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THE CENTRAL AND EASTERN EUROPEAN COUNTRIES' PROGRESS IN THEIR TRANSITION TO MARKET ECONOMY

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Abstract— The purpose of this study is to underline Central and Eastern European countries' progress in their transition to market economies. It focuses on the relationship between transition economies and privatization and their link with foreign direct investment inflows. The analysis covers two of the most successful transition economies in Central and Eastern Europe in terms of attracting foreign direct investment: Poland and the Czech Republic. Our topics of interest are the volume of inward foreign direct investment and the main characteristics of foreign direct investment in Central and Eastern European countries. The paper provides an overview of specific factors related to foreign direct investment determinants in regards to the relationship between foreign direct investment and multinational companies, yielding explanations about the reasons which cause the differences among the foreign direct investment inflows in Central and Eastern European countries. The results suggests that the volatility of the foreign direct investment inflows in Central and Eastern European countries is mainly related to the volatility of the privatization program. Other important factors affected the volume of foreign direct investment in Central and Eastern Europe region are location, market potential and the political and legal factors

This article contributes to the debate by providing an analysis of the differences in the process of accumulating foreign direct investment inflows.

Key words: privatization, foreign direct investment (FDI), economic transformation, Central and Eastern Europe (CEE).

I. INTRODUCTION

Foreign Direct Investment has become an increasingly important factor in the global economy. Compared to other types of foreign investment, foreign direct investment has many advantages both from the macroscopic point of view and the microscopic point of view. From a macro perspective, the host government introduces foreign direct investment through large-scale privatization can resolve the fiscal account deficits in the transition process and effectively balances the deficit of current account to resolve international payments imbalances. From the micro perspective, foreign direct investment can generate the spillover of technology, management and knowledge on the domestic economy, thereby promoting their technological progress, efficiency and sustained economic development.

Multinational companies (MNCs) are the developed world's most important source of corporate research and development (R&D) activity. The effects of FDI inflows depend of MNCs strategies. Many MNCs, because of their large size and financial strength, have access to financial resources not available to host-country firms. Their assets of foreign direct investment cannot be deprived, which can also compensate the economic and political risk in transition countries. Therefore, regardless of the recipients' role as either a transition country or multinational companies engage in FDI, foreign direct investment is a popular form of capital flow, whereby the scale of its investment occupies the highest proportion in the international balance of payments capital and financial accounts.

Based on the above analysis, our paper provides an overview of specific factors related to foreign direct investment determinants and the relationship between foreign direct investment and multinational companies, yielding explanations about the reasons which cause the difference among the foreign direct investment inflows in Central and Eastern European countries. The analysis covers two of the most successful transition economies in Central and Eastern Europe in terms of attracting foreign direct investment: Poland and the Czech Republic. The results suggests that the volatility of the foreign direct investment inflows in Central and Eastern European countries is mainly related to the volatility of the privatization program. Other important factors affected the volume of foreign direct investment in Central and Eastern Europe region are location, market potential and social relations.

The rest of the paper is organized as follows: the next section outlines the theoretical studies on economic aspects of transition and the influence factors of FDI on Central and Eastern European countries. Section 3 presents a study of the volume of inward foreign direct investment and the main characteristics of FDI in Central and Eastern European countries, such as the course of development, national source of investment, entry mode and investment behavior. Section 4 is an analysis on the main factors influence on foreign direct investment in Central and Eastern European countries. In this section, firstly, the author discusses the important factors affecting foreign direct investment in Central and Eastern European countries; secondly, he studies the relationship between FDI and multinational corporations (MNCs), finally, some concluding remarks are offered in the final section.

The paper provides some shortcomings mainly reflected in the following aspects: we need to further research as horizontal and vertical comparison between CEE countries; we should further categorize foreign direct investment and research the investment situation and influencing factors of each category. In terms of metrology and inspection, due to insufficient of data and sample size, the method and results of measurement should be further improved. At the same time, we need to apply econometric test and conduct an inspection by industry, based on the bilateral data of home and host country.

II. LITERATURE REVIEW

1. The Importance of Transition for Economics: "Washington Consensus" and "Post-Washington Consensus" approach to economic transition

Economic transformation refers to the transition from a centrally planned economic system, which is traditional and highly centralized, to the modern market economic system

(typically involving a democratic legal society). Socialist countries began an economic transformation wave in the late 1990s, which has sparked lively discussion on the transformation problem in the international academic community. Various theories of economic transition continue to emerge, allowing for a wide variety of theoretical explanations and policy suggestions about economic fluctuation, inflation, unemployment, corruption and other problems arising from the process of transition. We start with a comparison of the "Washington Consensus" and "Post-Washington Consensus" by emphasizing the importance of the system, analyzing the relationship between market and economic stability in transformation process.

Institutional economists believe that the key to economic development is developed through the systems and a series of policy practiced in the host country. The term "Washington Consensus" was coined in 1989 by English economist John Williamson to refer to a set of 10 relatively specific economic policy prescriptions that he considered constituted the "standard" reform package promoted for crisis-wracked developing countries by Washington, D.C.– based institutions such as the International Monetary Fund (IMF), World Bank, and the US Treasury Department. This view of institutional economics forms the theoretical basis of the "Washington Consensus" and is a guiding theory of economics in transition countries. Williamson (2000) pointed out that the "Washington Consensus" can be summarized in three aspects: (1) Market, namely the price is fully liberalized and determined by the market with a unified exchange rate; (2) Privatization, which namely to implement a large-scale privatization comprehensively and rapidly to protect private property rights, relax controls of market access, and eliminate barriers of impeding foreign direct investment; (3) Stabling the macro economy, to expand the tax base, strengthen the fiscal discipline of the government, eliminate the fiscal deficit, increase the public investment of government in high return areas, realize trade liberalization, maintain macroeconomic stability. As the new classical economics relied on, the fatal flaw of "Washington Consensus" is to ignore the importance of the system construction and regard the system arrangement matching the market economy as the established premise, disregarding the fact that the establishment of the market economy needs a lot of necessary system arrangement to support it. Without the inside support of these system conditions, these countries tend to fall into a system of vacuum and market disorder state, which is called "institutional no-man's disruption" by Hungarian economist Janos Ke Ernai. The "Washington Consensus" held that good economic performance required liberalized trade, macroeconomic stability and competitively viable prices. Once the government resolved these issues by removing itself from the equation private markets would produce efficient allocations and growth (Stiglitz, 1998). The "Post-Washington Consensus" was formed based on the perspective of institutional economics and with radical reform experience in Central and Eastern Europe. The main content of the "Post-Washington Consensus" is as that the privatization can simultaneously improve economic efficiency and reduce fiscal deficits. The idea is that if one could create property rights, then the profit-maximizing behavior of the owners will eliminate waste and inefficiency. The focus of the "Post-Washington Consensus" is on freeing up markets, in the case of financial market liberalization, may actually have had a perverse effect, contributing to macro-instability through weakening of the financial sector. More broadly, the focus on trade liberalization, deregulation, and privatization ignored other important ingredients required to make an effective market economy, most notably competition: competition, in the end, may be as or more important than these other ingredients in determining long-term economic success. This method must be combined with regulatory competition policy and the actual situation of the transition process. Second, it is impossible to get the benefits of financial liberalization if there is no preexisting competitive market. Third, the government should be the complement of the market and take action to make markets work well, and correct market failure. Fourth, the government is necessary to apply more policy tools to implement "a wider range of targets", with the so-called "broader goal" of "developing and transforming society as its core purpose", including higher living standards, and a realization of sustainable development, balanced development, democratic development, as well as the sharing of results of the development of all social groups (Stiglitz 1998).

2. Theoretical study on the influence factors of FDI on Central and Eastern European countries

Lansbury eta1. (1996), Holland and Pain (1998), Brenton et al. (1998), Garibaldi eta1(1999), Resmini (2000) researched the determinants of foreign direct investment in transition countries. The researchers investigated the relationship between foreign direct investment and the situation of the investment environment, trade integration, labor cost, and privatization restructuring. They found a weak correlation between political stability and foreign direct investment. Meyer (1995), Lankes and Venables (1996) continued a further study. Meyer believed that the size of the market played a significant role, while the labor cost little, which further confirmed the former analysis. At the same time he believed that political and economic stability, as well as the expected risk factors all act to influence FDI in Central and Eastern European countries. Grabby and Hughes (1998) Mayhew, (1998) researched foreign direct investment from the perspective of joining the EU. The study from Bevan and Estrin (2000) found that foreign direct investment in transition countries are subject to the impact of risks, labor costs, the size of the host country, and the factors associated with the Gravity model of trade in international economics (distance, GDP and population). They thought that the country risk would decrease with the engagement of transition countries to EU and this would lead to FDI increase. The FDI success of the Czech Republic, Hungary, and Poland is attributed to their political stability, as well as the privatization process and the speeding up pace of joining the EU. Deichmann etal (2003) specifically studied the main factors which Eurasian transition economies attracted FDI, which in turn are: human and social capital, reform and stability, resource scarcity and congenital conditions and financial market conditions. Contrary to popular opinion, they thought the rising labor costs would not decrease FDI, because the rising labor costs and increasing income levels represent an increase of human and social capital, which are crucial for attracting FDI. Kai Catsiellscn and FCud Toubal (2003) studied the influence factors of FDI on Central and Eastern European countries through the dynamic Panel data method. They thought that the size of the market had a significant effect on FDI, while at the same time the comparative advantages of low cost and resource advantage were important variables. The researchers also found the complementary relationship between

FDI and trade. Meanwhile the author thought that restructuring factors such as privatization level and the proportion of private sector were significant variables affecting the FDI in Central and Eastern European countries. Related to this, economic and political instability also influenced the FDI. The authors considered the main success factors absorbing FDI to be the size of the market and economic and political stability for Central European countries, although their labor costs hindered FDI to some extent. While the low labor costs in Southeast European countries played a prominent role in attracting FDI, their slow transformation process and economic and political instability hindered the development of foreign direct investment simultaneously.

III. Foreign Direct Investment in Central and Eastern European Countries

1. Foreign Direct Investment in Poland

Poland remains one of the most favorable countries in Central and Eastern Europe for FDI. The country started its political and economic transformation in late 1989. The privatization of state-owned enterprises in the country was conducted along two basic paths: indirect and direct privatization. In the 2002 privatizations lines, indirect privatization was predicted for 90 companies while 200 state enterprises were to undergo direct privatization. It was assumed that it would be possible to obtain the gross amount of PLN 6.8 billion in privatization revenues. However, at the end of 2002, the Ministry of the Treasury received only the gross amount of PLN 2.8 billion. The non-implementation of the planned revenues was due to a number of reasons. The primary reason why all of the privatization revenues could not be achieved was the fact that the privatization of state enterprises in 2002 was conducted under complex of macroeconomic circumstances, resulting mainly from a decline in economic growth, decreased value of Polish currency, reduced investment demand, and a policy of high interest rates increasing financial costs. Capital accumulation processes initiated by Polish entrepreneurs aimed at investment and development has also brought unsatisfactory results in view of the privatization needs of the Polish. In 2003, the worsening situation in the energy sector lead to delays in the process of implementing the six biggest projects. Delays were caused by the factors of so-called transactional or economic risk. In 2006 and 2007 a number limited-medium scale privatizations involved especially the manufacturing sector. After the slowdown in 2008, the privatization revenues increased to PLN 22.037 billion in 2010, as compared to PLN 2.4 billion in 2008. Revenues of PLN 11.53 billion were obtained from the sale of companies as part of public offerings on the stock market, whereas revenues from dividends paid to companies owned by the State Treasury amounted to PLN 7.84 billion. Over the last few years Poland has accelerated privatization process. In 2010 The Ministry of Treasury received revenues of PLN 22.037 billion. It is the highest result in the history of Polish privatization. Eurozone turmoil affected Poland's privatization plans in 2011 when revenues declined and totaled an amount of PLN 13 billion. From August 1, 1990 until the end of December 2012, 5 995 state-owned enterprises were subject to ownership transformation. As a result of state assets privatization, as well as establishment and development of private companies, the ownership structure of the economy has shifted in favour of the private sector

Since the collapse of communism in 1989, Poland has dramatically transformed its economy and has enjoyed success in terms of economic growth, financial stability and investment attractiveness. The inward FDI entering into the Polish economy has fulfilled a very important role in the process of privatization and restructuring. The FDI inflows to Poland increased from USD 3 659 million in 1995 to USD 9 445 million in 2000. The country was considered an attractive destination for FDI mostly because of its low-cost and qualified labor, market potential and access to natural resources. Between 2001 – 2002 the FDI inflow in Poland first halted, then sharply declined. In 2005 the FDI inflow in Poland continued to maintain its status as one of the most attractive countries for investment in Europe. Large numbers of international multinational companies, such as LG Philips, Michelin, and Sharp have signed big investment project contracts. In the same year the Polish Statistical Office (GUS), recorded the activities of 16 816 companies in Poland with foreign capital. In terms of the business sector, the most numerous activities of companies were in trade and repairs (29.1%) and industrial processing (30.1%). In third place were firms offering real estate and business services (19.6%), (PAIiIZ). According National Bank of Poland in 2006, the capital "in transit" amounted to EUR 3 114 million (20.7% of the inflow). The greatest amount of direct investment inflow in 2006 was invested in real estate and other business activities (EUR 4 900 million). The FDI inflows have been shifting as well from the manufacturing sector towards the services sector. It shall be noted that the reinvested profits were the major component of FDI, making up almost 40 percent of all FDI inflows, recording 50 percent growth over 2006. In 2007 Polish Statistical Office (GUS) recorded in Poland 18 515 companies with foreign capital. Among 1 758 new entities with foreign capital, the vast majority (1 537 companies) were Greenfields. This trend is highly positive, indicating growing Poland's attractiveness for foreign investors. Equity capital spending remained stable, whereas other capital inflows showed a 12 percent decrease. Among the new EU member states, Poland recorded the highest level of FDI inflow, and was followed by Romania, the Czech Republic and Bulgaria (PAIiIZ). In 2008 the global crisis led to major decreases in Polish FDI flows, more than 42 percent decrease, as compared to 2007. During the turmoil, FDI flow to Poland stabilized at USD 12 932 million in 2009. In 2011, after three years of decrease in Polish FDI inflow and despite the economic crisis, the trend finally changed. The FDI inflow in 2011 equaled USD 18 911 million, compared to USD 12 932 million in 2009. In 2012 the value of FDI inflow to Poland declined to USD 3 356 million. (UNCTAD). This result was heavily influenced by the scale of so-called capital "in transit," which grew globally and was an effect of global economic slowdown.

Through the analysis of FDI inflow, we can conclude that the proportion of total capital inflows in Poland over the observed period 1990 – 2012 is in stable growth. Privatization, which began in 1990, has transformed the Polish economy by increasing its competitiveness and stimulating economic growth. Polish political and economic stability, improved business effectiveness, innovation, corporate governance and developed capital markets have attracted a large number of investors. As a result of state assets privatization, as well as establishment and development of private companies, the ownership structure of the economy has shifted in favour of the private sector. Due to complex macroeconomic circumstances, 2002 resulted in dissatisfaction in view of privatization needs of the Polish economy, but with the EU accession in 2004, the strengthening domestic capital markets, and competitiveness of

the economy, the privatization process was accelerated. Acceleration of privatization helped to reduce the negative effects of the global financial crisis in 2008. Since 2008, privatization has generated revenues of USD 16 billion, of which USD 2.9 billion was raised in 2012. Despite over 20 years of privatization in Poland, there continues to be still further opportunities for privatization. Despite the decreased value of Polish FDI inflow in 2012, Poland ranked first in terms of attractiveness in the region of Central and Eastern Europe, according to 37 percent of the more than 800 international decision-makers who comprised the poll. The Czech Republic finished second with 15 percent support. The most widespread forms chosen by investors were mergers and acquisitions and Greenfield investments. Foreign investors' choice of Greenfield investment is mainly due to policy reversals and the complexity of the Polish government during the process of privatization. We can see that with the privatization of a large number of state-owned enterprises, the proportion of Greenfield investments increase. According to the statistics of UNCTAD, the Greenfield investments accounted to USD 17 554 million in pre-crisis period 2005-2007, as compared to USD 12 490 million in 2011 and 11 533 million in 2012. The country was placed second in terms of new Greenfield projects in the entire European Union. In the long-term the most severe source of FDI in the country are reinvestments.

2. Foreign Direct Investment in the Czech Republic

Compared to Poland, the growth of Czech Republic's FDI inflows is more variable. Until 2003 it appeared a larger decline, but in the following years it rebounded quickly.

The Czech Republic is one of the most successful transition economies in CEE countries in terms of attracting FDI. From its transformation in 1989, the first democratic election activated a privatization program in the country. The main goals of privatization in Czech Republic were to raise revenue for the state from the transfer of ownership, to improve the economic efficiency of privatized enterprises, to reduce the government's involvement in the economy, to broaden the enterprise ownership structure, to create competitive environment and to subordinate state owned enterprises to free market discipline. The privatization methods supplied by the former Czechoslovak government were: restitution, small-scale and large – scale privatization. The county was different from other neighboring countries in that it was more focused on the privatization rather than investment incentives to attract FDI. However, the economy of Czech Republic has experienced rising wage costs and inflation, bringing the budget deficit to a standstill. Therefore, in order to boost capital inflows, the government of Czech Republic absorbed the early privatization experience and set up stimuli to attract foreign investors in 1998. The introduction of investment incentives in 1998 has stimulated a massive inflow of FDI into both Greenfield and brownfield projects. By the end of 2002, the FDI inflow in the country reached an amount of USD 8 482 million. Due to severe flooding in 2002, the FDI inflows declined to USD 2 103 million in 2003, but with a fast recovery to the level of USD 11 653 million in 2005. The FDI inflows reached in 2005 were mainly due to the privatization of a number of projects, such as the sale of Czech Telecom. The attracted amount generated from Greenfield investment during the pre-crisis period 2005-2007 reached USD 6 576 million. Over the same period the amount attracted from cross-border merger and acquisition accounted to USD 2 486 million. (UNCTAD). Most foreign enterprises operated in good condition in the Czech Republic, and based on business confidence and the optimistic expectations of business prospects, they continued to reinvest profits. At the same time, foreign investment also increased the technical content, production and export competitiveness of many departments in manufacturing industry, and provided an opportunity for local manufacturers to participate in subcontracting, reduced imports and increased employment. The Czech Republic experienced rapid growth of FDI mainly because of its location between the developed countries in Western Europe and the developing countries in Eastern European countries, as well as benefitting from its privatization process, cheap labor costs and excellent basic environments for investment. After the Czech Republic joined the EU in May 2004, the macro economy further improved, economic growth accelerated significantly, domestic industrial and commercial prospered, the vitality of enterprises enhanced, foreign trade grew, and foreign direct investment increased. In 2008, the country saw significant increased FDI in the automotive sector, real estate and alternative energy. Despite the economic crisis on the continent in 2008, in 2009 the Czech Republic experienced a much smaller decline than the CEE region overall. In recent years, due to the continuous improvement of the investment environment and economic prospects, the foreign capital amassed in Czech, contributing to industrial production in ways that are increasingly apparent. Foreign-funded enterprises are mainly concentrated in the automotive, electronics, machinery manufacturing, chemical and other fields. The general trend of FDI inflows proved positive, amounting to USD 10 593 million by the end of 2012. This was the highest sum since 2009 (USD 2 927 million). Overall, many formerly state-owned firms of the Czech Republic have been privatized, including banks and telecommunications. The initially slow pace of privatization has accelerated in the subsequent years. Over the last few years the privatization process in the country has slowed. One of major factors that attract foreign investors to the Czech Republic is the broad offer of state investment incentives. Much of this aid goes to projects in manufacturing, with full and partial tax reliefs for up to 10 years, job creation grants up to EUR 2 000 per new job, training or retraining grants and preferential transfer of public land. Until recently, it was available only for investors operating in manufacturing industry. In July 2012 though, the amended legislative act on investment incentives extended the state aid on technology centers and business support services.

In terms of industrial flows of investment, we found that the investment scale in the manufacturing industry peaked in 2007, amounting to EUR 2 825 million (Czech National Bank), and the income reinvestment accounted for the vast majority of the investment methods. In 2012 the FDI inflow by manufacturing reached EUR 2 378 million (Czech National Bank). FDI Project trends showed that the leading sector was automotive components, which accounted for 12 percent of projects (fDi Markets, 2013). More investment is now being directed towards more high-technology sectors and research and development. Compared to other industries, we found that income reinvestments accounted for a considerable scale comparing with equity investments, which indicated that the transformation and economic stability in the Czech Republic brought the continued investment inflows of multinational companies in the country. In addition, we can see that industries such as trade, financial and commercial industries

have accounted for a large scale, which illustrates that the service industry is in a new development stage in the Czech Republic. We have also found that since the financial crisis, reinvested earnings have dominated the overall FDI inflow into the Czech Republic. Reinvestment can be expected to play an important role in the inflow of FDI and will therefore be one of the main sources of growth in the potential of the Czech economy. From this point of view, we have every reason to be optimistic about the future prospects of foreign direct investment in Czech.

IV. Analysis On The Main Factors influence On Foreign Direct Investment In Central And Eastern European Countries

Transition specific factor: privatization: it plays important roles in determining the flows of FDI into the CEE countries. The Privatization provided more opportunities for multinational companies. It also made it necessary that the host country government and the people change their attitude toward foreign direct investment. Whether through observation or area-related literature, the process of privatization and FDI inflows have consistently maintained a very close relationship. For the CEE countries, the inflows of FDI are not only related to the process and degree of privatization, but are also closely related to the methods of the privatization. Privatization originated with the selling of state assets to domestic residents; then it turned to the direct sale with geared interest toward the international market.

The factor “social relations”: previous studies of Crenshaw 1991, Dunning 1994, London, and Ross 1999 found out that social relations are the most important factor affecting FDI in Central and Eastern Europe. As the researchers have passed through investigation, they found that politics played a significant impact on foreign direct investment and it also reduced the influence of “social relation” factor.

The political and legal factors : directly affect the safety of the investment. An imperfect law can affect the rights and interests of investors and decrease the level of their investment protection. So we can assume that the above factors are the two basic conditions that determine the future FDI.

The comparative advantage factors (including labor and resources endowment): considering development law, the importance of these factors attracting foreign capital is gradually decreased.

The costs and incentive factors, including geographical advantage concerning transportation costs or local government preferential policy: currently, the role of the government's preferential policies attracting FDI lies in a weakening trend. Other important factors revolve around a country's regional internal factors, including the host country on FDI industrial clusters with a strong attraction in any given specific area, which can also become a host country’s sustainable competitive advantage in attracting FDI. Some scholars, after studying CEE countries in transition, found that the application of preferential tax breaks is not an effective way to attract FDI. In addition to the two special cases such as the taxation of high levels and the free flow of capital, tax incentives do not play a decisive role in the investment decisions of multinational corporations, and the smaller difference of corporate income tax among the state is unlikely to have a significant impact on investment decisions of multinational corporations.

Factors of investment decision for multinational corporations: the study of the relationship between FDI and multinational corporations (MNCs) let us understand the determinants of FDI further. Foreign direct investment (FDI) or the means by which MNCs obtains or expands a subsidiary can take a variety of forms. FDI can be by merger or acquisition of an existing firm, by participating in the construction of a new firm, or by expanding existing subsidiaries. Looking for domestic markets to sell more goods, seeking raw materials and managerial knowledge or technology and trying to find countries where factors of production are cheaper are the main motivations for MNCs. Based on MNCs motivation, FDI can be divided into resources demand type and market share type. The foreign direct investment of resource pursuing type pays more attention to the cost factors in these countries. The main motivation of multi-national corporation investment is the value of their lower costs, including cheap labor costs and raw material costs. The potential market size and the market profit are considered more important factors for market type multinational companies. With an increasing market, they can achieve economies of scale and reduce the average cost at the same time. In addition, the multinational companies can also obtain strategic assets through foreign direct investment. Thus, the general form of investment is achieved through acquisitions. Additionally, the type of investment such as joint venture or wholly owned subsidiaries highly affects the investment decisions. The openness of the host country to international trade is another dimension that affects investment decisions of MNCs which allows the companies to export their final product to alternative markets easily and without limiting their sales operations with the host country market.

There are two explanations about the reason that causes the difference among the foreign direct investment in the CEE countries: one is the fundamentals (d Brenton eta1. 1999) and the other is regarding the foreign direct investment as a result of the host government and investors decision. Simultaneously, we should be aware of the following question: Which factors play a greater influence on the FDI of transition countries? It depends on the entry mode, the industry and the investor decision. Therefore, in the study of the factors affecting FDI, it cannot be seen as a unified problem but should be regarded as a system problem, and we should question and further explore the internal mechanisms which interact with each other. When analyzing incentives that attract FDI in the host country, we can solve the deficit from two angles: the import and export and foreign investment, and the obtainment of advanced technology, management and systems. The upstream and downstream enterprises associated with the foreign investment companies can obtain a rapid growth. From the perspective of investment countries, they can benefit from the rich initial resources, cheap labor and a good developed communication network in CEE countries. MNCs have opportunities to expanding geographically. The location situated among Western Europe and the Middle East and West Asia allow MNCs to expand into new markets. There are also still a variety of privatization opportunities brought by the transformation.

The entry modes of foreign firms that have entered can be divided into three types, the first type being the targeting of market and gaining market share. The goal of such an entry method is geared towards the needs of local and regional markets. Because it involves the recipient of the transfer of production equipment, it can also be referred to the level of FDI (Horizontal FDI). The second type of entry mode of foreign firms is the resource type or capital type. This refers to the acquisition of particular resources not available at home,

such as natural resources, raw materials or cheap labour costs. Especially for manufacturing industry, the cost control is very important when foreign direct investors view export as the goal. Contrary to horizontal FDI, vertical or export-oriented FDI involves the recipient to redeploy some production chain, and low-cost labor is a basic power. The countries that are rich in natural resources are more likely to attract FDI. The third type is efficiency. Companies can benefit from economies of scale, even if the business is geographically dispersed. Bevan and Estrin (2000) are among the first researchers to support this view, on the basis of his study on the Czech Republic, Estonia, Hungary, Poland, and Slovenia. In order to attract more efficient FDI, the future European Union member states actively establish a regional cooperation network when they release the declaration to join the European Union. The above classification provides a guideline for by which to analyze the FDI in CEE based on cost factors and demand factors. The efficiency factors in themselves constitute the entire company's profit function. The behavior of investors is different, therefore the influence of foreign direct investment on international trade and on the market structure in the host country is not the same. From the demand factors, the size of the market in the host country is a major factor. In this regard, the GDP of the host country, per capita GDP, degree of urbanization and government spending have played an important role. The industrial structure of the host country also has an important impact on foreign capital entrance. The major cost factors include unemployment, wage levels, inflation, the level of infrastructure, the national credit rating, the level of industry concentration, and the policies of the host country attracting foreign investment. The level of skilled workers, their level of education and the political and economic stability in the host country (this can be seen in the evolution of FDI in Poland, where the privatization policy has led to repeated fluctuations of country's FDI) also affect investment decisions. The host government plays an important role in the process of accumulating FDI. In general, the host country participates through three channels: First, they set up several non-economic organizations to promote the realization of the investment process; Second, the host government directly participates in the investment process by formulating many policies of privatization, especially for foreign investment. Even the host country government directly sets up privatization programs to sell the state-owned enterprises to foreign capital. Third, the host government enacts policies of tax incentives and subsidy to stimulate the inflow of foreign capital. Finally, it is also important for the host government to consider the attitude of people in transition countries toward foreign capital European.

V. CONCLUSIONS

The significant relationship of transformation, privatization and foreign direct investment is a remarkable feature of the Central and Eastern European countries. Despite the overall rise of FDI inflows in economies in transition, there are periods of dynamic fluctuations. We found that the volatility of the FDI inflows in CEE countries is mainly related to the volatility of the privatization program. In the early phases of transition, the surge of inflows was due to CEE countries' government effort to become EU members. Due to the uncertainty of the initial transition, the privatization-related FDI were the more attractive type of FDI. As the privatization was accelerated and most of the state – owned enterprises were sold, the role of privatization in attracting FDI has gradually weakened. Comparatively, in CEE, the privatization and reconstructing process is ending, providing a main reason to shift to enhancing economic growth and productivity, encouraging employment and stimulating innovation and technology transfer.

The years 1995, 2000, 2004, and 2007 are the four years of the period of rapid development of FDI in Central and Eastern Europe. The CEE countries experienced a sharp drop in 2003, 2004 and 2009. The Global financial crisis in 2008 affected the volume of FDI in CEE, but certain economies like Poland proved to be more resistant to the decline. The crisis has also highlighted the need for new FDI policies. The volumes of foreign direct in CEE countries, as a result of privatization, economic reconstructing, development and geographic location, of course vary. Despite the grow potential and market opportunities, the investors should be aware of the geopolitical, institutional and the risk posed by European debt crisis. We find that the importance of location, market size and political and legal factors for international investment increased. Western European countries tend to invest to the location closer to their own countries. With the decreasing of privatization deals, FDI began to take the form of Greenfield investments. The industry analysis shows us that the highest proportion of FDI remains in the manufacturing industry. However, in last few years there is tendency of the FDI inflows to shift from the manufacturing sector towards the services sector. The analysis showing us that the private equity investment, which increased in recent years, is also the new channel of FDI into the host country.

Implications: We should use the "window period" to increase investment-promotion policies that will augment FDI inflows and ensure continued economic development of CEE countries.

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