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WORKING PAPER

How to Catch Foreign Fish?

FDI and Privatisation in EU Accession Countries

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HOW TO CATCH FOREIGN FISH? FDI AND PRIVATISATION IN EU ACCESSION COUNTRIES

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Abstract

In a partial adjustment framework the observed FDI stock is the result of two driving forces. First, the stock converges towards its equilibrium level, even without policy changes. Second, the equilibrium level itself is driven by changes in its determinants. By means of a dynamic panel data analysis we examine the determinants of investment by 'old' EU-members in ten countries of Central and Eastern Europe. We find a rapid adjustment towards equilibrium. Traditional variables, such as market potential, trade integration, and relative unit labour costs, are fairly stable as determinants of equilibrium FDI stocks in transition economies. Institutional development in all its forms is a robust determinant of the optimal level of FDI. The relationship between FDI and the privatization process is complex. Non-direct privatization schemes negatively affect the speed of adjustment towards the equilibrium, whereas current direct privatization strategies positively affect the equilibrium level of FDI. Privatization history increases equilibrium FDI, independently of the method applied.

JEL Classification: F20, F23, P33

Keywords: foreign direct investment, privatisation, partial adjustment

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