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RECENT TRENDS IN FOREIGN DIRECT INVESTMENT FLOWS TO EUROPEAN CMEA COUNTRIES

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PREFACE

The Regional and Country Studies Branch undertakes economic research in response to frequent requests for analyses and information of immediate relevance to economic and industrial policy-making. Through its research programme, the Branch regularly assists policy-makers in developing countries to monitor pertinent developments at the national and regional level, in particular as concerns industrial strategies and policies, emerging technological trends, actual and prospective changes in trade and investment patterns, as well as relevant corporate strategies.

An area of particular interest has recently been foreign direct investment (FDI) flows in terms of changes in their geographical distribution, branch composition and major determinants. In general, more developing countries have come to appreciate the developmental role of FDI and, through favourable promotional policies, have encouraged foreign investors to set up production facilities on their territories. Most recently, also many CMEA countries have begun to actively seek increased inflows of FDI with a view to strengthen their industrial base. This report deals with the magnitude and structure of recent FDI flows to the European CMEA countries and tentatively discusses their potential impact on developing countries.

The report was prepared by staff of the Regional and Country Studies Branch based on inputs provided by Mr. Geoffrey Hamilton and Ms. Rosemarie Vala as UNIDO consultants.

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I. INTRODUCTION

The recent drastic changes sweeping the countries of Eastern Europe are among the most significant economic and political forces of the post-war period. There is no doubting that the global economic landscape is indeed being redrawn, with repercussions on financial, trade and investment flows and hence on all actors in the global competitive system.

Most European CMEA countries are at present in a phase of transition and restructuring within the overall context of a major shift in industrial strategy and policies. The economic reform programmes are aimed at increasing the reliance on market forces; promoting private industry; enhancing the flexibility of the economic system; and adjusting the economic structure to better utilize the countries' comparative advantages. Foreign direct investment (FDI) is assigned a major role in most of the economic reform programmes in terms of bringing in modern technology and raising competitiveness and export earnings. To this end, many Euroepan CMEA countries have taken legal steps to create a climate more conducive to attracting foreign investment.

This increased emphasis promoting the inflow of foreign capital occurs at a time when the determinants of foreign investment and the structure of international investment flows are subject to significant changes. In particular the following features seem to emerge:

- FDI is gradually moving away from the export-oriented production of simple consumer goods and expanding into technologically more sophisticated production lines such as industrial electronics, machine tools and automobiles. Investment costs thus tend to be higher

- Investors generally tend to favour locations allowing them to serve regional and international export markets and, at the same time, to have access to an attractive domestic market in the home country.

- An increasing share of total FDI is directed to the services sector with key areas being banking, insurance and other financial services; wholesale and retail trade; and hotels and other tourism-related facilities.

- Labour cost differentials are gradually losing their key significance as crucial FDI determinants as the share of labour costs in total costs is declining in most industries (largely due to microelectronics- related automation). More generally, lower production costs are being eclipsed by other qualitative investment determinants, such as in particular the technological and human resource infrastructure of a country.

- Medium-sized and even some small-sized companies are becoming more active as investors in foreign countries. In many cases, such companies have built up a competitive position in certain product groups in the domestic market but are subsequently forced 'to go international'.

- As more countries are actively trying to attract FDI through far-reaching investment incentives the international market for investment locations has become extremely competitive. This increases the bargaining power of potential investors.

- The tendency of international trade towards greater regionalization and intra-OECD country trade seems to further accentuate the dominance of industrially advanced countries as both sources and recipients of FDI.

Notwithstanding the high degree of competition in the international market for investment locations, the CMEA countries can be expected to establish themselves as attractive sites on the global FDI map. It is no surprise, therefore, that governments in traditional FDI host countries - developed and developing countries alike - are concerned that present and future FDI flows may be diverted from their territories into the European CMEA countries.

Yet it is far too early to fully appreciate the far-reaching implications of the changing global FDI context, particularly with regard to the issue of 'investment creation' versus 'investment diversion'. The objective of this brief report, therefore, is rather modest. It attempts to review the most recent overall trends in FDI flows to CMEA countries and to shed some light on emerging patterns in terms of countries of origin and the distribution of inflowing FDI by industrial branches. Finally, selected potential implications for developing countries are outlined.

II. NEW FDI-RELATED LEGISLATION IN EUROPEAN CMEA COUNTRIES

Although the interest in and possibilities of transnational corporations (TNCs) engaging in business in the CMEA countries has only rather recently become tangible, it should be borne in mind that FDI inflows into these countries have predated the political and economic reforms in 1989 and indeed the reform movement in the Soviet Union since 1985. Laws allowing foreign investment in these countries have a rather long history dating back e.g. to 1972 in Hungary and Romania, 1976 in Poland and 1980 in Bulgaria. However, these laws generally allowed foreign enterprises market access only through joint ventures with a state trading organization or a domestic enterprise, in most cases restricted the foreign firms to minority ownership and set limits on profit remittances. Typically, and as a result of such restrictions, foreign enterprises used joint ventures as trading operations rather than for full-scale manufacturing activities. With limited investment opportunities, the number of joint ventures and the amounts of capital invested by foreign firms remained insignificant.

To create more attractive conditions for foreign direct investment in their economies, the USSR, Bulgaria, Czechoslovakia, Hungary and Poland have made significant amendments to their joint venture laws and regulations in late 1988 and 1989. There are a number of common elements in the new legislations. These aim largely at separating public administration from the actual management in running these economies. Screening procedures for joint ventures have been simplified and the scope and eligibility for such partnerships expanded. The autonomy of enterprises in appointing top

management and setting wages and prices has been further increased. Principles controlling the repatriation of profits, foreign majority share-holdings, the nationality of directors, and taxation have been substantially modified and a number of important legal guarantees against expropriation and divestment have been provided to foreign firms. In one or two cases, the right of domestic enterprises to participate directly in foreign trade operations has been extended. These new regulations in the various countries are outlined below.[1]

(i) The USSR: Entitled "On Further Development of Foreign Economic Activities of State, Co-operative and other Social Enterprises, Amalgamations and Organizations", the new Soviet decree dated 2 December 1988 significantly broadens the scope for foreign and local participation in joint ventures. Among other things, the decree enables foreign majority holding and foreign chairmanship or directorship of enterprises. Now both state enterprises and co-operatives may become joint venture partners. Joint venture enterprises have been given complete discretion in hiring and firing employees and in fixing salaries. The decree grants special incentives to joint ventures establishing operations in the Soviet Far East, including a three year tax holiday and substantial concessions to firms manufacturing consumer goods, medical equipment and high-tech products.

(ii) HUNGARY: Act No. VI on "Economic Associations" and Act No. XXIV on "Investment of Foreigners in Hungary" in effect dismantle the centralized organization of Hungarian enterprises and permit the creation of economic organizations previously unheard of in socialist countries. The Act on "Economic Associations" allows individual citizens to form business ventures with local or foreign companies. Further, it facilitates such collaborations by allowing those forms of partnership best suited for small and private entrepreneurs, namely, unlimited and limited liability companies. Citizens may invest their assets in business ventures. Act No. XXIV allows foreigners to hold up to 100 per cent interest in a Hungarian company and provides important safeguards for their investments. A third and most important piece of legislation, which entered into force on 1 July 1989, enables the transformation of state-owned enterprises into "self-governing" shareholding companies.

(iii) POLAND: The law entitled "Economic Activity with Participation of Foreign Partners", enacted 1 January 1989, creates a unified legal framework for foreign investments in Poland. Earlier, Poland had a double system of foreign investment: small private investments by foreigners of Polish descent, "Polonia" firms, were administered differently than larger investments in joint ventures with state enterprises. The law creates a unique, high-level Foreign Investment Agency, responsible for approving and promoting foreign investment agreements.

1/ This section gives a brief synoptic account only of the most significant changes in investment laws and codes. The more interested reader is referred to the rapidly growing body of literature on this subject.

(iv) BULGARIA: Decree No. 56 on "Economic Activities" went into effect on 11 January 1989. It provides the legal basis for foreign economic participation through wholly-owned subsidiaries or through representative offices and joint ventures, and strengthens the position of foreign firms. Foreign banks may be similarly established, but a minimal capitalization is imposed. Foreign firms may now issue shares locally.

(v) CZECHOSLOVAKIA: The law on "Enterprises with Foreign Capital Participation", enacted 1 January 1989, establishes a comprehensive legal framework for foreign investment in Czechoslovakia, replacing the non-statutory operating principles used previously. Czechoslovakian firms, co-operatives, and banks may become partners. Joint ventures may retain all foreign earnings, keep a foreign currency account in a local or foreign bank, and set their own prices according to market conditions.

III. FDI FLOWS TO EUROPEAN CMEA COUNTRIES: RECENT EVIDENCE

1. Overall trends

There has been a very strong growth in the number of joint ventures registered in the European countries of CMEA and Yugoslavia. According to the data base of the Economic Commission for Europe, there were, in total, 165 joint ventures at the beginning of 1988. By the end of June 1989, that figure had climbed to 1,375. By mid-October, more than another 700 joint ventures were added to this total and by the year's end, the overall total had climbed even further to 3,345. The three CMEA countries which have most liberalized their joint venture legislation accounted for the bulk of this FDI surge: the USSR, Hungary and Poland.

In the Soviet Union, since the registration of joint ventures began on 1 January 1987, the number has increased dramatically and, as table 1 shows, the major increase has occurred in 1989. This acceleration can be attributed, at least in part, to the new regulations adopted in December 1988, authorizing co-operatives to participate in joint ventures.

In cumulative terms, in the period from 1987 until the third quarter of 1989, the total capitalization of joint ventures in the USSR reached 2454.4 million SUR (Soviet Union Roubles). As compared with the end of 1988, when total capital was 811.6 million SUR, the total capital thus increased threefold. The cumulative foreign capital invested up to the beginning of October amounted to US $1620.8 million. After the relaxation of foreign participation rules in December 1988, from which date foreign partners have been allowed to hold majority shares in joint enterprises, 65 companies were registered in which foreign partners hold more than 50 per cent of the statutory capital. In 19 joint ventures, foreign participation is more than 60 per cent and in 6, it is more than 70 per cent. No enterprises have been registered in which the foreign share in capitalization exceeds 90 per cent.[1/]

In Poland, since regulations changed in December 1988, thereby liberalizing, to some extent, foreign investments in the country, the number

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1/ ECE data base on joint ventures.

Table 1. Number and statutory capital of joint ventures in the USSR
(May 1987 - September 1989)

Month/year	Statutory capital: Total (mio SUR)	Foreign (mio SUR)	Foreign (mio US$)	Number
May 1987	0.8	0.4	0.6	1
June 1987	5.4	2.5	3.9	4
July 1987	57.1	19.5	30.5	2
August 1987	0.0	0.0	0.0	0
September 1987	2.0	0.8	1.3	1
October 1987	37.3	11.6	18.4	3
November 1987	11.4	5.6	9.2	3
December 1987	45.4	15.1	25.5	9
January 1988	40.0	14.9	25.1	6
February 1988	0.0	0.0	0.0	0
March 1988	28.0	10.4	17.5	7
April 1988	13.2	6.2	10.4	5
May 1988	58.0	23.0	38.7	10
June 1988	54.1	18.3	30.4	12
July 1988	74.1	30.9	49.8	9
August 1988	33.2	14.3	22.8	16
September 1988	44.6	16.2	25.8	17
October 1988	13.7	5.7	9.1	8
November 1988	183.9	71.8	118.9	30
December 1988	109.6	41.0	68.2	48
January 1989	140.2	55.7	92.1	53
February 1989	99.7	33.3	53.9	46
March 1989	143.7	69.0	111.2	87
April 1989	125.3	57.7	92.1	53
May 1989	260.8	120.1	184.8	101
June 1989	429.7	202.8	312.0	160
July 1989	113.9	31.0	48.8	66
August 1989	219.3	96.2	151.5	126
September 1989	110.2	45.2	69.9	58
1987	159.3	55.5	89.3	23
1988	652.3	252.7	416.6	168
1989	1642.7	711.1	1115.0	738
TOTAL	2454.4	1019.3	1620.8	929

Source: ECE data base on joint ventures.

of joint ventures has increased. By 30 September 1989, a total of 490 new joint ventures had been approved, with total equity paid up by foreign partners amounting to US $70.3 million.[1] By October 1989, over 600 new joint ventures had been approved, as shown in table 2.

Table 2. Number of joint ventures in Poland
(December 1988 - October 1989)

Period	Number
Dec. 31 1988 - July 1 1989	52[a]
Jan. 1 1989 - Feb. 28 1989	9[b]
March 1989	21
April 1989	41
May 1989	60
June 1989	72
July 1989	105
August 1989	92
September 1989	90
October 1989	115
Total	657

Source: Foreign Investment Agency in Poland.

a/ Under 1986 joint venture law.
b/ Under 1988 investment law.

Note: The total paid-up equity of 605 new joint ventures approved until end-October 1989 is estimated at approximately US $120 million, plus investment loans amounting to about US $350 million.

The number of joint ventures in operation in Hungary by the end of March 1989 was 178 (see table 3). However, this considerably underestimates the total number of FDI projects in Hungary. It is estimated that by the end of October 1989, the total number of FDI projects in that country (including both joint ventures and wholly foreign-owned companies) was about 600[2].

As regards the 178 operating joint ventures, in the period from 1985 to the end of the first quarter of 1989, the total amount of capital invested grew from 3.6 to 27.8 billion HUF - that is, almost eight-fold. During the same period, the cumulative sum of foreign capital invested grew from US $44.1 million to US $263.3 million - that is, sixfold - at current official exchange rates.

In other European CMEA countries, recent growth in joint ventures has been less impressive. The number of registrations in Czechoslovakia grew from 7 to 50; Bulgaria registered an increase from 15 to 35. No new joint ventures were registered in Romania.

1/ Financial Times, Survey on East-West Trade, 8 December 1989.

2/ ECE data base on joint ventures.

2. Countries of origin

Taking European CMEA countries as a whole, the main investors in these countries come from EEC countries, followed by investors from the EFTA countries. Rather far back are foreign investors originating from other centrally planned economies or from the United States and Japan. Developing countries, as a group, only have a marginal interest in foreign investments in CMEA countries as yet, but for certain individual developing countries, such FDI is gaining in significance.

Table 3. Number and capital of operating joint ventures in Hungary (1974 - 1989)

Year	Total capital (mio HUF)	Foreign capital (mio HUF)	Foreign capital (mio US$)	Number of JVs
1974	92.2	45.0	4.9	2
1975	118.2	57.8	6.4	3
1976	118.2	57.8	6.4	3
1977	118.2	57.8	6.4	3
1978	118.2	57.8	6.4	3
1979	829.8	527.2	19.6	4
1980	969.2	595.8	21.7	6
1981	1094.8	654.8	23.4	7
1982	1540.5	859.8	29.0	12
1983	2108.0	1088.1	34.3	20
1984	2350.3	1143.7	35.5	27
1985	3568.3	1565.7	44.1	45
1986	5207.0	2501.7	64.5	62
1987	8799.1	3973.3	95.8	102
1988	27167.6	12239.5	259.8	176
1989 a/	27764.8	12424.1	263.2	178

Source: ECE data base on joint ventures.

a/ On 1 April 1989.

In the USSR, as seen from Table 4, 599 joint ventures (or 64.5 per cent of the total) have foreign partners who originate in Western Europe. Of these, 35.2 per cent have parent companies in the member countries of the EEC and 26.6 per cent in EFTA (the rest of Western Europe accounts for 2.5 per cent). Companies from the United States and Japan established 9.3 per cent and 1.9 per cent, respectively, of the joint ventures, while the share of developing countries is 5.3 per cent.

The Federal Republic of Germany is the main foreign investor, accounting for 139 or 15 per cent of all joint ventures, followed by Finland with 101 or 11 per cent.

Table 4. Joint ventures in the USSR, by origin of foreign partner
(as of 1 October 1989)

Region/country	Statutory capital			Number
	Total (mio SUR)	Foreign (mio SUR)	(mio US$)	
Western Europe, of which:	1588.3	639.4	1017.2	599
EEC	992.6	390.7	620.4	327
Belgium	2.1	1.2	1.9	7
Denmark	2.5	0.9	1.6	2
France	190.1	80.4	127.9	32
Germany, F.R. of	358.0	144.0	227.1	139
Greece	5.8	2.8	4.4	[illegible]
Ireland	16.8	8.1	13.3	3
Italy	227.7	77.2	124.9	53
Luxembourg	1.3	0.5	0.8	6
Netherlands	40.0	15.1	23.4	15
Spain	46.9	19.3	31.1	12
United Kingdom	101.4	41.2	64.0	53
EFTA	491.7	202.5	321.4	247
Austria	142.9	45.5	72.2	53
Finland	183.9	81.4	127.7	101
Norway	3.5	0.9	1.5	4
Sweden	78.4	37.5	59.6	32
Switzerland	67.0	29.4	47.9	45
Lichtenstein	15.9	7.8	12.4	12
Other Europe	104.0	46.2	75.5	25
Cyprus	7.2	2.6	4.1	9
Malta	1.5	0.6	1.0	1
Yugoslavia	95.3	43.0	70.4	15
Japan	44.4	21.2	33.9	18
United States	250.2	121.7	190.6	86
Developing countries	56.2	23.1	36.6	49
Afganistan	2.2	1.1	1.7	1
Brazil	9.2	2.3	3.8	2
Hong Kong	0.6	0.3	0.5	1
India	13.7	5.4	8.6	14
Jordan	0.3	0.2	0.2	2
Korea, Republic of	0.5	0.3	0.4	1
Kuwait	3.1	1.5	2.5	3
Lebanon	2.4	1.2	1.9	2
Pakistan	5.5	3.3	5.1	1
Panama	2.3	1.1	1.8	3
Saudi Arabia	0.2	0.1	0.1	1
Singapore	3.1	1.1	1.8	5
Syrian Arab Republic	6.7	2.6	4.2	3
Thailand	0.6	0.0	0.0	1
United Arab Emirates	3.0	1.5	2.3	2
Venezuela	2.7	1.1	1.8	7

Region/country	Statutory capital: Total (mio SUR)	Foreign (mio SUR)	Foreign (mio US$)	Number
Planned Economies	253.6	113.1	181.6	88
CMEA	199.1	87.9	141.6	68
Bulgaria	100.9	43.8	71.6	26
Czechoslovakia	4.0	1.8	2.9	3
German Democratic Republic	5.0	2.5	4.0	1
Hungary	50.0	21.9	34.9	12
Poland	36.1	16.5	26.0	23
Viet Nam	3.0	1.4	2.2	3
Other, of which:	54.5	25.3	40.0	20
China	25.5	11.1	17.4	13
Korea, Democratic P.R. of	29.0	14.2	22.6	7
Other countries	262.8	101.1	161.2	89
Australia	19.1	9.5	15.1	9
Canada	56.2	24.6	39.8	20
New Zealand	1.5	0.6	0.9	2
Multi-party a/	186.0	66.4	105.4	58
TOTAL	2454.4	1019.3	1620.8	929

Source: ECE data base on joint ventures.

a/ Joint ventures with foreign partners from two or more countries.

Table 5, which shows foreign investment in Poland by origin of the foreign partner, demonstrates even more clearly than the case of the Soviet Union that the preponderance of foreign investors - no less than 150 joint ventures (or more than 82 per cent) - originates in Western Europe.

The Federal Republic of Germany accounts alone for 43.4 per cent of the total number of joint ventures - that is, 79. The dominance of this country's investments in Poland is revealed by the fact that the next biggest investor in the country - Austria - has only 16 joint ventures. Few developing countries have joint ventures in Poland, while Japan has none.

In Hungary, in almost half (46.6 per cent) of the operating joint ventures, the foreign partner is from a West European country which is not a member of the European Economic Community (EEC). In the total population of 178 joint ventures, the foreign partner is from Austria in 49 cases, from Switzerland in 18, and from Sweden in 10. In one third (34.8 per cent) of the cases, the foreign party originates from the EEC. In this group, the Federal

Republic of Germany holds first place with 37 joint ventures, followed by the Netherlands with eight, and the United Kingdom with 5 joint ventures[1].

Table 5. Joint ventures in Poland, by origin of foreign partner
(as of 1 June 1989)

Region/country	Statutory capital			Number
	Total (mio PLZ)	Foreign (mio PLZ)	Foreign (mio US$)	
Western Europe, of which:	25189.6	10711.4	21.0	150
EEC	19015.8	8307.5	16.2	112
Belgium	450.6	217.1	0.4	5
Denmark	81.0	39.7	0.1	2
France	20.0	10.3	0.0	1
Germany, F.R. of	8101.4	4211.0	7.7	79
Italy	3743.4	900.7	1.2	6
Netherlands	584.6	415.5	0.7	7
Spain	170.4	78.0	0.1	2
United Kingdom	5864.5	2435.3	6.0	10
EFTA	6173.7	2403.9	4.8	38
Austria	3427.3	1106.7	2.0	16
Finland	388.5	61.8	0.1	1
Lichtenstein	536.0	263.5	0.7	3
Norway	49.9	39.9	0.1	1
Sweden	867.4	457.7	0.9	10
Switzerland	904.7	474.2	1.0	7
United States	4289.1	2279.8	4.1	13
Developing countries	162.8	114.1	0.2	4
Lebanon	62.0	62.0	0.1	1
Thailand	42.0	25.2	0.0	1
Tunisia	55.0	25.0	0.0	1
United Arab Emirates	3.8	1.9	0.0	1
Planned Economies	689.0	310.8	0.7	5
Hungary	119.0	47.6	0.1	1
USSR	570.0	263.2	0.6	4
Other	2295.6	871.6	2.0	10
Canada	420.2	195.6	0.3	4
Multi-party a/	1218.2	505.1	1.3	5
Unknown	657.2	170.9	0.4	1
TOTAL	32626.0	14287.4	28.0	182

Source: ECE data base on joint ventures.

a/ Joint ventures with foreign partners from two or more countries.

1/ ECE data base on joint ventures.

If foreign participation is measured by the amount of capital invested by foreign parties, the picture changes significantly from the foregoing. By this yardstick, the Republic of Korea is first, with 95 million USD invested, which amounts to 36.4 per cent of the total foreign investment. That country is followed by the Federal Republic of Germany (28.6 million USD) and Austria (28.5 million USD). Companies from these three countries and from Switzerland and the Netherlands account for US $177.1 million - that is, 67.3 per cent - of the total foreign investment of US $263.3 million. The statutory capital of the joint ventures in which these companies participate is 18.0 billion HUF - that is, 64.9 per cent of the total statutory capital of the joint ventures reviewed[1].

In Czechoslovakia, as in the case of Hungary, it is Austria which is home to most joint ventures in terms of numbers. It has 10 (26 per cent) of joint ventures and is followed by France (5 joint ventures), the USSR and the Federal Republic of Germany (4 each), and the Netherlands (3) (see table 6).

Table 6. Joint ventures in Czechoslovakia, by origin of foreign partner
(as of 1 October 1989)

Region/country	Statutory capital			Number
	Total (mio CSK)	Foreign (mio CSK)	Foreign (mio US$)	
Western Europe, of which:	770.1	286.4	42.0	28
EEC	599.0	206.7	30.2	17
Belgium	4.5	1.5	0.1	1
Denmark	165.3	81.0	14.9	2
France	134.5	65.1	7.3	5
Germany, F.R. of	31.2	14.7	1.7	4
Netherlands	241.0	33.4	5.5	3
United Kingdom	22.5	11.0	0.7	2
EFTA	171.1	79.7	11.8	11
Austria	162.2	75.2	11.5	10
Sweden	8.9	4.5	0.3	1
Planned economies	245.2	122.6	18.4	7
CMEA	190.4	95.2	13.4	6
Bulgaria	10.0	5.0	0.3	1
Hungary	65.0	32.5	5.2	1
USSR	115.4	57.7	7.9	4
Other	54.8	27.4	5.0	1
China	54.8	27.4	5.0	1
Multi-party a/	98.3	42.6	2.8	3
TOTAL	1113.5	451.6	63.2	38

Source: ECE data base on joint ventures.

a/ Joint ventures with foreign partners from two or more countries.

1/ ECE data base on joint ventures.

3. Distribution of joint ventures by sector and industry

The ECE data base provides a rather detailed industrial and sectoral breakdown for FDI in the USSR, Poland and Hungary. Given the smallness of the sample (38), such data is less useful for Czechoslovakia.

In all three countries, most joint ventures, in terms of number, are concentrated in the manufacturing sector - 48.8 per cent, 65 per cent and 60.7 per cent for the Soviet Union, Poland and Hungary, respectively. These investments account for 73 per cent of the foreign capital in Poland, 60 per cent in the Soviet Union, and 35 per cent in Hungary. The rest of joint venture activity is practically all accounted for by the service sector, as FDI in primary products for these countries is negligible.

Within the Soviet Union's manufacturing sector, in terms of the number of joint ventures, production of office equipment and computers represents the largest branch (15.5 per cent of total joint ventures), followed by non-electrical machinery and instrument engineering. The manufacture of chemicals, rubber and plastics accounts for 8.6 per cent of the total number of joint ventures in manufacturing, while food production accounts for 9 per cent of manufacturing joint ventures.

As can be seen from Table 7, in Poland, too, joint ventures are particularly prominent in the food industry (the largest account for 19 per cent of the total in manufacturing), metals, wood processing and chemicals, although, unlike in the Soviet Union, wearing apparel is important in terms of number (12.6 per cent of all joint ventures).

In Hungary, within manufacturing, food production, communications equipment, non-metallic mineral products, office and computer equipment, and chemicals, respectively, hold the largest shares (see Table 8).

Within all three countries, trade, hotels and restaurants, and business services represent considerable poles of attraction for joint ventures in the service sector.

In the USSR, almost 15 per cent of the joint ventures (138) belong to the group "other business activities", which includes services relating to engineering management, marketing, advertizing, law, architecture and other business services. 7 per cent belong to the hotel and restaurant business, while 6 per cent are accounted for by computer-related activities.

In Poland, where joint ventures in services are less developed, about 8 per cent of foreign investments engage in trade, and 7 per cent in hotels and restaurants. In Hungary, in contrast, two branches of services alone - financial services, on the one hand, and hotels and restaurants, on the other - attract 30 per cent and 18.3 per cent of total foreign capital, respectively.

Table 7. Manufacturing joint ventures in Poland, by branches of industry
(as of 1 June 1989)

ISIC CODE Rev.3	INDUSTRY	STATUTORY CAPITAL			Number
		Total (Mio PLZ)	Foreign (Mio PLZ)	Foreign (Mio US$)	
15	Food	2693.9	1345.9	2.7	23
16	Tobacco	61.1	30.5	0.0	1
17	Textiles	324.0	142.6	0.2	2
18	Wearing apparel	860.7	562.0	0.9	15
20	Wood and wood products	2285.4	1980.8	3.3	11
21	Paper and paper products	160.0	80.0	0.1	2
22	Publishing and printing	232.5	126.0	0.3	2
24	Chemicals, of which:	1130.3	340.0	0.7	7
241	Basic chemicals	68.0	33.3	0.1	1
242	Other chemicals, of which:	1062.3	306.6	0.6	6
2424	Cosmetics	42.0	25.2	0.0	1
	Other	1020.3	281.4	0.6	5
25	Rubber and plastics	92.7	66.0	0.1	3
26	Non-metallic products	770.8	356.1	0.7	10
28	Metal products	4465.1	1217.4	2.5	12
29	Machinery and equipment N.E.C., of which:	3375.2	1341.0	2.3	11
291	General purpose machinery	1855.2	697.0	1.3	3
292	Special purpose machinery, of which:	1520.0	644.1	1.1	8
2921	Agriculture and forestry machinery	686.9	236.7	0.5	3
2925	Food processing machines	100.0	44.0	0.1	1
2926	Textile machinery	48.0	25.0	0.0	1
	Other	685.0	338.5	0.5	3
30	Office equipment and computers	222.0	115.1	0.3	2
32	Communication equipment, of which:	293.6	89.7	0.2	3
3220	TV, radio transmitters	96.4	36.6	0.1	1
	Other	197.2	53.1	0.1	2
33	Precision instruments	206.1	118.0	0.2	2
34	Motor vehicles	200.0	80.0	0.2	1
35	Other transport equipment	3503.7	772.7	1.1	3
36	Furniture and manufacturing N.E.C.	2026.1	734.9	2.6	3
37	Recycling	2252.5	949.3	2.3	6
	TOTAL	25155.7	10358.0	20.6	119

Source: ECE data base on joint ventures.

Table 8. Manufacturing joint ventures in Hungary, by branches of industry (as of 1 April 1989)

Industry	Total Capital (mio HUF)	Foreign Capital (mio HUF)	Foreign Capital (mio US$)	Number of JVS
Food	1464.5	535.8	11.5	10
Textiles	932.0	464.1	9.2	4
Wearing apparel	552.6	217.1	4.5	7
Leather	51.6	19.7	0.3	2
Wood and wood products	800.1	383.1	7.8	7
Paper and paper products	119.5	60.8	1.2	3
Publishing and printing	153.8	84.2	1.6	6
Chemicals	946.2	362.4	8.0	12
Rubber and plastics	82.7	36.0	0.8	3
Non-metallic products	1088.3	498.1	10.2	7
Basic metals	21.4	10.7	0.2	2
Metal products	348.6	165.6	3.3	8
Machinery and equipment N.E.C.	524.2	244.5	5.4	13
Office equipment and computers	1006.5	325.7	6.5	3
Electrical equipment	128.9	52.9	1.1	4
Communication equipment	1294.4	439.1	8.7	5
Precision instruments	500.7	250.1	5.3	3
Motor vehicles	44.0	25.5	0.5	1
Other transport equipment	158.4	80.8	1.6	1
Furniture	181.4	81.0	1.6	4
Recycling	219.2	96.1	1.9	3
TOTAL MANUFACTURING	10619.1	4433.2	92.2	108

Source: ECE data base on joint ventures.

IV. POTENTIAL IMPACT ON DEVELOPING COUNTRIES

Two principal questions can be raised concerning the impact on developing countries of the emergence of joint venture activity in East European countries: (i) is the amount of FDI moving into these new markets at all of a significant scale and (ii) is such FDI actually or potentially substituting FDI to developing countries?

As regards the first question, it was shown in this report that actual amounts of FDI into European CMEA countries up until the end of 1989 have grown rapidly yet remained relatively small. It can be estimated that the total foreign component in the statutory capital of the 2,090 foreign investments in Czechoslovakia, Hungary, Poland and the Soviet Union was (at

current exchange rates) about US $2.2 billion on 15 October 1989[1]. Comparing this to the total stock of inward FDI to for instance Mexico in 1988, it can be seen that $2.2 billion represents under 10 per cent of the US $21.9 billion registered by this single Latin American country[2].

Nevertheless, in some specific industrial sub-sectors FDI to European CMEA countries may become more significant in the future. The spate of deals which have taken place in the automobile industry (see Table 9) is a case in point.

Table 9. Joint ventures announced by TNCs in the automobile industry

Foreign Corporation	Country and joint venture partner	Nature of deal and date
Renault (France)	Czechoslovakia (Bratislava Automobile Zavodi)	Local assembly of light commercial vehicles; January 1990
General Motors (US)	Hungary	$100 million joint venture to build engines and assemble cars; January 1990
Volkswagen (FRG)	German Democratic Republic	Production of small cars or light commercial vehicles; December 1989
Suzuki (Japan)	Hungary	Small cars; December 1989
Daihatsu (Japan)	Poland	Small cars; December 1989

Source: ECE/UNCTC data.

It is perhaps too early to speculate about the future course of FDI flows to these countries. However, even at this stage, a number of salient factors are worth bearing in mind. Despite liberalization in the investment codes of these countries - most notably, Hungary, Poland and the Soviet Union - such measures alone probably still have not created the conducive environment for

1/ ECE data base on Joint Ventures.

2/ Director General of Foreign Investments, Mexico, 1989.

FDI that would be required to attract more substantial inflows. To some extent, this is due to the still untried nature of the legislation. Despite the existence of new investment opportunities, foreign companies have tended to prefer the traditional joint venture form of arrangement until the other options become more tried and tested. After all the reforms in these countries, joint venture legislation still does not allow for the free and easy repatriation of profits. Alternatives to profit repatriation, like the taking over of raw materials as a substitute for hard currency, are commonly practised in the case of joint ventures between Finnish and Soviet Union firms. However, it is difficult to imagine how arrangements such as these could succeed in encouraging the scale of FDI inflow that these countries seem to wish and require. Thus, until more attractive investment regimes emerge in these countries, FDI flows will probably remain rather small. It can further be assumed that the overall institutional and infrastructural weaknesses will constitute bottlenecks once the first wave of FDI has taken place.

Concerning the question of whether FDI flows to European CMEA countries are substituting investments that normally would have gone to developing countries, the upsurge in investment into the European CMEA countries is still too recent as yet to have had a major impact. At the same time, if it could be established that certain investors who had favoured developing countries were now investing in these new markets, then clearly the potential impact could well be negative for the developing countries concerned. To answer this question would require knowledge about the country of origin of the investor, the industry in which FDI took place, and in particular the main motive for FDI.

As was shown above, the main investors in European CMEA countries come from Western Europe and, particularly because of historical, linguistic and geographic ties, the Federal Republic of Germany and Austria. Neither of these two countries are substantial investors in developing countries. While there has been a decline in the Federal Republic of Germany's share of total OECD FDI flows to developing countries, this decline began in the 1970s, i.e. before the new political and economic developments in European CMEA countries. Thus, it would be erroneous to argue that any decline in FDI to developing countries from the Federal Republic of Germany has been caused by increased activity in Eastern Europe. Moreover, the United States and Japan, the number one and number two principal foreign direct investors in developing countries, have not as yet figured largely in the establishment of joint ventures in European CMEA countries.

For these reasons, there is, thus far, little evidence that countries with traditionally strong FDI ties to developing countries are now investing in European CMEA countries.

The evidence on whether FDI in European CMEA countries is occurring in the same manufacturing industries as FDI in developing countries is rather inconclusive. FDI in developing countries, is spread rather widely, although in many developing countries, the chemicals and electrical/electronic equipment industries are especially favoured. In European CMEA countries, FDI in the chemicals industry, especially in Hungary and the USSR, was significant. In contrast, in no European CMEA country did the electrical/electronic equipment industry so far receive a large share of manufacturing FDI inflow.

In the European CMEA region, in fact, machinery and equipment N.E.C. played a very substantial role in the manufacturing FDI inflow to those countries, ranking as the number one sector for FDI manufacturing inflow in Hungary and Czechoslovakia, number two in the USSR and number four in Poland, as a percentage of the number of joint ventures in manufacturing. Food and food products was another important area for FDI inflow into manufacturing in the European CMEA countries, ranking number one in Poland and number three in both Hungary and the USSR.

There is a general tendency, however, for FDI to be concentrated in the low technology, more mature industries in European CMEA countries where demand and expansion possibilities in TNCs' home countries are rather limited. Developing countries, and especially those with generally large markets, have attracted FDI of this sort. More specifically, firms in such mature industries as power generating and food processing, which need to increase market share, have moved, in recent times, into developing countries. In the same fashion, it is logical to predict that such TNCs will, all things being equal, also develop their businesses in European CMEA countries.

As regards the overall purpose of FDI in European CMEA countries, if new ventures were established as a relatively cheap labour production site for export back to developed market countries, then clearly, FDI in certain developing countries could be affected. But so far, the motive of most firms has predominantly been to increase market share within the European CMEA countries. A sizeable proportion of FDI is directed towards the production of consumer goods and services for the domestic market. However, there are exceptions: the Republic of Korea's investment in Hungary is clearly aimed at using a cheap manufacturing base there to export to West European markets, which not only restrict access from Korean locations, but also have strong local content requirements for Korean FDI within their countries. As such, the preferential access which Hungarian-based manufacturers possess to the EC is attractive to a foreign investor with the type of market access problems faced by firms from the Republic of Korea.

To sum up, it appears that at present FDI flows into European CMEA countries have hardly taken place at the expense of developing countries. Firstly, to the extent that FDI is determined by attractive domestic markets, (as is the case for the industrially more advanced and/or larger developing countries) also in the future substitution effects will probably remain insignificant. Secondly, so far there is no evidence that European CMEA countries are utilized by transnational corporations as major export platforms. Thirdly, where FDI is actually undertaken to gain access to the EC market (as in the case of some joint ventures in Hungary), geographic proximity is the key locational advantage. As witnessed by the Korean investment in Hungary referred to above, this type of investment opportunity can even work to the benefit of industrially more advanced developing countries.

These countries may further be able to seize some of the substantial new investment opportunities in connection with the urgent need of East European countries to modernize their infrastructural facilities and rehabilitate, upgrade and expand industrial production.

In the medium to long run - as was the case following the post-war economic reconstruction of Western European countries - the building up of new industrial capacities in the European CMEA countries and their integration into the global division of labour may be expected to lead to a major stimulation of production and trade worldwide. The resulting gains from increased levels of exchange and specialization between East European and other countries will partly accrue also to developing countries.