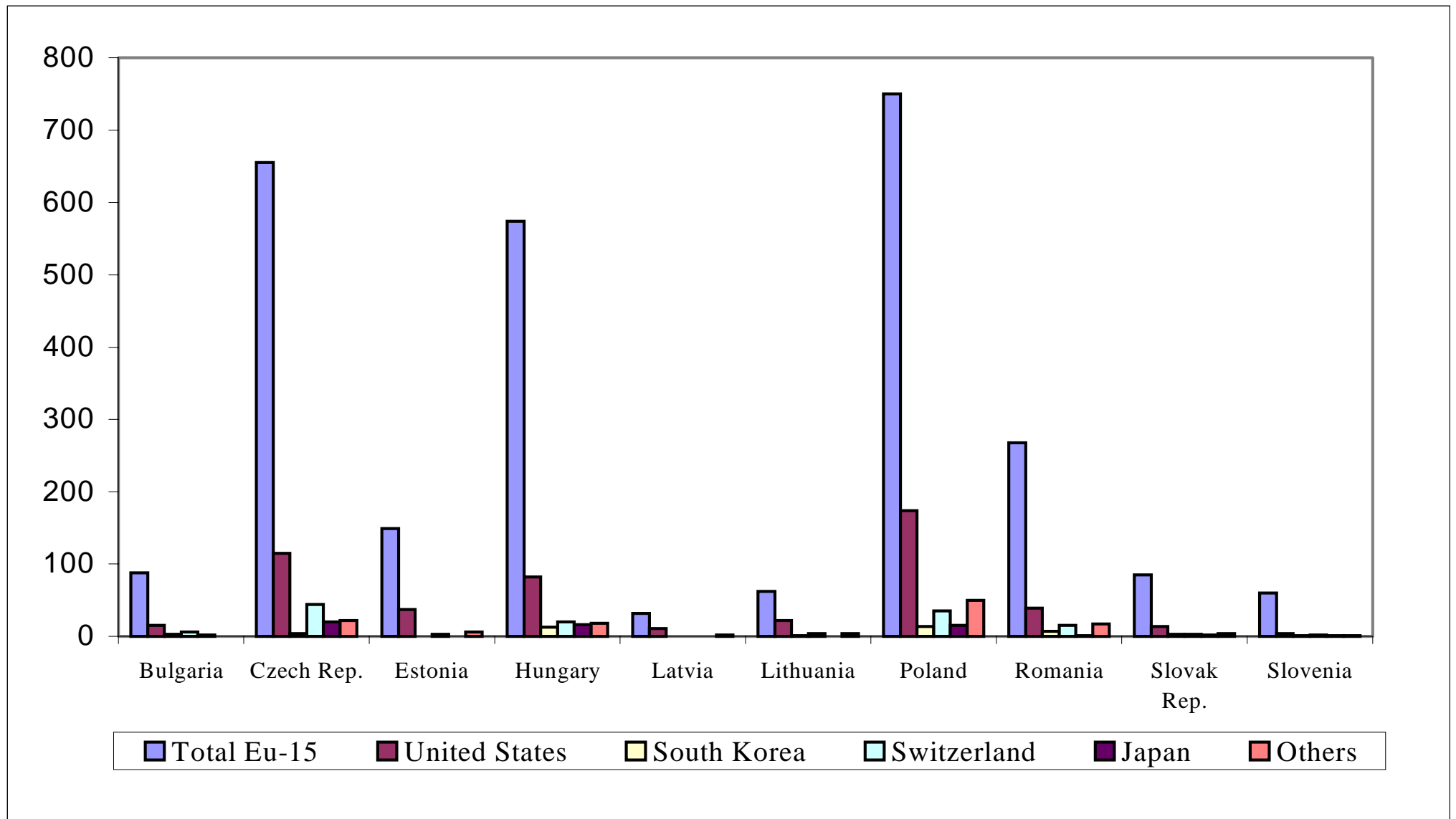
Source: Author's calculations from PECODB database

Graph 3.3 – The evolution of the legal framework in CEE and MED countries
(scale 1-10)



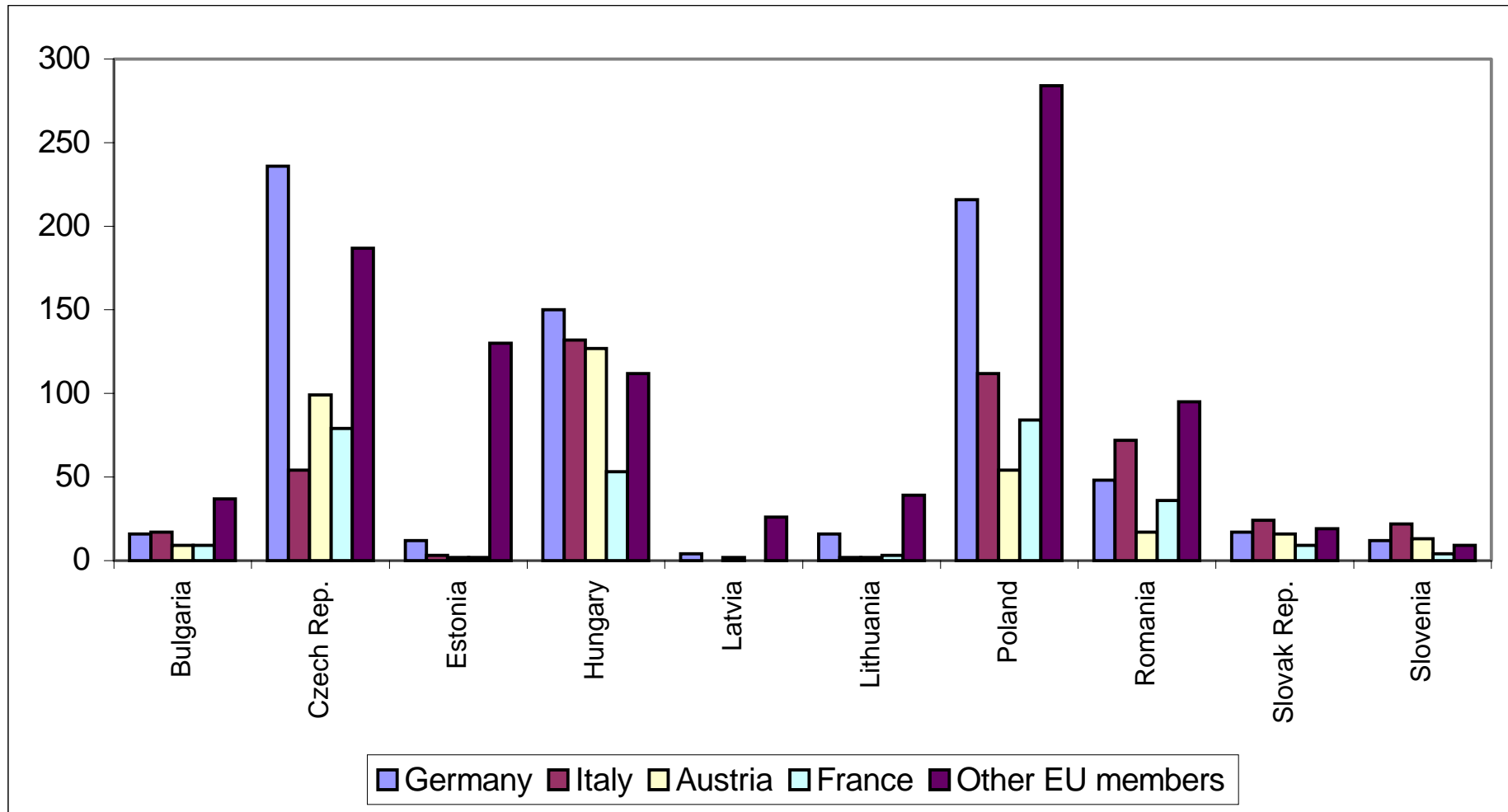
Source: World Bank Development Tables

Figure 2.1a - Number of investments by home and host countries in the CEECs 1987-1998



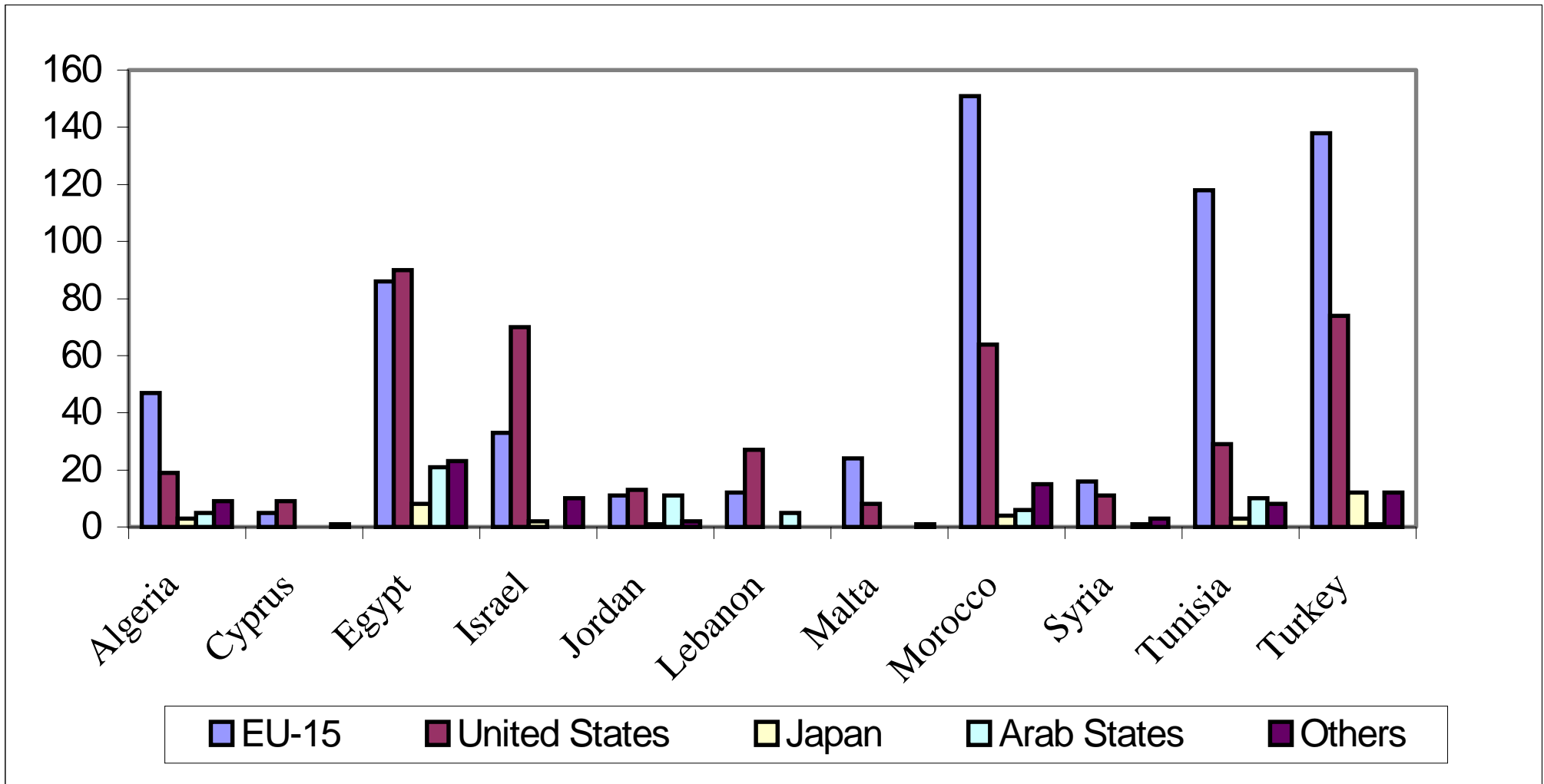
Source: Author's elaboration based on Alessandrini (2000).

Figure 2.1b - Number of EU investments by home and host countries in the CEECs 1987-1998



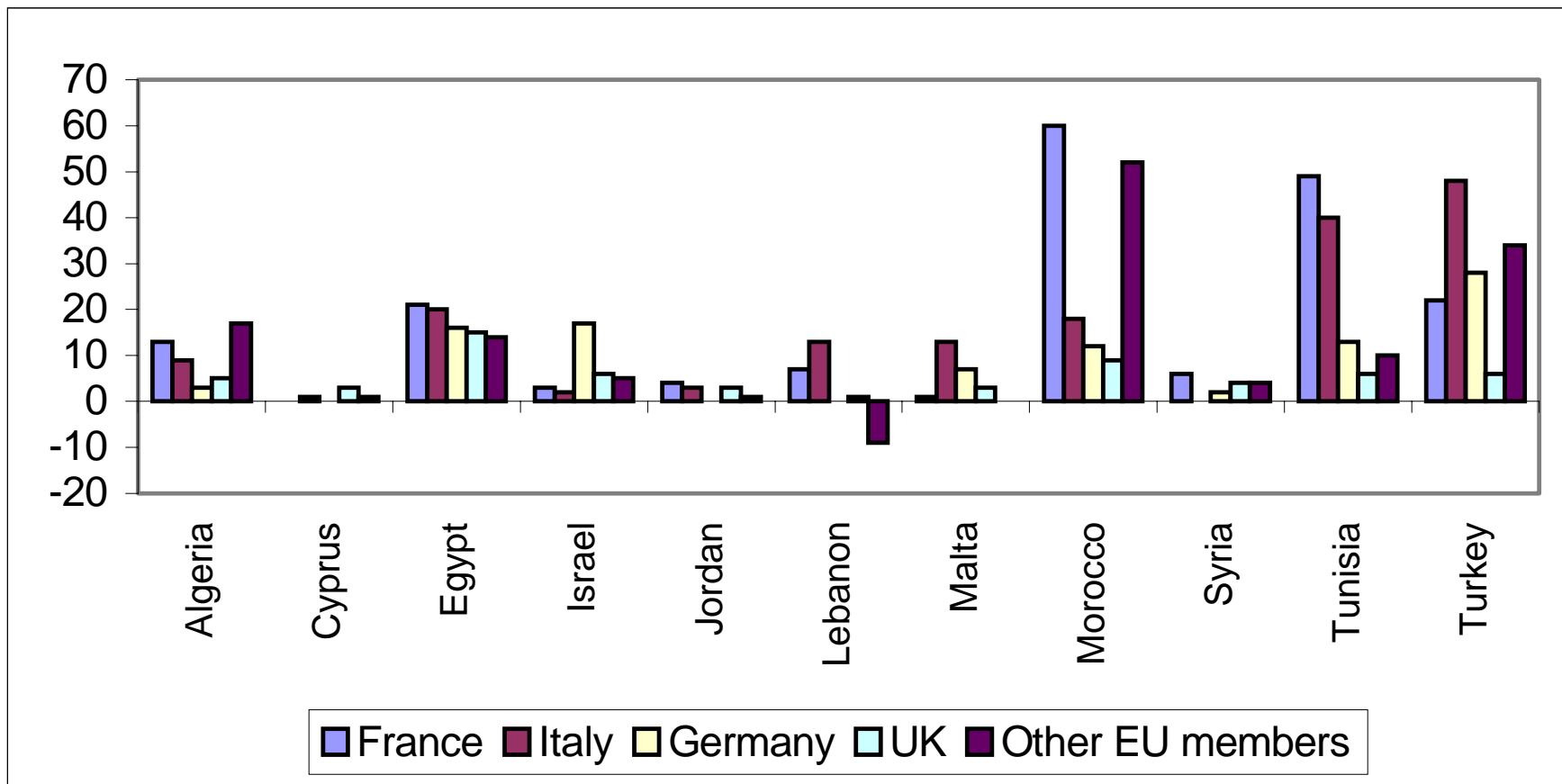
Source: Author's elaboration based on Alessandrini (2000).

Figure 2.2a - Number of investments by home and host countries in the MED area 1950-2000



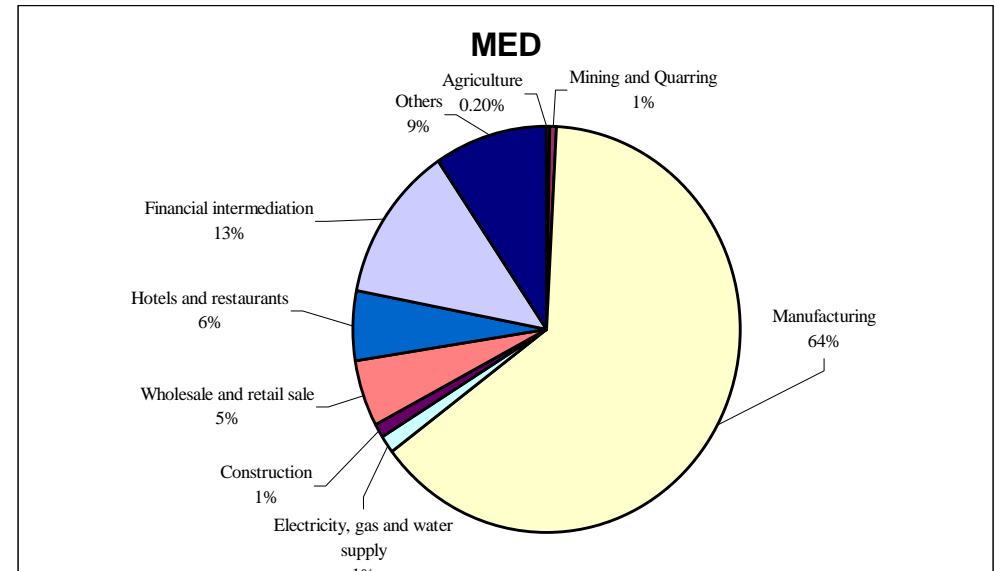
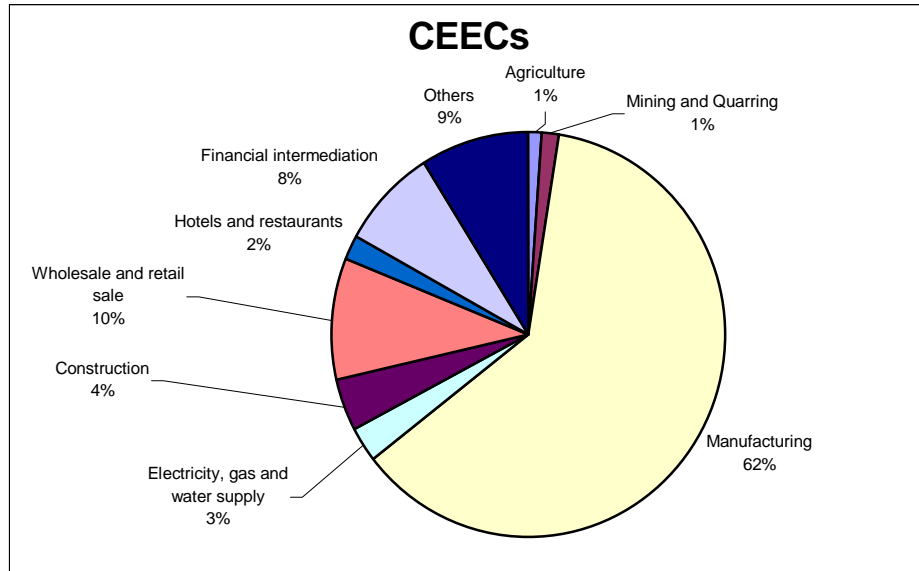
Source: Author's elaboration based on Alessandrini (2001).

Figure 2.2b - Number of EU investments by home and host countries in the MED area 1950-2000



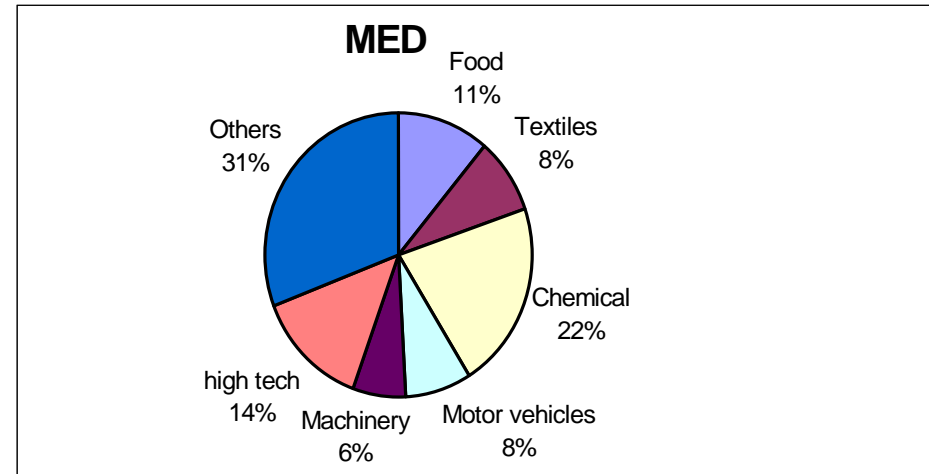
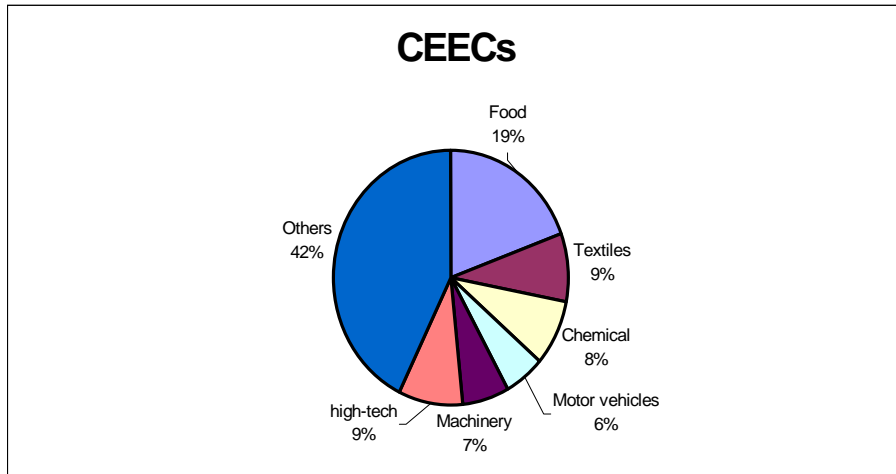
Source: Author's elaboration based on Alessandrini (2001).

Figure 2.3a and 2.3b - Distribution of FDI: all sectors



Source: Author's elaboration based on Alessandrini (2000 and 2001).

Figure 2.4a and 2.4b - Distribution of FDI: Manufacturing



Source: Author's elaboration based on Alessandrini (2000 and 2001)