

# A Review of FDI Theories: An Application for Transition Economies

**Olga Vasyechko**

*University Paris 2, ERMES*

E-mail: o.vasyechko\_stat@yahoo.fr

## Abstract

This paper presents a review of theories of foreign direct investment (FDI) in the context of their role in explaining what motivates multinational companies (MNCs) to do business in transition countries. The paper then addresses the question of the determinants that could explain this phenomenon. Empirical studies indicate the importance of transition-specific determinants of FDI. Some studies even argue that their explanatory capacity is exhaustive and independent of classical theory. The patterns of FDI also differ from those in developed countries.

The purpose of this research is to identify the actual factors determining the decision of multinational firms to invest in transition countries. Empirical results seem to validate the hypothesis that both classical and transition-specific determinants have a theoretical foundation. The main difference of transition consists in a high level of uncertainty. A high-risk business environment influences the decisions of MNCs and the patterns of FDI. This idea is not completely new, occurring in neoclassical assumptions and being further developed in more recent theories. However, the choice of FDI location always depends on a preliminary analysis of countries' advantages and disadvantages and their factor analysis. And only on this basis is the MNC's activity encouraged or limited by the actual level of transition achieved in the host country. Therefore, FDI in transition countries can only be fully explained by a combination of classical approaches and transition-specific approaches.

**Keywords:** Foreign Direct Investment, Transition, FDI determinants

**JEL Classification Codes:** F21, F23, L22.

## 1. Introduction

FDI growth in transition countries is often regarded as being driven by the process of economic liberalization and entry into the international market place and thus the elimination of barriers to FDI. According to UNCTAD (2006, 2011), transition countries now absorb more than half of global FDI, of which about 29 percent comes from exchange between these countries. Outward FDI from those economies also reached record highs, with most of their investment directed towards other transition countries. In contrast, FDI inflows to developed countries continued to decline. Hence, there is evidence of the growing role of transition economies not only as a recipient but also as a source of FDI.

Researchers conclude that there is not one single theory of FDI, but a variety of different theoretical assumptions, approaches, and models (Blonigen, 2006; Faeth, 2009). Despite the obvious importance of FDI and MNCs in the world economy, research on the factors that determine FDI

patterns and the impact of MNCs on investor and host countries is very far from being completed and generalized (Blonigen, 2006). The growing interest of investors for transition markets has stimulated a vast stream of empirical studies on the subject. The most important general questions are: what factors determine where in transition FDI occurs and what impact do these MNC operations have on the parent and host economies? Different ideas have already been expressed in this regard. The answers are not straightforward. Researchers are conducting a thorough search of all available factors that might explain the phenomenon. In particular, the literature has shown that beside well-known traditional determinants, drawn from the theory, some transition-specific factors have an unambiguous general impact on FDI patterns in these countries. We can assume this approach to have two effects. Some studies use different extensions of already-existing classical models of FDI, others argue that transition has an exceptional character that cannot be explored within general FDI theory, calling for new approaches and specific proxies of FDI determinants. Moreover, some researchers argue that FDI flow does not need to be explained by any traditional factor such as location advantage or ownership advantage, but that it is a natural process driven by the rational behavior of MNCs in an uncertain environment (Cukrowski and Aksen, 2002). However, although the models and the set of FDI variables can vary from one study to another, it is reasonable to consider that all these variables describe different aspects of a single phenomenon – a high-risk transition environment, but they originate in theory.

The objective of this research is to provide an overview of different theoretical and empirical studies to explain the relations between the theory of FDI and the approaches applied to transition countries, as well as theoretical origins of transition-specific variables. This paper will not attempt to reopen the arguments already investigated in other studies, limiting itself to a discussion of the evolution of relevant ideas. In turn, we are interested how the transition issue contributes to general FDI theory.

The paper is organized as follows. Section 2 presents the background of the issue. Section 3 presents an overview of the main theories on FDI flows and a brief summary of the results obtained by these theories for transition countries. Section 4 concludes the basic findings of the study.

## 2. Background

The importance of FDI has led to the development of numerous theories and models seeking to explain the motivations behind FDI and MNCs' choice of particular entry modes and localizations. Several studies provide overviews of FDI theories: see for example, Agarwal (1980), Calvet (1981), Helleiner (1989), Cantwell (1991), Meyer (1998) and Markusen (2002), and more recently, Faeth (2009). Given the complexity of the issue, the interdependence of many theoretical assumptions is obvious. Some determinants of FDI may appear under more than one heading and be used in more than one theory. Moreover, the classification of FDI theories may result in some overlap (Lizondo, 1991; Agarwal, 1980). However, with the progressive accumulation of theoretical studies and empirical results, such a classification has become indispensable for systematic understanding of the issue and its development.

Casson (1982) argued that the theory of FDI is based on three integrating theories, namely (1) international capital market theory, (2) *theory of the firm*, and (3) international trade *theory*. International trade theory has developed the general equilibrium model of world trade (Ohlin, since the 1920s), from which are drawn the model of Heckscher-Ohlin-Samuelson, the Leontief paradox (1953), and partial equilibrium theory. The *theory of the firm*, initiated by Coase (1937), was subsequently developed by Williamson (1975, 1985), Grout (1984), Grossman and Hart (1986), Hart and Moore (1990). The new trade theory began to emerge in the 1970s.

There is not, however, a single FDI theory, and moreover FDI sub-theories are not mutually exclusive. Each sub-theory requires elements of others, meaning that each is incomplete if taken in isolation. In order to conceptualize the nature of FDI, early economics has evolved into descriptive political analysis and more recently into empirical analysis with econometrics, made possible by advances in computing.

In fact, it is very difficult to separate FDI from international trade theory. Overall, in particular based on a classification proposed Faeth (2009), we can distinguish 12 main branches of FDI theory, according to the earliest mentions: (1) monopolistic advantage theory, (Hymer, 1960; Vernon, 1966), (2) aggregate variables as determinants of FDI (Scaperlanda and Mauer, 1969), (3) the substitute theory (Mundell, 1968), (4) the complement theory (Kojima, 1975), (5) OLI paradigm (Dunning, 1981), (6) the theory of traditional multinational activity determinants of horizontal FDI according to the proximity-concentration hypothesis and vertical FDI according to the factor-proportions hypothesis (Markusen, 1984; Helpman, 1984), (7) the theory of horizontal FDI, vertical FDI and the knowledge-capital model (Markusen, 1996, 1997; Markusen and Venables, 1998), (8) the resource-based theory (Wernerfelt, 1984; Barney, 1991), (9) the business network theory (Jarillo, 1988; Ebers and Jarillo, 1998), (10) theory of new economic geography (Krugman, 1995), (11) diversified FDI and risk diversification model (Rugman, 1975, 1976; Kopits, 1979; Miller and Pras, 1980), and (12) policy variables as determinants of FDI (Bond and Samuelson, 1986; Black and Hoyt, 1989; Haufler and Wooton, 1999; Haaland and Wooton, 1999). To clarify the terminology, we also use the term *General FDI theory* to encompass all the mainstream theoretical variety on the issue.

To investigate FDI in the context of transition economies, we need to answer several questions. What is a transition economy? Why should we pay particular attention to FDI in transition? Does classical FDI theory cover the case of transition?

In the literature, the concept of a 'country in transition' covers a wide variety of different transition states under rapidly changing conditions. Over the world, the countries in transition can be divided into three groups, which are not, however, homogeneous within each group and had different initial conditions. These are: (1) Central and Eastern European (former communist) countries, (2) rent-seeking countries of Africa and the Middle East, (3) emerging countries (China, India, Latin America). These countries have such common characteristics as the collapse of a whole economic system (abandonment of centralized planning and a common trade space, the recognition of private property, opening up to Western economies). However, they remain separated from the rest of the world because of an insufficient level of political and economic transformation towards democracy and the free market. The direction and scale of these reforms are not always obvious, and the worst scenarios of the past can be repeated. This sort of separation from the rest of the world is also due to stronger regional ties within some groups of transition countries.

At first glance, the FDI issues for transition economies appear to be the same as those studied for economically advanced countries, but researchers argue that general FDI theory cannot automatically be applied to transition economies. FDI theory was mainly developed for economically advanced countries, initially for outward FDI, and only later for inward FDI. Transition countries, on the contrary, were first considered as FDI host economies, and much later as potential sources of FDI. This literature can be divided into two broad categories, one consisting of papers on the consequences of FDI for these countries and the other on FDI determinants and patterns in transition countries. The first category covers such issues as FDI impact on economic growth, spillover effects, the impact on host country competition and the emergence of domestic MNCs. The other category is devoted to the application of FDI theory and its extension to transition economies.

In transition countries, ownership of productive assets is undergoing substantial change and private capital is scarce. So FDI has a positive impact, and the governments of these countries should pursue policies to attract FDI. In the 1990s, the consequences of FDI for developing and transition economies were explored by Singh and Jun (1995), Borensztein *et al.* (1995), and Mallampally and Sauvart (1999). They examined the relationship between FDI and economic growth in developing countries. The subsequent economic and political mutations in transition countries have modified many findings. New evidence was proposed by Campos and Kinoshita (2002), who examined the effects of FDI on growth for the period 1990-1998 for Central and Eastern European and former Soviet Union transition economies. Lyrroudi *et al.* (2004) explore the latest FDI consequences on economic growth in South Eastern Europe. Johnson (2005) studies FDI impacts for Central and Eastern Europe,

Commonwealth of Independent States economies and 8 ‘high-performing’ economies, namely China, Hong Kong, Indonesia, Korea, Malaysia, Singapore, Taiwan and Thailand. He shows that FDI inflows have a positive effect on host country economic growth in developing economies but not in developed economies. Aitken and Harrison (1999) discuss the question of whether domestic companies really benefit from FDI in transition economy (evidence for Venezuela), while Liang (2004) explores such new phenomena as competition between foreign MNCs and local firms. FDI stimulates domestic competition, and numerous transition countries have become new emerging economies producing their own MNCs and therefore investing abroad. Wang and Swain (1995) and Basave Kunhardt and Guitierrez-Haces (2008) find evidence of a steady expansion in an adverse economic environment of emerging MNCs in East Europe, Asia and Latin America. The principal findings reveal that outward FDI from developing countries increases with foreign competition in the domestic market augmented by inward FDI. In addition, FDI as capital investment is more and more associated with other forms of MNC implantation based on subcontracting, franchising, licensing and offshore outsourcing. This phenomenon, which emerged in the 1980s and was amplified by the collapse of the Soviet Union, has since expanded greatly and is now widely present in transition countries (D’Cruz, 2007). Summarizing the relevant literature, the main conclusion is that FDI clearly have a positive impact on the economic development of host economies by stimulating market competition and technology transfers.

Extension of the general FDI theory to transition countries became both necessary and possible owing to new, unknown market conditions in these countries and the openness of the FDI theory. The main difference between transition economies and economically advanced countries, as far as inward FDI is concerned, consists in less-developed market institutions, unstable economic and political situations and hence a high level of uncertainty, representing potential risk for business. In many transition countries this uncertainty is caused by sovereign debt and budget and finance disequilibria. It is evident that institutional factors, economic and political uncertainty play an important role in risk management for MNCs doing business in transitional economies. On the other hand, the openness of FDI theory gives flexibility to the FDI model, which can be extended by additional regressors. Hence, when modeling FDI determinants for transition economies, researchers split their proxies into two groups. The first group consists in the ‘traditional’ FDI variables drawn from theory; the second introduces transition-specific determinants. Often, researchers argue that the determinants of inward FDI in developed countries are very different to those of inward FDI in less-developed (transition) countries, and that the differences are still not captured adequately in the empirical specifications.

Although a good deal of research exists on this issue, there is no clear directive as to how to model the determinants of FDI into transition economies. Can the evidence for transition countries be separated from general FDI theory or is it simply a branch of it? Should we use the classical approaches as a basis for describing the new FDI evidence in transition? What do “transition-specific” FDI determinants mean, and what are their origins and roles?

### **3. FDI Theories and Extensions to Transition Economies**

#### **3.1. Neoclassical Theories**

The neoclassical macro-level international trade and international capital market theories assume perfectly competitive markets. As a result of such perfectly competitive markets, international specialization leads to gains from international trade. The Marshallian variant of neoclassical theory is also relevant to FDI. The relevance is practical: cost-benefit analysis on particular projects is conducted to evaluate the projects in question (Akrami, 2008). The neo-classical approach states that, due to the scarcity and relatively high cost of labor in developed countries, they tend to transfer production facilities to less developed, labor-intensive countries (Caves, 1996; Cantwell, 2000). Consequently, there is only one direction of capital flows: from advanced countries to capital-scarce countries. The Heckscher-Ohlin model has been widely used to explain FDI in a general equilibrium framework.

The neoclassical approach has been criticized by researchers for its lack of realism and inability to explain FDI (Hymer, 1976; Kindleberger, 1969). In the context of transition, not only does the perfect competitive market not exist, but even the basic market institutions and tools are yet to be developed. Zerbergs (1998) investigates whether the FDI patterns can be proxied in the standard neoclassical model or in modified versions of this model that allow for differences in production technologies across countries. He argues that the standard neoclassical approach is not particularly useful to explain FDI flows in less-developed (transition) countries. However, the neoclassical assumption that capital moves from economically developed countries towards the capital-scarce countries was very important for understanding FDI incentives in transition economies (McDougall, 1960; Kemp, 1964). Capital endowments, currency risks and risk premiums gained by foreign investors also explain the interest of MNCs in many transition economies (Aliber, 1970). Two essential factors of business activity proposed by neoclassical FDI theory - namely global market uncertainty as a factor of risk for investors and the role of government in creating institutions - later became the foundation of empirical study of FDI in transition economies.

### **3.2. Monopolistic Advantage Theory**

Discussion of the efficient allocation of assets to dispersed locations was initiated by Coase (1937), who introduced the concept of transaction costs to explain the nature and limits of the organization of the firm. Coase studied the firm in relation to international activities. According to Coase, using the neoclassical price system has a cost (contradicting the neoclassical hypothesis of perfect information), and this cost explains the formation of such structures as companies, which help to reduce transaction costs. The contribution of Coase was to emphasize the various obstacles to the ideal use of the price system in neoclassical theory.

In line with Coase, Hymer (1960) offered an alternative: a microeconomic analysis of MNCs based on industrial organization theory. This relates FDI to MNCs' motives to extend their activity abroad and transfer intermediate products such as knowledge and technology over the world. In fact, he focused attention on the MNC as a business entity for international production rather than international trade. If classical macro-level theory was based on the concept of a perfectly competitive market, Hymer argued that MNCs exist in an imperfect market. Thus he introduced the advantages of non-financial MNCs compared with other MNCs in the same economic activity. Many of Hymer's assumptions became a foundation for future theoretical and empirical FDI research, also used to shed light on the nature of FDI in transition economies. The theory highlights such important factors for transition economies as product differentiation, managerial expertise, new technology or patents, government intervention, information asymmetry, culture differences and business ethics (Caves, 1971). Here we find again the idea of uncertainty and the high risk level of the international market, from which many determinants of FDI were then derived.

In 1966, Vernon introduced a theoretical framework to explain FDI flows based on the hypothesis of comparative advantage of factor endowments. This was the theory of international product life cycle, which highlighted the information, uncertainty and scale economies rather than merely factor costs. Factor endowment theory suggests that differences in endowments and initial conditions between countries explain the geographical pattern of inward FDI (Kinoshita and Campos, 2004) and consequently how the phenomena of developed countries investing in transition countries might take place. However, Vernon's model simplifies FDI as a substitute for trade and cannot explain the phenomenon of developing and transition countries investing in advanced economies.

### **3.3. Aggregate Variables as Determinants of FDI**

Scaperlanda and Mauer (1969) tested aggregate variables to explain MNCs' incentives to invest. Their hypothesis was not based directly on any existing theory of FDI. However, they found evidence of an impact of GNP size on FDI in Europe. Other researchers also showed the important role of such FDI

determinants as market size, market growth, distance between the investor and host countries, cultural and language similarities, and diverse trade barriers (Goldberg, 1972; Davidson, 1980; Lunn, 1980). These variables were largely used in modeling, especially in the gravity model. Many investigations of FDI in transition economies are based on this approach. In 1998, Altomonte proposed the real option theory of FDI testing for the countries of Central and Eastern Europe and showed, among other findings, that the bigger the size of the market and its potential demand, the higher the probability of attracting foreign investment; the distance between the home and the host country also influences MNCs' FDI decisions. Brenton, Di Mauro and Liicke (1998), using an empirical model of bilateral FDI flows between the EU and Central and Eastern European countries, find that the key determinants of FDI to the region are income growth and business-friendly government policies. Carstensen and Toubal (2003), based on a dynamic panel analysis of Central and Eastern European countries with the traditional variables, find a robust and positive impact of the market potential on FDI. In turn, the results of Lyroudi, Papanastasiou and Vamvakidis (2003) for transition countries for the years 1995 to 1998 indicate that FDI does not exhibit any significant relationship with economic growth. This can be explained by the fact that in the earlier period of transition all the countries concerned were in a similar crisis situation characterized by low economic growth and thus could not create such an incentive for investors. Later, Cukrowski and Kavelashvili (2001) and Cukrowski and Mogilevsky (2001) argue that the poor transition economies attract many fewer investors. Mateev (2008) argues that FDI flows into different groups of transition economies are determined by the same macroeconomic factors. In this theory, the gravity model is widely used to test the hypotheses on proxies of FDI determinants, later extended in numerous empirical research works. Abid and Bahloul (2010) show the importance of information costs and bilateral trade in determining bilateral asset holdings between the Middle Eastern and North African countries and the developed economies.

### **3.4. Substitute Theory of FDI**

In 1968, Mundell argued that when high trade barriers deter commodity movements, the relations between commodity and factor movements are substituted. This implies that an increase in FDI will reduce exports from the home country to the host country. Thus, Mundell concludes that capital movements driven by FDI are the perfect substitute for exports, if FDI flows always follow the trace of a particular curve (Rybczynski, 1955), due to the relative higher efficiency or lower transformation costs of production factors. In line with Mundell's substitute theory, Goldberg and Keln (1999) argued that FDI can serve as a complement for trade or a substitute for trade based on the effects identified by the Rybczynski curve. The results indicated that FDI could alter the sector composition of capital and labor in an economy through different channels. That is to say, the relations between FDI and trade present a mixed pattern of linkages. Evidence reveals that some FDI flows tend to expand manufacturing trade, while other FDI reduce trade volumes. Researchers have criticized the substitute theory because FDI flows and trade can never be perfect substitutes in the real world economy and FDI can co-exist with exports. Johnson (2005, 2006) proved that the relations between FDI outflows and exports in transition economies are mixed, indicating that outflows of FDI can be function as both a complement and a substitute for exports. He also argued that investment in a host country leads to an increase in the trade of intermediate goods used in production. That is, MNCs invest in the transition host country in order to export the output to third countries.

### **3.5. Complement Theory of FDI**

The complement theory, as a synthesis of the Heckscher-Ohlin model, the Rybczynski theorem, Linder's hypothesis, and the Vernon product cycle hypothesis, was developed by Kojima in the late 1970s. Kojima's thesis offers an alternative hypothesis to Mundell's substitution theory (Ozawa, 1979). He argued that FDI originates from the comparatively disadvantaged industries of the home country, which are potentially comparatively advantaged industries for the host country depending on

the different stages of economic development in home and host countries. Kojima's approach predicts that export-oriented FDI occurs when the source country invests in those industries in which the host country has a comparative advantage. FDI is the "transfer of superior production functions to replace inferior ones in the host country" (Kojima, 1975). Thus, Kojima derived the results that export-oriented FDI is welfare improving and trade creating since it can promote both host countries' and source countries' exports. Evidence found by Kojima for Japanese business may also reflect the ad hoc response of Japanese business to market distortions created by government policies in developing countries (Tsurumi, 1979). Obviously, besides East Asia, this can be extended to other transition countries.

### **3.6. The Theory of Internalization of FDI (OLI Paradigm)**

During 1981-1988, Dunning proposed and developed the theory of internalization. The theory of internalization evolved out of Hymer's work and was based on Coase's transaction cost theory. It argues that transactions are made within an institution if the transaction costs on the free market are higher than the internal costs. This process is called internalization. The internalization theory was developed into the eclectic OLI paradigm. The OLI frameworks include both macroeconomic location advantages and microeconomic ownership advantages, as they are incomplete if taken separately (Straker, 2006). For Dunning, in addition to the organizational structure, the three factors of ownership, location, and internalization advantages are also important. The OLI conditions constitute a more comprehensive theoretical framework integrating the key elements of various explanations of FDI. Dunning distinguished the patterns of FDI according to five levels of economic development of a country (Park and Lee, 2001). In the context of transition, Dunning was the first to consider structure of resources, market size and government policies as the determinants of the location of FDI in a host country, also arguing that the patterns of FDI are not constant but vary according to these determinants. Dunning's paradigm also takes into account human nature as an element motivating MNCs' FDI decisions (Straker, 2006). In line with this idea, Van de Laar and de Neubourg (2002), studying Dutch firms' incentives in Central and Eastern Europe, argue that adding emotions to FDI theory can also enhance our understanding of MNCs' decision-making. Directly and indirectly, the theory of internalization of FDI has formed the theoretical basis of a vast number of empirical studies of MNCs' incentives to invest in transition economies.

### **3.7. The Theory of Traditional Multinational Activity**

Within the theory of traditional multinational activity, three approaches were proposed which came to be known as the vertical FDI model (Markusen, 1984), the horizontal FDI model (Helpman, 1984), and the knowledge-capital model (Markusen *et al.*, 1996). The horizontal FDI model argues that FDI produces the same goods and services in different locations, and the vertical FDI model describes how FDI geographically fragments the production process into stages. Both horizontal and vertical models highlight variables such as research and development across plants, plant-level scale economies, market size, factor endowments and transport costs, including geographical and cultural distance costs as well as the other kinds of barriers involved in the trade between home country and host country. In vertical FDI theory, FDI possibly reverses trade in terms of asymmetries of factor endowments between host country and home country, and the asymmetries between countries also make it possible for trade and FDI to coexist. In horizontal FDI theory, it is assumed that the interacting countries are identical in technologies, preferences, and factor endowments. Hence, MNC can be motivated by international trade. Another idea is that FDI flows are motivated by high productivity, lower labor costs, resource endowments, and favorable business environments. Markusen integrated vertical and horizontal approaches into the so-called knowledge-capital model, accounting for a much wider set of MNC patterns. Brenton, Di Mauro and Liicke (1998) demonstrated that FDI in transition countries diverges little from the normal patterns. This contradicts those who have argued that FDI in transition

is very small compared to overseas investment in countries of similar income over the world. They prove that FDI has a direct impact on the economy of the source country in terms of being a substitute for trade. This study supports previous empirical analyses suggesting a complementary relationship between FDI and trade. Whereas Driss (2007) used an extension of the gravity model and finds evidence of vertical FDI in Tunisia, Johnson (2005) argued that the relationship between FDI outflows and exports in transition countries are mixed, indicating that outflows of FDI can be both a complement and a substitute for exports. Lankes and Venables (1996) note that the mode of MNCs' entry into transition economies forms different patterns of FDI, which are variable, thus confirming Dunning's assumption. The evolution of FDI patterns reflects changes in both internal and external conditions. Many aspects of this issue have been studied for Central and Eastern Europe (Bevan and Estrin, 2000; Hunya, 2000), for Slovenia (Kumar and Zajc, 2003), and for the new EU countries (Sova, Albu, Stancu, Sova, 2009). General findings are that MNCs investing in transitional economies prefer to construct horizontal FDI patterns because of the high uncertainty of host markets

### **3.8. The Resource-Based Theory**

Summarizing multiple MNCs' incentives, Behrman (1972) proposed and developed a typology of FDI. This classification is based on industrial organization theory and corporate governance. According to Behrman, MNCs are always seeking one of four types of results: resources, markets, efficiency (global sourcing FDI), and strategic assets. However, because ownership and internalization advantages are supply-side factors, they are not considered by Behrman.

The resource-based theory of the firm (Wernerfelt, 1984; Barney, 1991; Grant, 1991; Davidow, 1986) creates a methodical basis for MNC investment strategy to achieve competitive advantage by understanding the external and internal forces that strongly affect an organization (Lindelöf and Löfsten, 2004). According to this theory, MNCs aim to possess resources that are rare, unique, and limited so as to beat their competitors in various performance indicators. The resource-based theory has been developed to explain how organizations achieve sustainable competitive advantage (Caldeira and Ward, 2003). Accordingly, firms must look for unique attributes that may provide superior performance (Barney, 1991; Caldeira and Ward, 2003). This theory focuses more on the advantages associated with the complexity of managing a multiplicity of activities and functions in a volatile but innovatory global economy (Dunning, 2000). The findings of Tøndel (2001) support a hypothesis of market-seeking and resource-seeking investments prevailing in Central and Eastern Europe and former Soviet republics. Kudina and Jakubiak (2008) also find that market-seeking orientation has the most positive effect on investment performance, followed by skilled labor and cheap input orientations in smaller transition countries. Resmini (2000) argues a statistically significant positive relation between FDI and market size, wage differential, the stage of the transition process and the degree of openness of the economy. However, MNCs emerging in transition economies with the government as main stakeholder limit the natural-resource-seeking activity of foreign investors. This situation is especially characteristic of rent-seeking countries, including Russia (Filippov, 2008). The rent-seeking empires of the oligarchs became monopolists on the domestic natural resources market. As a result, foreign investors should seek labor and efficiency and form horizontal FDI patterns. This may partially explain the predominance of horizontal FDI patterns in transition economies.

### **3.9. The Business Network Theory**

The business network theory is based on a set of relationships between firms, including strategic alliances, joint ventures, long-term buyer-supplier partnerships, and collaborative relationships and also includes reputation and brand image as part of the network (Ebers and Jarillo, 1998; Gowa and Mansfield, 2004; Jarillo, 1988). Castells (2000) considered the network as a new form of paradigm and regarded it as the fundamental node from which new organizations are and will be made.



Since the system of MNC is most often conceptualized as a differentiated inter-organizational network, the position of MNCs affiliates, doing their business in transition economies, is assumed to be quite different to that of affiliates operating in developed economies (Pesalj, 2011). These differences are present at the level of age and business experience of the affiliate, business and political conditions, diverse risks, management competences and workforce skills. Therefore, during the establishment phase affiliates in the transition economies could have an inferior position in the MNC system, in terms of its contribution to the market and organization performances, participation in the creation and transfer of knowledge (Subramaniam and Watson, 2006; Moilanen, 2007). Researchers indicate that the relations between headquarters and the affiliate operating in a transition economy could be more properly conceptualized using the traditional, classical view of MNCs rather than following modern contributions drawn from the knowledge and network-based theories. Affiliates in transition economies mainly act as receivers of knowledge transmitted predominantly from the headquarters and these affiliates are characterized by traditional dependency on the MNC headquarters (Pesalj). Pesalj argues that the theoretical approaches that have usually been applied to study MNCs' affiliate patterns need to be treated with caution for affiliates doing business in transition economies. These propositions should be established rather on the basis of the previous empirical evidence than on the basis of the existing theoretical approaches.

### 3.10. The Theory of New Economic Geography

According to the theory of new economic geography (Krugman, 1991, 1999), the "home market effect" interprets agglomeration as the outcome of the interaction of increasing returns, trade costs and factor price differences. If trade is largely shaped by economies of scale, as Krugman's theory argues, then those economic regions with most production will be more profitable and will therefore attract even more production and FDI. In other words, instead of spreading out evenly around the world, production will tend to concentrate in a few countries, regions, or cities, which will become densely populated but will also have higher levels of income.

In line with Krugman and Venables (1994), Damijan and Kostevc (2008) find very strong evidence that in most of the transition countries analyzed, trade liberalization has caused a decline and divergence in relative regional wages, but the relative wages then adjusted toward the shock mainly through economic geography factors. For instance, in Central and Eastern European countries, important inter-regional relocations of manufacturing activity have taken place after trade liberalization with the EU, and inward FDI mostly to the capital and border regions has helped to foster these adjustment processes. However, since economic integration with the EU provides important opportunities for individual regions, it can also have severe polarization effects. In fact, such a polarization can be observed in all transition countries. For example, Ledyeva and Linden (2006) note that the central region of Russia has a rather high value of accumulated FDI per capita compared with other regions. In fact, the city of Moscow clearly plays a dominant role in attracting FDI to the region. It accumulated almost 40 percent of total FDI stocks in Russia and has the highest FDI per capita. According to Pan-European Institute estimates (Pan-European Institute Report, 2004), out of the 20 Russian regions receiving the most FDI, 11 of them have cities of more than a million inhabitants. Hence, big city advantages like high levels of business infrastructure and large market size are important factors of inward FDI. Ledyeva and Mishura (2006), analyzing FDI distribution in Russian regions, show that only a factor of aggregate profit in a particular region is robustly related to regional distribution of investment in Russia. They explain this result by the fact that the investment climate in Russia is unfavorable and only high profits can compensate for the risks and attract investors.

Suggesting regional homogeneity of FDI factors for transition economies, Deichmann *et al.* (2003) examine the extent to which non-spatial determinants of FDI organize themselves by spatial proximity. Thus, within the group of all transition factors, we can also distinguish some regional subgroups according to regional historical, economic and cultural conditions.

### 3.11. Diversified FDI and Risk Diversification Model

A large stream of empirical contributions have analyzed the role of risk factors in explaining FDI patterns and MNCs' incentives to invest abroad (Rugman, 1975, 1976; Kopits, 1979; Miller and Pras, 1980; Caves, 1996). Faeth (2009) notes that while horizontal and vertical patterns of FDI can be explained well by the transaction-cost approach and the knowledge-capital model, diversified FDI, which is growing in importance, cannot be explained, as it occurs because of MNCs' desire to spread investment risk. Firms' risk aversion, which had been considered a minor factor of FDI, is gradually emerging as one of the main determinants of FDI. Rugman's 'diversification hypothesis' has been widely supported by empirical evidence. In contrast to horizontal and vertical patterns, conglomerates arise as a response to high-risk business environments. Kopits was the first to describe this form of MNC in 1979. Bettis (1981) suggested that firms achieved better performance because of openness to the possibility of differentiation and segmentation based on identified risk factors.

However, Baniak *et al.* (2002) state that not all MNCs are identical with regard to risk aversion. Moreover, the likelihood of investment in a country is inversely related to the degree of risk aversion of the potential investor. The value of the expected utility from future profits could be too small for long-term investors (characterized by high risk aversion), but it could be satisfactory for less risk-averse or risk-loving firms, focused more on speculative transactions. Hence, the unstable economic situation may result in adverse selection of investors. It may happen that only firms interested in short-run speculative transactions are ready to invest in the host country.

In the context of risk management, empirical observations indicating the existence of more complex forms of FDI have led to the development of FDI models where MNCs are not strictly defined as being vertical, horizontal or knowledge-based. Yeaple (2003b) presents a three-country model where MNCs follow so-called 'complex integration strategies'. Researchers distinguish two kinds of FDI diversification - in product and in location - which, when combined, are described as 'double diversification'. According to recent studies, there is strong evidence of this phenomenon among MNCs emerging in transition countries. Because of high domestic risk, the structure of new emerging MNCs often takes the form of conglomerates, what can be referred to as highly diversified FDI (Khanna and Yafeh, 2007). This type of MNC spans diverse activities with requirements for high profitability from each affiliate. At the core of the group we can usually find a financial intermediary managing financial flows. Emerging MNCs use the opportunity to enter in different segments of the market and thereby spread the risk.

As Baniak *et al.* (2002) argue, although uncertainty in the host market harms the flow of FDI, it may be that uncertainty in the investor's home market is a principal motive for FDI. In other words, apart from advantage-seeking, a crucial incentive to capital outflow is avoiding or diminishing the impact of an unfavorable environment for domestic business. The attitude to risk in the source country is strongly related to the size of FDI flows abroad that can be witnessed in transition countries (Kimino, Saal, and Driffield, 2007; Kayam, 2009).

Thus, this theory explains the behavior of two competitive actors: foreign MNCs doing business in transition economies and MNCs emerging within those transition economies. For the former, diversification is the means to spread risk in high-risk international and new transition markets. For the latter, the same risk factor creates an incentive to invest abroad using double diversification and, as result, to become an MNC.

### 3.12. Policy Determinants of FDI

The earliest studies by Bond and Samuelson (1986), Black and Hoyt (1989), Haufler and Wooton (1999), and Haaland and Wooton (1999) argued that there are strong links between MNC strategy and government policy in host countries. Empirical studies show that an MNC's decision to invest can be influenced by such factors as information asymmetry, structure of the host economy, market size and market evolution, openness, the level of infrastructure and the level of political, economical and

financial risk (see, for example, Resmini, 2000). Altomonte (1998) obtained evidence by including variables measuring the institutional and economic uncertainty under which the investment is made. In the context of institutional and risk factors, we can identify a dual role of government in transition countries. The government is not only interested in attracting FDI, but can also provide large support for domestic MNCs, being a key stakeholder in them. This phenomenon has been explored in a wide empirical literature (Brouthers and Bamossy, 1997; Cass, 2007; Drahokoupil, 2008). Deichmann, studying the origins of FDI in Poland (2004) and in the Czech Republic (2010), finds that origin effects and government promotion abroad play an important role. This means that the dual role of government is a source of numerous implicit contradictions that complicate FDI into transition economies. Using political leverage (an administrative resource like close ties to the government or lobbying in parliament) and domestic media leverage, emerging MNCs protect and promote their business, but also successfully compete with foreign companies within the host market and regional markets (Khanna and Yafeh, 2008).

Usually, FDI uncertainty is associated with such specific transition factors as the level of privatization (Merlevede and Shoors, 2005). Carstensen and Toubal (2003) argue that both the level of privatization as an indicator for the transition status to a market economy and the method of privatization as a proxy for the efficiency of corporate governance have considerable positive impact on the decision to invest in Central and East European countries. This has been discussed by many authors (see, for example, Bergsman *et al.*, 2000). Lansbury *et al.* (1996) find that the timing and form of privatization programs have an impact on inward FDI and its patterns. The objective of privatization should be to attract new private strategic investors to enhance the operational efficiency of the entities sold. However, most studies have concluded that privatization in transition economies, especially of the infrastructure monopolies, has not been accompanied by the establishment of effective competition policy and regulatory discipline so as to prevent a simply shift from public monopoly to private monopoly. Furthermore, privatization is not geographically and regionally homogeneous, and it is constantly evolving. In many European countries large-scale privatization occurred several years ago, and now most enterprises are already privatized. For instance, in contrast with previous studies, Mateev (2008) states that the evidence about the role of privatization in explaining the scale of inward investment is ambiguous. At the same time, the risk of expropriation and resale remains very high, especially for large companies. Reselling a large enterprise is often considered by transition governments as an additional financial source to resolve the debt problem. Together with the lack of transparent mechanisms of privatization, it can create a risky situation for foreign investors. This type of risk is close to political and legislative risks, since in states with undeveloped democracy and weak private rights any political change may lead to the abandonment of guarantees given to investors by political predecessors (Cukrowski and Aksen, 2002).

Corruption as a determinant of FDI is very similar to the above issue. Bevan and Estrin (2000) studying FDI flows from 18 market economies to 11 transition economies, find that a host country's credit rating is determined largely by the private sector size and the level of corruption. Corruption is a serious hindrance to the development of democracy and market economy, and creates an unfavorable institutional environment for FDI (Smarzynska and Wei, 2001; Wei, 2000b). It is largely present in many transition countries and unfortunately shows little signs of improving. Corruption appears as a usual everyday phenomenon in all spheres where individuals and businesses deal with local authorities and administrations. Abuse of power in local authorities is common practice. Corporate governance incentives and institutions are not brought in line with market-based principles and international practice to engender greater transparency and accountability (Bergsman *et al.*, 2000). As a result, the cessation of MNCs' activity in some transition countries due a high level of corruption regularly makes the headlines. The International Anti-Bribery and Fair Competition Act (1998) and The Bribery Act of the Parliament of the United Kingdom (2010) make it illegal for US companies and companies with links to the United Kingdom to bribe foreign officials, candidates, or political parties, regardless of where the crime occurred. However, as local companies use corruption widely to promote their

business, those of foreign investors working according to good practice face very unlevel playing fields.

Acquiring a mass-media outlet can give MNC new advantages in influencing political decision-makers and consumers. This factor is amplified by the regional aspect. New MNCs from the nearest transition countries having resources and playing similar game rules often have stronger control over lobbyists and mass media in the host market than MNCs from developed countries (Andreff, 2002).

Uncertainty caused by an imperfect legislative base is also widely present in transition countries. New regulations developed, for example, in the CIS countries are either drafted by inexperienced local legislators or are replicas of the respective laws of the Russian Federation. As a consequence, they do not reflect the new social, economic and political reality and it is quite common for already prevailing laws to be frequently revised, over short periods of time. For instance, imperfect legislative systems and insufficient recognition of private rights in transition countries affects the protection of intellectual property rights (Smarzynska, 2004). In many transitional countries, the risk of economic espionage depends directly on the intensity of industrial growth.

Therefore, the level of development of corresponding laws and the volatility of the institutional environment in transitional economies can also be considered an important FDI determinant for MNCs doing business in these countries (Cukrowski and Kavelashvili, 2001; Mogilevsky and Khasanov, 2001; Baniak *et al.*, 2002).

An evident limiting factor for MNC activity is political and as a result economic instability. This factor influences MNCs from developed countries as well as emerging domestic MNCs. One of the consequences of political instability and high domestic risk is capital flight from the transition country. If an MNC does not have ties to the government it can be at risk of non-market competition. This MNC will therefore seek to mitigate potential risk by outsourcing and offshore business registration. Once the capital has become “foreign” and thus more secure, it can then be put to work in the risky transition market again. Thus, capital originating in the transition country and moving offshore becomes an important source of inward FDI in these countries. In this context, the offshore jurisdiction is considered as an offshore financial centre with a relatively large number of financial institutions engaged in business with non-residents, with external assets and liabilities out of proportion to domestic financial intermediation, and offering some or all of the following advantages: low or zero taxation, moderate or light financial regulation, banking secrecy and anonymity (IMF, 2000). Capital flight is observed in many East European countries, including Russia, Ukraine, and the Baltic states. Therefore, offshore is becoming the main country destination for emerging FDI. Among all the tax havens, the majority of these transactions are carried out with Cyprus. In fact, the advantage of using Cyprus is based on the fact that Cyprus is one of the few countries with which many CIS countries have agreements to avoid double taxation (Grigoryev and Kosarev, 2000; Brada *et al.*, 2009).

In turn, the largest share of FDI into CIS markets comes from offshore jurisdictions, mainly Cyprus. It is likely that these MNCs are mainly businesses originally from the transition countries but registered offshore. This suggests the return of capital and the use of Cyprus for capital transit (Loungani and Mauro, 2000). Pelto *et al.* (2003) note that in some Central and East European countries, Cyprus ranks among the ten largest investors. They also note that the share of Cyprus is usually higher in those countries where FDI from Russia is lower. The explanation they propose is that Russian firms use Cyprus as a financial transit gate, when conducting investments directly has met with obstacles. However, the dominant position of Cyprus may also indicate that many foreign companies trading with CIS countries use Cypriot subsidiaries because of favorable taxation in Cyprus and the double-taxation agreement between Cyprus and many CIS countries (Hejazi, 2010).

Together with country risk determinants, the offshore phenomenon is a signal to governments to adjust domestic policy for better governance. There is evidence that offshore has a positive impact on undemocratic, autocratic governments, forcing them to shift their regulatory efforts towards direct regulation methods or to reduce them (Rose and Spiegel, 2007; Morris, 2010).

#### **4. Conclusions**

There is clearly a large reciprocal contribution made by FDI theory to the understanding of FDI in transition economies and by the transition phenomenon to the general theory of FDI.

Although the standard neoclassical approach is not particularly useful to explain FDI flows in transition countries, the neoclassical assumption that capital moves from economically developed countries towards capital-scarce countries is important for understanding FDI incentives in transition economies. Such factors as capital endowments, risks and risk premiums also explain the interest of MNCs in transition economies. The role of government in creating the appropriate institutions, as described by neoclassical FDI theory, and market uncertainty as a risk factor assume central importance for determining FDI in transition economies.

Monopolistic advantage theory covers transition advantages such as product differentiation, managerial expertise, new technology or patents, government intervention, information asymmetry, culture differences and business ethics. Factor endowment theory suggests that differences in endowments and initial conditions among countries explain the geographical pattern of inward FDI, thus, a phenomenon of developed countries investing in transition countries might take place. However, this theory simplifies FDI as a substitute for trade and cannot explain why developing and transition countries invest in advanced economies. Again, an assumption about uncertainty and the resulting high levels of market risk was examined within the context of monopolistic advantage theory for the international market, from which many relevant determinants of FDI were later developed.

The theory of aggregate variables as determinants of FDI argues that FDI determinants for transition countries differ from those for developed countries. In this theory, proxies of FDI are divided into two groups: one for developed countries and one for transition economies. It is assumed that within the same group of transition economies, FDI flows are roughly determined by similar macroeconomic factors such as market size and evolution, distance between source country and host country, or information costs. Widespread use of the gravity model drastically expanded empirical modeling of the issue, also having an impact on other FDI theories.

The substitute theory of FDI, in contrast with earlier theories, suggests that the relationship between FDI outflows and exports in transition economies are mixed, indicating that outflows of FDI can function as both a complement and a substitute for exports. Inward FDI leads to an increase in the trade of intermediate goods used in production in a host country. In fact, MNCs invest in the transition country in order to export the output to third countries. This means that, all else being equal, FDI patterns in transition are related to economic development, regional concentration and risk.

Complement theory assumes that FDI is welfare-improving and trade-creating, since it can promote both host countries' and source countries' exports. This reflects the ad hoc response of businesses from developed countries to market distortions created by government policies in transition countries. Once again, this highlights the role of the government in pursuing policies to attract FDI.

The OLI paradigm was crucial for understanding MNCs' incentives to invest both in developed and transition countries. The OLI conditions constitute a comprehensive theoretical framework, incorporating the key elements of various explanations of FDI. It distinguishes the patterns of FDI according to the level of economic development of a country. The OLI paradigm confirms and develops previous assumptions that apart from the structure of resources and market size, government policy can also determine the location of FDI in a host country, also taking into account human nature as motivate of MNCs for FDI. It also argues that the patterns of FDI are not constant, varying with these determinants.

The theory of traditional multinational activity allows to study the evolution of FDI patterns in transition countries. Earlier results suggest that they diverge little from the normal patterns. More recent empirical studies within this theory show that the relationship between FDI outflows and exports in transition countries are mixed, indicating that outflows of FDI can be both a complement and a substitute for exports, forming different patterns of FDI. However, a general finding is that MNCs investing in transitional economies tend to favor horizontal FDI patterns, because of the high

uncertainty of the host market. In line with the OLI paradigm, this theory states that FDI patterns in transition are not steady. Pattern evolution reflects changes in both internal and external environments.

Empirical results based on the resource-based theory support a common hypothesis of market-seeking and resource-seeking investments prevailing in transition countries. However, a highly volatile international market affects MNCs' incentives to invest. New MNCs emerging in transition economies with oligarchs as the main stakeholders seriously restrict the natural-resource-seeking of foreign investors. As a result, foreign investors need to seek labor and efficiency. In turn, the transition countries where productive and service sectors are well-enough developed and diversified become more attractive for MNCs than those rent-seeking countries that are rich in natural resources. This can partially explain why horizontal FDI patterns prevail in transition economies.

The business network theory argues that during the establishment phase, affiliates in the transition economies may have an inferior position in the MNC structure in terms of their contribution to the market and organization performances, and their participation in the creation and transfer of knowledge. Affiliates in transition economies mainly act as receivers of knowledge issued by the headquarters. The form of their dependence on the MNC headquarters is traditional. Hence, the relationship between the headquarters and the affiliates located in transition countries has to be explained rather by traditional theory than by the knowledge and network-based theories.

The theory of new economic geography provides very strong evidence that in transition economies trade liberalization has caused a decline and divergence of relative regional wages. The capital and border regions are more attractive for inward FDI and therefore more developed. In turn, the chances of less-developed regions attracting FDI diminish, thus exacerbating the economic contrast between regions. Assuming regional homogeneity of FDI factors for transition economies, we can also distinguish some diversity in regional subgroups dependent on regional historical, economic and cultural conditions.

Empirical studies based on the diversified FDI and risk diversification model have shown that risk aversion plays an important role in determining FDI. Here, the factor of risk, mentioned in other theories, becomes a crucial determinant of FDI. To spread the risk, MNCs use double diversification and form conglomerate patterns, especially in new transition markets. The unstable economic situation in transition economies may result in an adverse selection of investors, attracting speculative capital. In turn, new businesses emerging in transition countries become MNC as a response to the unfavorable economic and political conditions in their home country, forming conglomerates as a predominant pattern of FDI.

Use of policy determinants of FDI in empirical models shows that MNCs' FDI decisions can be influenced by such factors as whether the host government seeks to promote an attractive business environment for foreign investors. The role of government, already examined in the neoclassical theory of FDI, has been greatly developed for the study of FDI in transition economies. In transition, this factor is strengthened by a high level of uncertainty and therefore risk. Tests of different proxies of transition uncertainty produce evidence of the impact on MNCs' investment decisions of factors such as the level of privatization and risk of expropriation, corruption, use of mass media by competitors, imperfect legislative systems, political and economic instability, and the dual role of government in declaring policies to attract investment while in fact promoting domestic MNCs in which it is a stakeholder. Many of these factors also cause capital flight from transition countries and then capital return via offshore jurisdictions. In turn, the existence of bilateral agreements to avoid double taxation between offshore jurisdictions and transition countries can attract FDI inflows to these countries but via offshore.

Therefore, four main findings have emerged from this review. (1) Summarizing the literature, we can conclude that the studies of FDI patterns and their determinants in transition countries are closely related to all main components of the general FDI theory. Although empirical studies indicate that not all the FDI theories mentioned are applicable to transition economies, many relevant ideas occur within these theories. With liberal policy frameworks becoming commonplace, transition, as part

of a global world, cannot be considered an isolated process but is involved in general multi-vector relations. In turn, transition issues contribute to general FDI theory and modify many earlier theoretical assumptions. (2) Nevertheless, transition determinants remain key factors. While classical determinants of FDI roughly have the same impact on FDI flows in transition economies as in economically advanced countries, transition-specific factors differ and are not stable. As 'transition' is not a permanent state, the determinants of FDI in transition are subject to change. The evolution of transition-specific FDI determinants has to be examined from various points of view. (3) The main result is the presence of high levels of investment risk during the transition period. If the international market is more risky than the domestic market, the risk level in transition markets is much higher than over the international market on average. All principal proxies of FDI determinants in transition describe the different aspects of this uncertainty. The *complexity* of the issue stems from the variety of such uncertainty. (4) However, the choice of FDI location always depends on a preliminary analysis of countries' advantages and disadvantages and their factor analysis. Conditions pre-existing in each country can always roughly predict the type of FDI: resource-seeking, market-seeking, efficiency-seeking or capability-seeking FDI. And only then, independently of the overall incentive, is the MNC's activity encouraged or limited by the host country's actual situation, i.e. the stage reached in the transition progress.

Therefore, FDI in transition economies can only explained by a combination of classical theories and transition-specific approaches, which will perhaps become 'classical' in the near future.

## References

- [1] Abid, F., Bahloul, S. (2010) Selected MENA countries' attractiveness to G7 investors, available from: <http://www.eip.gov.eg/Upload/Publications/MENA%20COUNTRIES%E2%80%99.pdf>
- [2] Agarwal, J. (1980) Determinants of foreign direct investment: a survey. *Weltwirtschaftliches Archiv* 106: 739-773.
- [3] Aitken, B., Harrison, A., (1999) Do domestic firms benefit from direct foreign investment? Evidence from Venezuela. *The American Economic Review* 89(3), 605-618.
- [4] Akrami, F. (2008) Foreign Direct Investment in Developing Countries: Impact on Distribution and Employment. A historical, theoretical and empirical study. The University of Fribourg, Switzerland.
- [5] Altomonte, C. (1998) FDI in the CEECs and the Theory of Real Options: an Empirical Assessment, Licos Discussion Paper No. 176.
- [6] Andreff, W. (2002) The new multinational corporations from transition countries. *Economic Systems*, Volume 26, Issue 4, pp. 371-379.
- [7] Baniak, A., Cukrowski, J., Herczyński, J. (2002) On Determinants Of Foreign Direct Investment In Transition Economies. *Problems of Economic Transition*. 2005;48(2):6-28.
- [8] Barney, J.B. (1991) Firm resources and sustained competitive advantage. *Journal of Management* 17 (March): 99-120.
- [9] Basave Kunhardt, J., and Guitierrez-Haces, M.T. (2011) Mexico's global players in MNEs from Emerging Markets: New Players. Chapter 8 – in the World FDI Market. Edited by K. P. Sauvart, V. Govitrikar, and K. Davies, The Vale Columbia Center on Sustainable International Investment, pp. 239-296.
- [10] Behrman, J. (1972) *The Role of International Companies in Latin America: Autos and Petrochemicals*. Lexington, MA: Lexington Books.
- [11] Bergsman, J., et al (2000) Improving Russia's Policy on Foreign Direct Investment, *The World Bank, Policy Research Working Paper* 2329.
- [12] Bettis, R. (1981) Performance Differences in Related and Unrelated Diversified Firms. *Strategic Management Journal*, 2 (1981): 379–393.

- [13] Bevan, A., and Estrin, S. (2000) The Determinants of Foreign Direct Investment in Transition Economies, Center for New and Emerging Market, London Business School, CENM 9.
- [14] Black, D., and Hoyt, W. (1989) Bidding for firms. *American Economic Review* 79: 1249-1250.
- [15] Blonigen, B. (2006) **Foreign Direct Investment Behavior of Multinational Corporations**, NBER Reporter: Research Summary Winter 2006.
- [16] Bond, E., and Samuelson, L. (1986) Tax holidays as signals. *American Economic Review* 76: 820-826.
- [17] Borensztein, E., et al. (1995) How does Foreign Direct Investment affect economic growth? NBER Working paper No. 5057, Cambridge, Massachusetts: National Bureau of Economic Research.
- [18] Brada, J., et al. (2009) The Costs of Moving Money across Borders and the Volume of Capital Flight: The Case of Russia and Other CIS Countries, Emerging Markets Group Cass Business School City University, London.
- [19] Brouthers, K., and Bamossy, G. (1997) The Role of Key Stakeholders in International Joint Venture Negotiations: Cases Studies from Business Studies, 2, 285-297.
- [20] Caldeira M.M. and Ward J.M. (2003), 'Using resource-based theory to interpret the successful adoption and use of information systems and technology in manufacturing small and medium-sized enterprises'. *European Journal of Information Systems*, 12(2): 127-141
- [21] Calvet, A. (1981) Synthesis of Foreign Direct Investment theories and theories of Multinational firms. *Journal of International Business Studies*, Spring 1981; ABI/INFORM Global, pg. 43.
- [22] Campos, N., and Kinoshita, Y. (2002) Foreign Direct Investment as Technology Transferred: Some panel Evidence from the Transition Economies, *Centre for Economic Policy Research. Discussion Paper No 3417*.
- [23] Cantwell, J. (1991) A survey of theories of international production. In C. Pitelis and R. Sugden, *The Nature of the transnational firm* (pp. 16-63). London: Routledge.
- [24] Carstensen, K., and Toubal, F. (2003) Foreign Direct Investment in Central and Eastern European countries: A Dynamic Panel Analysis, Kiel Working Paper No. 1143, Kiel Institute for the World Economy.
- [25] Cass, F. (2007) Attracting FDI to transition countries: the use of incentives and promotion agencies. *Transnational Corporations*, Vol. 16, No. 2, August 2007.
- [26] Casson, M. (1982) *Transaction Costs and the Theory of the MNE* in A. M. Rugman (ed.) *New Theories of the Multinational Enterprise*, New York, St. Martin's Press.
- [27] Castells, M. (2000) Information Technology and Global Capitalism. In A. Giddens & W. Hutton (Eds.), *Global Capitalism* (pp. 52-74). New York: The New Press.
- [28] Caves, R. (1996) *Multinational Enterprise and Economic Analysis*, Cambridge: Cambridge University Press.
- [29] Caves, R. (1971) International Corporations: The industrial economics of foreign investment, *Economica* 38: 1-27.
- [30] Coase, R. (1937) The Nature of the Firm, *Economica* 4 (16): 386-405.
- [31] Cukrowski, J., and Aksen, E. (2002) Demand Uncertainty, Perfect Competition and Foreign Direct Investment. *Center for Social and Economic Research (CASE)*. Mimeo.
- [32] Cukrowski, J., and G. Kavelashvili (2001) Determinants of Foreign Direct Investment in Georgia. *CEU-CASE Working Papers* No. 39, Warsaw, pp.39.
- [33] Cukrowski, J., and Mogilevsky, R. (2001) The role of macroeconomic stabilization in attracting foreign investment in the Kyrgyz Republic. *Studies and Analyses* No. 222, *Center for Social and Economic Research (CASE)*, pp. 30 (in Russian).
- [34] Damijan, J., Kostevc, C. (2008) Trade liberalization and economic geography in transition countries: Can FDI explain the adjustment patterns of regional wages? LICOS, Discussion Paper Series Discussion Paper 222/2008.



- [35] Davidow, W. (1986) *Marketing High Technology: An Insider's View*. The Free Press. New York, NY.
- [36] D'Cruz, B. (2007) *Offshore IT Outsourcing and Transition Economies: A Critical Comparison of Poland, Hungary and Ukraine*, available at: <http://www.mngt.waikato.ac.nz/ejrot/cmsconference/2007/proceedings/theopenstream/dcruz.pdf>
- [37] Deichmann, J. I., Eshghi, A., Houghton, D. M., Sayek, S., Teebagy, N., Topi, H. (2003). Geography Matters: Kohonen Classification of Determinants of Foreign Direct Investment in Transition Economies. *Journal of Business Strategies*, 20(1): 23-44
- [38] Deichmann, J. I. (2004) The Origins of Foreign Direct Investment in Poland, 1989-2001. *Journal of Business and Economic Studies*, 10(1): 12-28.
- [39] Deichmann, J. I. (2010). Origin-Effects and Foreign Direct Investment in the Czech Republic: The Role of Government Promotion Abroad. *Comparative Economic Studies (Palgrave)*, 53(2): 273-285
- [40] Drahokoupil, J. (2008) The Investment-Promotion Machines: The Politics of Foreign Direct Investment Promotion in Central and Eastern Europe, *Europe-Asia Studies*, 60 (2), March, pp. 197 – 225.
- [41] Dunning, J. (1981) *International Production and the Multinational Enterprise*, London: George Allen and Unwin.
- [42] Dunning, J. (1988) The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions, *Journal of International Business Studies*. Vol 19, No 1, pp. 1 – 31.
- [43] Dunning, J. (2000) A Rose by any other name...? FDI theory in retrospect and prospect, University of Reading and Rutgers University.
- [44] Ebers, M., and Jarillo, J.(1998) The construction, forms, and consequences of industry networks. *International Studies of Management and Organization*, 27:4, pp.3-21.
- [45] Faeth, I. (2009) Determinants of foreign direct investment – a tale of nine theoretical models. *Journal of Economic surveys*, vol. 23, No. 1, pp. 165-196.
- [46] Filippov, S. (2008) Emerging Russian Multinationals: Challenges and Opportunities. Conference “Emerging Multinationals”: Outward Foreign Direct Investment from Emerging and Developing Economies, 9-10 October 2008, Copenhagen Business School, Denmark.
- [47] Goldberg, M. (1972) The Determinants of US Direct Foreign Investment in the EEC: Comment, *American Economic Review* 62, 692-699.
- [48] Goldberg, L., and Klein, M. (1999) *International Trade and Factor Mobility: An Empirical Investigation*. National Bureau of Economic Research, No. w7196.
- [49] Gowa, J., and Mansfield E. (2004) Alliances, Imperfect Markets, and Major Power Trade. *International Organization*, 58: 775-805.
- [50] Grant, R. (1991) Porter's Competitive Advantage of Nations: An Assessment, *Strategic Management Journal*, 12:535-48.
- [51] Grigoryev, L., and Kosarev, A. (2000) Capital Flight: Scale and Nature, paper presented at the conference on Investment Climate and Russia's Economic Strategy; Moscow, April 2000.
- [52] Grossman, S., and Hart, O. (1986) The Costs and Benefits of Ownership: a Theory of Vertical Integration, *Journal of Political Economy*, 94, pp. 691-719.
- [53] Grout, P. (1984) Investment and Wages in the Absence of Legally Binding Contracts: A Nash Bargaining Approach. *Econometrica*, 52: 449-60.
- [54] Haaland, J., and Wooton, I. (1999) International competition for multinational investment. *Scandinavian Journal of Economics* 101: 631-649.
- [55] Hart, O., and Moore, J. (1990) Property Right and the Nature of the Firm, *Journal of Political Economy*, 98, pp. 1119-1156.
- [56] Haufler, A., and Wooton, I. (1999) Country size and tax competition for foreign direct investment. *Journal of Public Economics* 71: 121-139.

- [57] Hejazi, W. (2010) Dispelling Canadian Myths about Foreign Direct Investment. *IRPP Study*, No. 1.
- [58] Helleiner, G. (1989) Transnational corporations and direct foreign investment. Chapter 27 in H. Chenery and T.N. Srinivasan (eds.) *Handbook of Development Economics* (vol. II). Elsevier Science Publishers BV: Amsterdam.
- [59] Helpman, E. (1984) Multinational Corporations and Trade Structure, *The Review of Economic Studies*, 52: 442 – 458.
- [60] Helpman, E. (1984) A simple theory of trade with multinational corporations. *J. Polit. Economy* 92, 451–471.
- [61] Hunya, G. (2000) *Integration through Foreign Direct Investment*, Cheltenham: Edward Elgar.
- [62] Hymer, S. (1960, published 1976), *The International Operations of National Firms: a Study of Direct Foreign Investment*, Cambridge, MA: MIT Press.
- [63] Jarillo, J. (1988) On Strategic Networks. *Strategic Management Journal (1986-1998)*, 9(1), 31.
- [64] Johnson, A. (2005) Host country effects of foreign direct investment: The case of developing and transition economies. *Jönköping International Business School*, Dissertation Series No. 031.
- [65] Johnson, A. (2006) FDI Inflows to the Transition Economies in Eastern Europe: Magnitude and Determinants. The Royal Institute of Technology. CESIS (Centre for Excellence for Studies in Science in Innovation). Paper No.59.
- [66] Khanna, T., and Yafeh, Y. (2007) Business groups in emerging markets: paragons or parasites?, *Journal of Economic Literature*, vol. 45, Pittsburgh, American Economic Association Publications, July.
- [67] Kinoshita, Y., and Campos, N. (2004) Estimating the Determinants of Foreign Direct Investment Inflows: How Important are Sampling and Omitted Variable Biases? *BOFIT Discussion Papers 10/2004*, Bank of Finland, Institute for Economies in Transition.
- [68] Kojima, K. (1978) *Direct foreign investment*. Croom Holm, London.
- [69] Kojima, K. (1975) *Direct foreign investment: a Japanese model of multinational business operations*. Croom Holm Ltd., 2/10 St John's Road, London SW11.
- [70] Kojima, K. (1975) International Trade and Foreign Direct Investment: Substitutes or Complements, *Hitotsubashi Journal of Economics* 16: 1-12.
- [71] Kopits, G. (1979) Multinational conglomerate diversification. *Economia Internazionale* 32 : 99-111.
- [72] Krugman, P. (1991) *Geography and Trade*. Cambridge, Mass.: MIT Press.
- [73] Krugman, P. (1995) *Development, Geography, and Economic Theory*, MIT Press.
- [74] Krugman, P. (1999) Was it all in Ohlin?, in <http://web.mit.edu/krugman/www/ohlin.html>
- [75] Krugman, P., and Venables, A. (1994) *The Location of Economic Activity: New Theories and New Evidence*. London: Centre for Economic Policy Research.
- [76] Kudina, A., and Jakubiak, M. (2008) The Motives and Impediments to FDI in the CIS, OECD, Global Forum on International Investment, April, 2008.
- [77] Laar, Van de, M., and De Neubourg, Ch. (2002) Emotions and foreign direct investment: A theoretical and empirical exploration, *Management International Review*, Volume 46, Number 2, 207-233.
- [78] Lankes, H., and Venables A. (1996) Foreign Direct Investment in Economic Transition: The Changing Pattern of Investments. *The Economics of Transition*, 4(2), pp. 331-47.
- [79] Lansbury *et al.* (1996) Foreign Direct Investment in Central Europe since 1990: an Econometric Study, *National Institute Economic Review*, 106, May, pp.104-14.
- [80] Ledyeva, S., and Linden, M. (2006) Testing for Foreign Direct Investment Gravity Model for Russian Regions, Department of Business and Economics, University of Joensuu.
- [81] Ledyeva, S., and Mishura, A. (2006) Determinants of Investment Distribution Across Russian Regions: A Bayesian Averaging of Classical Estimates (BACE) Method Application.

- [82] Liang, G.(2004) New Competition: Foreign Direct Investment and Industrial Development in China, *ERIM Ph.D. Series*, 47 (Rotterdam: RSM, Erasmus University).
- [83] Lizondo, J. (1991) Foreign Direct Investment , in Determinants and Systematic Consequences of International Capital Flows. *IMF Occasional Paper No.77*, Washington, D.C.: IMF.
- [84] Loungani, P., and Mauro, P.(2000) Capital flight from Russia. *IMF policy discussion paper, Research department*.
- [85] Lyrouti, K. Papanastasiou, J., and Vamvakidis, A. (2004) Foreign Direct Investment and Economic Growth In Transition Economies South Eastern Europe *Journal of Economics* 1 (2004) 97-110.
- [86] Mallampally, P., and Sauvart, K. (1999) Foreign Direct Investment in Developing Countries. *Finance and Development*, Vol. 36, No 1.
- [87] Mallya *et al.* (2004) Are incentives a good investment for the host country? An empirical evaluation of the Czech National Incentive Scheme. *Transnational Corporations* 13(1): 110-148.
- [88] Markusen, J. (1984) Multinationals, Multi-Plant Economies, and the Gains from Trade, *Journal of International Economics*, 16(3-4): pp. 205-26.
- [89] Markusen, J. (1997) Trade Versus Investment Liberalization, NBER Working Paper No. 6231.
- [90] Markusen, J. (2002) Multinational Firms and the Theory of International Trade. MIT Press, Cambridge.
- [91] Markusen, J., and Venables, A. (1998) Multinational Firms and the New Trade Theory, *Journal of International Economics* 46, 2:183-203.
- [92] Markusen, J., Venables, A., Eby-Konan, D., and Zhang, K. (1996) A Unified Treatment of Horizontal Direct Investment, Vertical Direct Investment, and the Pattern of Trade in goods and Services, NBER Working Paper No. 5696.
- [93] Mateev, M. (2008), Determinants of Foreign Direct Investment in Central and Southeastern Europe:
- [94] New Empirical Tests, available at: <http://ebookbrowse.com/miroslav-mateev-doc-d18709618>
- [95] Merlevede, B. and Shoors, K. (2005), "How to Catch Foreign Fish? FDI and Privatization in EU Accession Countries", William Davidson Institute Working Paper no. 785
- [96] Meyer, K. (1998) Direct Investment in Economies in Transition, New Horizons in International Business, Edward Elgar Publishing Limited.
- [97] Miller, J., and Pras, B. (1980) The effects of multinational and export diversification on the profit stability of US corporations. *Southern Economic Journal* 46: 792-805.
- [98] Mogilevsky R., and R. Khasanov (2001) GDN Explaining Growth. *Global Research Project: Kyrgyz Republic*. Mimeo.
- [99] Moilanen, S. (2007) Knowledge Translation in Management Accounting and Control: A Case Study of a Multinational Firm in Transitional Economies, *European Accounting Review*, 16, 4, 2007, pp. 757–789.
- [100] Morris, A. (2010) The role of Offshore Financial Centers in Regulatory Competition, Washington, D.C.: AEI Press, c 2010, vi, 199 p.
- [101] Mundell, R. (1968) *International Economics*, London, Macmillan, 332 p.
- [102] Park, B. and Lee, K. (2001) Comparative Analysis of Foreign Direct Investment in China : The Korean, the Hong Kong, and the United States Firms in the Shandong Province, Working Paper Series no40, Institute of Economic Research, Seoul National University.
- [103] Pelto, E., Vahtra, P., and Liuhto, K. (2003) Cyprus investment flows to Central and Eastern Europe - Russia's Direct and Indirect Investments via Cyprus to CEE. Electronic Publications of Pan-European Institute, No 2.
- [104] Pesalj, B. (2011) Competitive advantages of multinational companies – a review of theoretical approaches *bibliid 0025-8555*, 63(2011), vol. Lxiii, br. 2, str. 237–259, Izvorni naučni rad.

- [105] Resmini, L. (2000) The determinants of Foreign direct investment in the CEECs. New evidence from sectoral patterns. *Economics of Transition*, 8 (3), pp. 665-689.
- [106] Rose, A., and Spiegel, M. (2005, published in 2007) Offshore Financial Centres: Parasites or Symbionts?, *Economic Journal*, Royal Economic Society, vol. 117(523), pages 1310-1335, October.
- [107] Rugman, A. (1975) Motives for foreign investment: The market imperfections and risk diversification hypotheses. *Journal of World Trade Law*, 9(5): 567-573.
- [108] Rugman, A. (1976) Risk reduction by international diversification. *Journal of International Business Studies*, 7(2): 75-80.
- [109] Rybczynski, T. (1955) Factor Endowment and Relative Commodity Prices, *Economica* 22: 336-341.
- [110] Scaperlanda, A., and Mauer, L. (1969) The determinants of US direct investment in the 35 EEC, *The American Economic Review*, vol. 59, no. 4, September, pp. 558–568.
- [111] Singh, H., and Jun, K. (1995) Some new evidence on determinants of foreign direct investment in Developing countries, *World Bank Policy Research Working Paper*, No 1531.
- [112] Smarzynska, B., and Wei, Sh.-J. (2001) Pollution Havens and Foreign Direct Investment: Dirty Secret or Popular Myth?, NBER Working Papers 8465, National Bureau of Economic Research, Inc.
- [113] Sova, R., Albu, L., Stancu, I., Sova, A. (2009) Patterns of Foreign Direct Investment on the new EU Countries. *Romanian Journal of Economic Forecasting*, No 2.
- [114] Straker, H. (2006) Understanding the Global Firm, Research, Nov.12, <<http://hel.org.uk/business/essay.doc>>
- [115] Subramaniam, M. and Watson, S. (2006) How interdependence affects subsidiary performance, *Journal of Business Research*, 59, pp. 916–924.
- [116] Vernon, R. (1966) International investment and international trade in the product cycle. *Quarterly Journal of Economics* 80, pp. 190-207.
- [117] Wang, Z., and Swain N (1995) The Determinants of Foreign Direct Investment in Transforming Economies: Empirical Evidence from Hungary and China. *Weltwirtschaftliches Archiv*, 131(2), pp. 359-82.
- [118] Wei, Sh.-J. (2000b) Local Corruption and Global Capital Flows *Brookings Papers on Economic Activity*, 0(2): 303-46.
- [119] Wernerfelt, B. (1984) A resource-based view of the firm. *Strategic Management Journal*. 5 (April-June):171-180..
- [120] Williamson, O. (1985) *The Economic Institutions of Capitalism: Firms, Markets and Relational Contracting*, The Free Press, New York.
- [121] Williamson, O. (1975) *Markets and Hierarchies: Analysis and Antitrust Implications*. New York: Free Press; London: Collier Macmillan.
- [122] Yeaple, S. (2003b) The complex integration strategies of multinationals and cross country dependencies in the structure of foreign direct investment," *Journal of International Economics*, Elsevier, vol. 60(2), pages 293-314, August.
- [123] Zerbergs H. (1998) Can the Neoclassical Model Explain the Distribution of Foreign Direct Investment Across Developing Countries? IMF Working paper.

### Official Papers

- [1] IMF (2000) Offshore Financial Centers. IMF Background Paper. Prepared by the Monetary and Exchange Affairs Department.
- [2] UNCTAD (2011) *World Investment Report 2011: Non-Equity Modes of International Production and Development*. New York and Geneva: United Nations.
- [3] UNCTAD (2006) *World Investment Report 2006: FDI from Developing and Transition Economies – Implications for Development*. New York and Geneva: United Nations.