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Foreign Direct Investment and economic transition: Panacea or pain killer?

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Abstract

This article sets out to make an assessment of the relationship between Foreign Direct Investment (FDI) and economic growth in transition countries through a review of the empirical record to date. The first part reviews the phases of transition in combination with policy efforts to attract FDI. In the second part, different growth studies across levels of analysis are juxtaposed to better understand the overall growth impact of FDI in transition countries. Since foreign firms have a large direct effect on performance at the level of the firm, the article also discusses the role of FDI in the economic growth of transition countries. The article concludes that the concept of 'trickle down' growth is not supported by the evidence. The effects of FDI on local economic growth are complex and need to be analysed in the context of the overall economic environment. The article also discusses the role of FDI in the economic growth of transition countries. The article concludes that the concept of 'trickle down' growth is not supported by the evidence. The effects of FDI on local economic growth are complex and need to be analysed in the context of the overall economic environment.

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holidays, subsidies and acquisition discounts, it is not certain that positive direct effects equate with economic growth in these countries.

Notes

- ¹The experiences of the CIS countries are considered to be in a category of their own. This will become more clear in the section below, ‘Explaining FDI inflows’.
- ²See for example Campos and Kinoshita ([2003](#)), Altomonte and Guagliano ([2003](#)), Carstensen and Toubal ([2004](#)), Disdier and Mayer ([2004](#)), Frenkel et al. ([2004](#)), Walkenhorst ([2004](#)) and Janicki and Wunnava ([2004](#)).
- ³However, the ‘servisation’ of the world economy breaks with the old stages approach to economic development (Chenery & Taylor [1968](#), pp. 391 – 416). For example, developing countries relying more heavily on ‘servisation’ in relation to tourism rather than traditional industrialisation are also bound to attract relatively more FDI in service industries.
- ⁴Poland, Hungary and Czechoslovakia signed the Europe Agreement in 1991, followed by Bulgaria and Romania in 1993, and the Baltic countries and Slovenia in 1994.
- ⁵Owing to the depressed value of firm-specific assets in this process, foreign investors may obtain a cheap ticket to the local market, immediate production volume, participation in well-established networks (including supplier and distribution networks), and avoid cumbersome license application processes. In some cases there are also real strategic asset seeking aspects associated with such privatisation acquisitions by foreign investors, such as local brands, technology and human assets (Meyer & Estrin [2001](#)).
- ⁶Even though the EBRD has been established by the World Bank, it is not a part of the World Bank Group. It is a separate institution with its own capital and governance structure. It is a multilateral development bank with a mandate to promote economic development and private sector growth in Europe and Central Asia. It is not a part of the World Bank Group.
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⁸However, reinvested earnings are not taxed in Estonia. Estonia also has a major advantage over the other Baltic States in terms of her cultural affinities with Finland.

⁹Some companies in labour-intensive industries will disinvest and move their production to third countries and some efficiency seeking FDI may favour EU or third countries over the transition countries, which may also mean de-facto disinvestment.

¹⁰For Estonia see Varblane and Ziacik ([1999](#)), Hannula and Tamm ([2003](#)), Jones and Mygind ([2002](#)) and Sinani and Meyer ([2004](#)). For the Czech Republic see Zemplerova & Benacek ([1997](#)) and Djankov and Hoekman ([2000](#)). For Hungary see Bosco ([2001](#)) and Sgard ([2001](#)). For Poland see Zukowska-Gagelmann ([2000](#)) and Jensen ([2004](#)). For Romania see Hunya ([2002b](#)). For Slovenia see Rojec ([1998](#)). In addition there also exist a number of edited books on this topic that are not mentioned in the survey here for sake of brevity.

¹¹For a central theoretical exposure in relation to FDI see Narula and Dunning ([2000](#)).

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