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IMPACT OF FOREIGN DIRECT INVESTMENTS ON CITY TRANSFORMATION IN CENTRAL AND EASTERN EUROPE

Abstract: This paper is based on Chapter 5 in the book edited by F. E. I. Hamilton, Kaliopa Dimirovska Andrews, and Nataša Pichler – Milanović (Eds.) Transformation of Cities in Central and Eastern Europe: Towards Globalisation, published in 2005. Chapter 5 Foreign Direct Investments and City Restructuring was originally written by well known university professors and scientists: FEI Hamilton and FW Carter, and post-mortem completed and edited by Nataša Pichler – Milanović.

Key words: city, transformation, foreign investments, Central and Eastern Europe

Извод: Рад је заснован на петом поглављу књиге: Трансформација градова у Централној и Источној Европи: ка глобализацији, чији су редактори F. E. Ian Hamilton, Kaliopa Dimirovska Andrews и Nataša Pichler – Milanović, која је издата 2005. године. Наведено поглавље: Директне стране инвестиције и реструктурирање града, написали су познати универзитетски професори и научници: F. E. Ian Hamilton и Francis W. Carter, да би после њихове смрти поглавље комплетирала и уредила Nataša Pichler – Milanović.

Кључне речи: град, трансформација, стране инвестиције, Централна и Источна Европа

1. Introduction

Cites across the post-socialist states are experiencing a range of restructuring trends. This plurality broadly expresses the varied national, regional or specific local outcomes of the interplay between the characteristics, strengths or weaknesses of four sets of forces – three 'endogenous', one 'exogenous' (Hamilton, 1999; Smith and Pickles, 1998). The first of these forces involved the commitment by, and success of, governments and people to implement real institutional and market reforms since 1989. The second concerns the extent to which, and how, the continuities of socialist culture, economy, organisation and society are still acting as a drag on reform. The third comprises the spatially diverse legacies of embedded pre-socialist socio-cultural and behavioural environments that have been handed down from generation to generation, and now foster, shape, exploit or hinder the reforms and conditions of the transition. The fourth embodies the salient features and

influence of exogenous forces through inward flows of capital, ideas, information, innovation, know-how, technology and trade, i.e. 'globalization' forces.
Foreign direct investment (FDI) is the most important phenomenon among the 'external' forces shaping urban development, landscapes and restructuring in Central and Eastern Europe in 1990s. It is a major factor helping to propel leading cities and national and regional urban systems along the economic, political and social paths of transformation from socialism to capitalism. FDI transfers much-needed capital into the cities during a period of local scarcity. Yet it is also a medium for economic integration through bilateral and multilateral trade and information flows, technological innovation, enterprise restructuring, organisational and sectoral modernisation and marketing know-how (Garibaldi et al., 1999; Holland and Pain, 1998). As a result, and given the interaction with the three endogenous forces noted above, FDI symbolises the complex interrelationships emerging in Central and Eastern Europe in 1990s between forces of globalization and city transformation.[1]
Since the end of 1980s Central and Eastern European countries have undergone a political, economic and institutional transition from various forms of socialist structures towards democratic and market-economy systems. Globalisation as a term and concept can be interpreted here as a two-fold process. Firstly, in the form of ***transition*** or structural adjustment as a shift from socialist to democratic societies and market-based economies, and ***internationalisation*** or functional (re)integration in the global processes after demise of the Cold War. Secondly, the prospective accession of these countries to fully-fledged membership of the European Union (EU) represents a completely new phase of institutional development. The systematic process of EU enlargement and integration – ***Europeanisation***, or rather '*EU-isation*' of values, standards, norms and policies can thus be interpreted as a specific "mode" of globalization of Central and Eastern Europe in a particular macro-regional context, to achieve global competitiveness in the 21st century.
In this respect, the pressures of the world economy, particularly in terms of city competition for attracting capital investment and improving the position within the international urban hierarchy, trans-national and cross-border urban networks, – are just as applicable in Central and Eastern Europe as elsewhere in the world. Therefore, the world (or global) city formation and the position of Central and Eastern European capital and other large cities within the wider global – and European urban hierarchy, is yet to be determined.

[1] Globalization can be defined as a process which is diffusing, deepening and accelerating the functional integration, competition and co-operation, dependency or interdependency of cities and their regions, across (inter)national borders, continents and oceans. As such, the term "globalization" had to await the 1990s when broader, more comprehensive approaches, stimulated by the ending of the *Cold War*, began to encompass a multiplicity of interrelated cultural, economic, environmental, political, social and technological dimensions.

Through long periods of history, the ”Central and Eastern Europe” has been plagued by contested definitions, to territorial identity and affiliation, nationalist conflict, and frequent use of these to support geopolitical and geo-strategic interests. Frequent wars and changing political boundaries, relocating territory from one empire or state to another, have distorted urban development, creating real functioning environments of poverty and economic, military and political instability for cities, whose people have had to adjust and readjust to new circumstances. Few cities in the region have enjoyed a stable interaction with the same territory; most have had to adapt to new political, social and economic relationships in space. After the Second World War and the emplacement of the Iron Curtain effectively destroyed the historic concepts and functional reality of *Mitteleuropa*, dividing it between East and West. Thus, during the socialist period it became common in the Western world to refer to the region as ”Eastern Europe”, an area encompassing Albania, Bulgaria, Czechoslovakia, East Germany (the German Democratic Republic or GDR), Hungary, Poland Romania and Yugoslavia, as distinct from the Soviet Union, i.e. the area lying between the (then) USSR to the east and the civil societies or market economies of Western Europe or the member countries of NATO to the west. The dramatic changes since 1989 – the collapse of Communist power, the break-up of the Soviet Union, Czechoslovakia and Yugoslavia and the end of the Cold War – have reconfigured this region.

Central Europe has re-emerged as a distinctive sub-region embracing the Czech Republic, Hungary, Poland, Slovakia and Slovenia (or more precisely *Central-East Europe*). Although former East Germany is now part of unified Germany, it is also in some respect part of this zone because of Berlin’s potential wider regional influence. Very distinctive, too, is the Balkan region or ***South-East Europe*** comprising former Yugoslav republics of Bosnia-Herzegovina, Serbia and Montenegro, and Macedonia (FYROM), as well as Albania, or Bulgaria and Romania, although Croatia may consider itself marginal and more part of Central Europe despite its division between areas focusing respectively on the southern Pannonian plain and those focusing on the Adriatic (Mediterranean) Sea coast. With the break-up of the USSR, however, two other distinct sub-regions have emerged: first, the ***Baltic states*** of Estonia, Latvia and Lithuania; and second, ***East Europe*** which is used nowadays to describe the western areas of the former Soviet Union, namely Belarus, Moldova, Ukraine, and in some respect also European part of Russia (as far east as the Urals). These regional sub-divisions suggest initially that cities in Central and Eastern Europe, which were subjected to a relatively high level of uniformity in their development under socialism (see French and Hamilton, 1979) may be experiencing much more divergent forces and trends in the 1990s and will do so in the foreseeable future. Yet the situation is dynamic and fluid, not static, because of the accession of eight Central and Eastern European countries to the EU in year 2004 – that are already shaping trends in cities in much of Central Europe (Poland, Czech

Republic, Hungary, Slovenia, Slovakia) and in Baltic states of Estonia, Latvia and Lithuania. Although there could be spill-over effects on cities in adjacent EU candidates such as Bulgaria, Romania and Croatia, (i.e. known as ”second-

Figure 1. – Eastern Europe after 1989: subregionalisation[2]

wave” EU candidates), and ”long-term excluded” territories from the EU enlargement such as other former republics of Yugoslavia (Bosnia and Herzegovina, Serbia and Montenegro, and FYRoM) and Albania (known as ”Western Balkans”), or East European states of Belarus, Moldova and Ukraine.
Therefore the effects of globalization are visible in the highly differentiated trends in city landscapes, both structurally and spatially. The first, the structural, concerns the position of the cities of transitioning economies on a kind of scale from the

[2] FEI Hamilton, N Pichler – Milanović, K Dimitrovska Andrews, ”Introduction: Globalization and the Transformation of Cities in Central and Eastern Europe” in: F.E. Ian Hamilton, Kaliopa Dimitrovska Andrews, Nataša Pichler – Milanović (Eds.) *Transformation of Cities in Central and Eastern Europe: Towards Globalization*, Tokyo: UNU Press, 2005, p. 9.

’worst-case scenarios’ of industrial stagnation, de-industrialisation or rural marginalisation to the ’best-case scenarios’ of (relatively) successful manufacturing adjustment, re-industrialisation, and tertiarisation (i.e. the growth and diversification of consumer and producer services). The structural position of cities on such a scale has been determined largely by the extent to which market reforms have been introduced, diffused and adopted to foster FDI (Bevan and Estrin, 2000; EBRD, 1997).[3] The second, the spatial dimension, is the ’uneven’ geographic distribution of the structural scale across the region’s cities and city systems. Broadly speaking, real urban development through restructuring towards the ’best-case scenarios’ is faster and deeper in areas adjacent to, or more accessible from, the European Union (EU); and it declines significantly with increasing distance from the EU eastwards and south-eastwards into the Balkans and East Europe where ’worst-case scenarios’ are more common and corruption is rampant. So, although potential locations for FDI are very numerous throughout the city systems of Central and Eastern Europe, the actual pattern of FDI has been, and remains, very uneven not only between countries, but also between cities within them. In general the larger cities have attracted most FDI, although more business opportunities are now being sought by foreign investors in smaller cities.

2. The International Patterns of FDI Location and Its Determinants

More than a decade ago, Hamilton (1990) predicted that FDI flows into Central and Eastern Europe from firms headquartered in advanced market economies would be essential if the (then) socialist countries were to attempt seriously to bridge the competitive, managerial, organisational, sectoral and technological ’gaps’ between them and the dynamic global economy. It is now evident that foreign-owned and ’globalizing’ or multinational enterprises (MNEs) have indeed become a major force transforming the post-socialist states, especially those within Central Europe and close the EU (Barta et al 1997; Hamilton, 1995, 1999, 2000, 2001; Hunya, 2000; Swain and Hardy, 1998). FDI flows into the region have grown significantly since 1993. Although FDI is often difficult to measure with precision, the United Nations Economic Commission for Europe (UNECE) estimated the cumulative stock in the region to be 102 billion USD in 1999 (UNECE, 2000) while the *Transition Report Update* of the European Bank for Reconstruction and Development (EBRD) put the figure for year 2000 at 113.3 billion USD (EBRD, 2001). In fact, data published annually in *The World Investment Report* by United Nations Conference on Trade and Development (UNCTAD) indicate that Central and Eastern Europe was attracting less than 2.5 percent of global FDI in the early 1990s but that this share has risen relatively sharply to more than 5 percent in 2000. Clearly, the significance of

[3] Expressed as the average of eight European Bank for Reconstruction and Development (EBRD) performance indicators of transition reforms in Central and Eastern Europe.

FDI for, and its impact on the Central and Eastern European cities has grown. Earlier observers such as Sinn and Weichenrieder (1997) argued that FDI levels were low before 1995, more recent data (EBRD, 1999, 2000, 2001) and analysis (Bevan and Estrin, 2000) indicate that FDI was high relative to GDP and GDP per capita in the region as a whole. These broad statements, however, cloak a very uneven pattern of FDI inflows between host countries.

A vast literature developed on the determinants of FDI from the late 1950s, especially in economics, much of which was not spatial per se (e.g. Hymer, 1976; Buckley and Casson, 1976; Caves, 1982). The locational aspects were fostered within the realm of economic geography and linked to the decision-making and organisational behaviour of large firms (McNee, 1958; Hamilton, 1974, 1976; Hakanson, 1979; Hamilton and Linge, 1981). Within economics, however, major conceptual contributions of spatial relevance were provided by Vernon's product cycle hypothesis (Vernon, 1966, 1979), and Dunning's eclectic paradigm which interrelates the significance of ownership, location and internal advantages to explain international patterns of FDI (Dunning, 1980, 1988a, 1988b). Although it is necessary to defend the importance of location in economic analysis, there is now a growing body of research seeking to infuse both the "new economic geography" and the 'cultural turn' in geography into conceptual and empirical work on FDI. This seeks to synthesise investment behaviour, economies of scale and scope, international trade and logistics, location and accessibility theory (Krugman, 1991; Meyer, 1998; Morsink, 1998; Deichmann, 1999; Hamilton, 2000).

So why is location important? First, the attributes of place – a city and its region, for instance impinge upon its business attractiveness through the local mix of competitive advantages or disadvantages in supply conditions. Second, the development of business in a city or its vicinity to exploit these conditions will have various economic and social impacts locally and generate spillover or multiplier effects. Such effects can, of course, be positive or negative. Third, the selection of a city for business location will create feedback effects on the local mix of conditions, and alter them, both directly through local impacts and indirectly through trade relations; these processes can propel a city through a series of 'life cycles' in a dynamic manner but they can also 'fossilise' its structure and functioning (Hamilton, 1974).

Since market reforms were introduced after 1989, and governments opened their state borders to FDI, most literature on FDI has attempted to explain why investment has flowed into certain transitioning economies rather than into others (Hunya, 2000; Meyer, 1998). The question why FDI has been located in specific cities and regions within these countries is comparatively neglected. Yet, in reality, the two are closely interrelated. The selection of a location for FDI within a state often explains the importance of the host country for inward FDI, and vice-versa. Very often, managements of both existing MNEs and firms entering international production to become MNEs for the first time put first priority on the selection of a host country for investment and tend to treat the issue of the choice of a specific location within it as

rather secondary. Yet this may also be because a firm considers the capital city of that country or a place just across the border of a neighbouring state as a ’natural’ location choice. In the case of Central and Eastern Europe, however, the specific conditions of the transition suggest that, for at least two reasons, firms might select a specific city first, with the host country of secondary concern. A very significant proportion of FDI in the region has been associated with the privatisation process. In other words, FDI has flowed into specific ’brownfield’ sites, i.e. existing enterprises (usually in manufacturing or utilities, but also some service establishments) which, by virtue of their production capacities, profiles and potentials, MNEs see as ’matching’ their global or European growth strategies. Thus, FDI location in a city (and a host country) will be defined by the timing of privatisation and the ’supply’ of a particular enterprises on the market. The second reason can be conceived where a foreign firm seeks to serve the markets of a group of Central and Eastern European states from a new ’greenfield’ facility. In this case the firm is likely to select a location in a very ’nodal’ city or urbanised region, such as capital cities of Prague, Budapest, Bratislava, Warsaw, etc.

Once governments in Central and Eastern Europe resolved to open their borders to foreign investors, the body of published theoretical, conceptual and empirical work on the operations of MNEs in the non-socialist world provided insights which, in many respects, have made the character and patterns of FDI in post-socialist states quite predictable. First, most predictably, it has been large or medium-sized MNEs operating in oligopolistic sectors that first clamoured to acquire privatising brownfield facilities or to establish new greenfield capacities in the region. By extending their oligopolistic behaviour into ’virgin market territory’, such MNEs aimed at securing significant gains (e.g. increased world market shares) and profits by exploiting lower labour or other input costs or by dominating local markets. Lead firms thus sought to gain a ’first mover advantage’ (Lankes and Venables, 1996) in individual, or groups of, national markets through the achievement of monopolistic control over resource inputs, existing production capacities and markets. Such behaviour, however, induced their European or global competitors to retaliate either to gain a ’first mover advantage’ in another national arena or to pursue a ’follow-the-leader’ strategy and exploit lower costs to be competitive (Knickerbocker, 1973) and so acquire alternative existing, or establish new, production facilities in the same or a neighbouring post-socialist economy. This explains the predominant flows of FDI by manufacturing MNEs into such sectors as processed foods, drinks and tobacco products, vehicles and automotive components, tyres, consumer electronics, heavy electrical engineering, paper, pharmaceuticals, plastics and some chemical products (see Hamilton, 2001). The trend explains why these industries, and hence the cities in which they are located, have increased their relative importance in the manufacturing profiles of the Central European states during the 1990s.

But the extension of oligopolistic market structures to the region through FDI is not restricted only to manufacturing (see Table 1). It also occurs in public utilities and

especially underpins the expansion of more advanced producer services such as accountancy and management consultancy, banking, insurance and real-estate management into selected cities as well as of consumer services such as modern retailing (supermarkets, hypermarkets, specialist retailers), hotels, petrol stations and fast-food restaurant chains into many cities. The irony is that MNEs in these sectors have invested in facilities in post-socialist states to exploit their firm-specific ownership and internalisation advantages and have done so in markets which were either poorly developed or did not really exist at all as they remained the province of state-owned monopolies or were underdeveloped 'deficit' sectors. In other words, MNEs which had been perceived by the (neoclassical) economists (such as IMF, World Bank or other advisers) and by the new governments of host countries as purveyors of market reforms and competition, in reality often engaged in FDI in Central and Eastern Europe to exploit national or regional market failure!

Table 1. – Sectoral composition of inward FDI stock in Central and Eastern Europe (1998)[4]

Sector	Sub-Sector	Total FDI (%)
Primary	Farming, fishing, forestry, mining	4
Utilities	Electricity, water etc.	4
Secondary	Manufacturing	41
	Automotive industries	4
	Chemicals industries	5
	Food, drink, tobacco industries	12
	Other manufacturing	20
Tertiary	Services	43
	Trade	13
	Financial services	12
	Transport and Telecommunications	10
	Business services	4
	Other services	4
Unspecified		8
TOTAL		100

In a significant number of cases the Western firms entering these markets to gain 'first mover advantage' included those which had built new or equipped existing factories with new technology in growth sectors during the socialist period and were thus quick to exploit their knowledge of, and contacts with, the region to acquire those facilities as they were privatised. In some instances, firms 'returned' to the region by acquiring what had been their own pre-Second World War (and later confiscated or nationalised) facilities, i.e. *Bata* (shoes) in Zlin (Czech Republic) and *Josef Meinl*

[4] UNCTAD, World Investment Report 1999, p. 73.

(retailing) in Hungary are examples. In other cases, MNEs with no previous ties of significance in the region sought 'first-mover advantage' through the acquisition of privatised state enterprises with established national brand names in an attempt to secure 'captive markets', as *Volkswagen* (Skoda in the Czech Republic), *General Electric* (Tungsram in Hungary), *Nestlé* (several renowned national chocolate manufacturers in the region) and *Philip Morris* (several state-owned tobacco factories) are cases in point. New greenfield investments however, have been the hallmark of MNEs seeking 'first-mover advantage' in the 'deficit' service sectors, especially retailing with firms such as *Blockbuster Videos*, *Carrefour*, *IKEA*, *Makro*, *Tesco or Virgin* opening large stores, supermarkets or hypermarkets.

Table 2. – International distribution of FDI in Central and Eastern Europe 1989–2000 (*USD*)[5]

Sub region/Country	Cumulative Stock FDI (1989–1999)		FDI stock per capita (2000)	FDI stock per head city population (2000)	FDI inflow as % of GDP (2000)
	(USD bill.)	%	(USD mil.)	(USD mil.)	(%)
Baltic states	6.7	5.8	895	1.600	4.4
Estonia	1.9	1.6	1.337	1.585	4.6
Latvia	2.4	2.1	1.027	1.920	4.8
Lithuania	2.4	2.1	642	960	3.8
Central Europe	80.4	70.4	1.269	2.024	5.2
Croatia	4.1	3.6	907	1.572	5.4
Czech Republic	21.7	19.0	2.102	3.170	10.4
Hungary	19.4	17.0	1.935	2.892	3.2
Poland	29.1	25.5	751	1.145	5.0
Slovakia	3.6	3.1	669	1.095	5.5
Slovenia	2.5	2.2	1.250	2.273	1.5
South-East Europe	11.4	9.3	237	380	3.5
Albania	0.5	0.4	161	411	1.8
Bulgaria	3.3	2.8	407	581	7.3
Bosnia-Herzegovina	0.3	0.3	71	164	2.5
Serbia and Montenegro	0.1	0.09	13	22	NAV
FYRoMacedonia	0.4	0.4	219	353	2.9
Romania	6.8	5.9	303	521	3.0
East Europe	16.8	14.5	65	121	2.1
Belarus	0.8	0.7	78	108	1.3
Moldova	0.4	0.4	102	174	4.8
Ukraine	3.3	2.8	67	92	1.8
Russian Federation	12.3	10.7	9	109	0.6

Once such firms moved in, rival MNEs began to invest in the region in 'follow-the-leader' fashion, more commonly in new greenfield sites to exploit market opportunities or low-cost labour advantages, or both. Some of the most

[5] EBRD: *Transition update 2000* (own calculations).

publicised examples are drawn from the automotive sector (*Audi*, *Ford*, *General Motors*/*Opel or Suzuki*), consumer electronics (*Ericsson*, *Nokia*, *Philips*), foods and drinks (*Cadbury-Schweppes*, *Coca Cola*, *Unilever*) and tobacco (*British American Tobacco*, *Reemstma*) and, especially retailing (*Cora*, *Metro*, *Spar*, *Carrefour*, *Tesco*.)

The second predictable feature concerns the broad geographic distribution of FDI across Central and Eastern Europe. Table 2 indicates that by the end of 2000 Central Europe[6] concentrated almost 70 percent of total FDI in the region. With the Baltic states, about three-quarters of all FDI is located in countries which lie adjacent to, or highly accessible from, the more advanced economies of the EU. By contrast, South-East Europe has attracted only 10 percent and the European part of the Commonwealth of Independent States (CIS) including the entire Russian Federation – just 15 percent. As a result, the cumulative stock of FDI and annual FDI inflows per capita and as a percentage of GDP tend to be much higher in Central Europe and the Baltic states than in countries to the east and southeast. This indicates a marked division of the region in FDI inflows and impacts. Indeed, Bevan and Estrin (2000) argue that this dichotomous pattern essentially reflects the operation of two quite contrary ’circles’ which appear to be largely self-reinforcing. First, a virtuous circle of forces fostering FDI in Central Europe and the Baltic states, and second, a vicious circle restraining FDI elsewhere. These ’circles’ appear to be analogous to Myrdal’s ’cumulative causation’ hypothesis developed to explain the emergence and persistence of ’core’ as opposed to ’peripheral’ states or regions (Myrdal, 1956, 1957).

There are good reasons why such a dichotomous pattern could be expected. The first is the greater commitment to, and achievement of, macroeconomic and microeconomic market and institutional reforms, especially in Hungary, Poland, the Czech Republic, and Estonia. These reforms yielded more sound opportunities for greenfield investments by foreign firms and, through more rapid and relatively larger-scale privatisation, also a greater supply of former state-owned enterprises for brownfield investments. These states offer lower risks to foreign investors and thus their operating business environments, protection of property rights, profit repatriation possibilities, lower inflation rates, greater currency stability and low corruption levels have enabled them to enjoy higher credit ratings in international financial markets. They have thus achieved higher EBRD ’transition scores’.

Second, these states achieved a significant economic ”U-turn” from recession before, to real GDP growth after 1993, making their consumer and producer markets far more attractive to diversified foreign investments than in East and

[6] Croatia is included in Central Europe because of its historic cultural ties to Austro-Hungarian Monarchy and the fact that it, together with Slovenia, was the most developed part of the former Yugoslavia (Hamilton, 1967, Pichler – Milanovich, 1996).

South-east Europe where recession has been more prolonged. This is particularly evident from Table 3 in the cases of Poland, Slovenia, Hungary, Slovakia and the Czech Republic where GDP per capita exceeds 1989 levels, or is close to it, and is far higher than elsewhere. It underlines the 'pull' exerted on FDI by market size and market growth dynamics.

Table 3. – Gross domestic product (GDP) indicators (USD)[7]

Sub region/Country	GDP per capita 2000[8]	Index (1988=100)	GDP 2000 (bill. USD)	GDP 2000 (%)
Baltic states	3.160	70	23.29	3.3
Estonia	3.409	82	4.77	0.7
Latvia	3.019	64	7.25	1.0
Lithuania	3.045	64	11.27	1.6
Central Europe	5.140	105	313.22	45.0
Croatia	4.211	80	18.95	2.7
Czech Republic	4.797	98	49.41	7.1
Hungary	4.734	105	47.81	6.9
Poland	4.109	127	159.00	22.8
Slovakia	3.650	103	19.41	2.8
Slovenia	9.320	114	18.64	2.7
South-East Europe	1.360	65	69.53	9.9
Albania	1.195	72	3.83	0.5
Bosnia-Herzegovina	972	45	4.18	0.6
Bulgaria	1.484	70	12.02	1.7
FR Yugoslavia (Serbia and Montenegro)	1.225	48	10.53	1.5
FYRo Macedonia	1.685	77	3.37	0.5
Romania	1.596	77	35.60	5.1
East Europe	940	55	258.83	41.8
Belarus	1.104	85	11.04	1.6
Moldova	326	32	1.04	0.2
Ukraine	640	39	31.74	4.6
Russian Federation	1.697	62	246.75	35.4

Table 3 presents GDP (2000) as a 'proxy' for current market size.[9] While, as one would expect, the Russian Federation, with a population of 145.4 million ranks first, it is followed in descending rank order of market size by Poland (population of 39 million), the Czech Republic (10 million), Hungary (10 million) and Romania (22 million) which lie ahead of Ukraine (50 million). In fact, as Table 3 shows, if

[7] EBRD *Transition Update 2000*; (own calculations).
[8] Real prices.
[9] This is a rather crude indicator. GDP at PPP (purchasing power parity) would be a better proxy.

Romania is added to Central Europe and the Baltic States, this group has more than half the market of the European transition economies and has attracted more than 81 percent of the cumulative stock of FDI. This is important because while the literature, especially in economics – tends to focus on the national markets, for many MNEs FDI in a location in Central Europe is attractive by virtue of the geographic proximity of the combined markets of Poland, the Czech Republic and Hungary to form a core market area, together with the prospect of high accessibility to smaller but developing markets elsewhere in Central Europe (i.e. Croatia, Slovakia, Slovenia), the Baltic States, and South-East Europe (especially Romania and Bulgaria) which provide a further attraction to FDI in or near the core. It also means however, that MNEs can invest in modernising brownfield sites with which they have historic (socialist period) links in the smaller Central European economies so as to supply the wider core market. The production of the Clio by Renault in Novo Mesto (Slovenia) is an example. These generalisations are supported by more detailed analyses which demonstrate the significance of the business environment, the form and timing of privatisation, the size of market and market access as the main determinants of FDI across this growth region (Lankes and Venables, 1996; Holland and Pain, 1998; Brenton et al, 1998; Meyer, 1998; Garibaldi et al, 1999; Hamilton, 2000).

A third predictable dimension concerns the effects of supra-national trade agreements on FDI, the growing openness of the transitioning realm to trade, the geographic proximity of the EU and prospective membership of the EU. This shows the importance of the progressive 'reintegration' of Central and Eastern Europe into EU (Grabbe and Hughes, 1998; Mayhew, 1998; Smith, 2000) on the attraction of FDI.[10] Indeed, research by Dokopoulou and Hamilton (1988) established that, in the cases of Greece in the 1970s and Spain in the early 1980s there was a strong tendency for MNEs to invest in a country in advance of its accession to the EU so as to be in a position to reap the full benefits of access to an enlarged, integrating market from the very beginning rather than to wait until the entry date and possibly lose out then to competitors. The prediction that this would be the case in Central and Eastern Europe (Hamilton, 1995) is borne out by analysis by Bevan and Estrin (2000).

Within the EU the largest domestic markets (like Germany) and the Single Market itself can encourage MNEs achieving significant economies of scale to concentrate production within Western Europe, and thus to export products eastwards to Central and Eastern European markets. Yet it is also true that economies of scale and scope in logistics encourage firms to decide to operate

[10] Examples are Austria and Germany respectively through the former Austro-Hungarian and Prussian Empire respectively; Finland's linguistic proximity to Estonia; France's political and cultural ties with Poland; or Italy's mainly socialist period connections with Poland, Romania and former Yugoslavia.

multiple facilities and thus locate in Central and Eastern European countries. One would expect this factor to reinforce the decisions to locate in the region by two major groups of firms:

a) MNE's which pursue a horizontal integration pattern of organization to supply similar or identical products, especially bulkier products (e.g. drinks), and certainly produced or consumer services from dispersed centres within international, national or local markets;

b) dispersion of FDI production into Central and Eastern Europe is stimulated in MNEs with vertically-integrated production to 'disintegrate' their production chains into the region in the form of smaller 'branch', or 'flexible specialisation' facilities. In this latter case the main attraction of the region lies in its low input costs, especially labour costs which provide a particularly powerful competitive edge for supplying the EU market, perhaps as the main market, with the Central and Eastern European market as a more peripheral, but growing demand market.

In fact, Bevan and Estrin (2000) found that low labour costs has been a major factor attracting FDI. It is expected that because wage differentials between Central and Eastern Europe and the EU are substantial, low wage costs will play an enhanced role in attracting FDI both as accession approaches and after accession of these countries as new EU members. If one pursues these various lines of argument, then it could be predicted that progress towards accession to the EU in the case of individual or groups of transition states would have a positive effect on the inflows and location patterns of FDI in the region. That this has indeed been the case is borne out by Bevan and Estrin (2000) who make two findings pertinent to this:

– there was a large increase in FDI flows into the *Visegrad* group (Czech Republic, Hungary, Poland and Slovakia) between 1995–1998 following the *Essen European Council* (1994) which launched the pre-accession strategy and the *Amsterdam Treaty* (1997) which reaffirmed the EU commitment to eastward enlargement;

– the *Agenda 2000* announcement (July 1997) that identified 'two waves' of accession led to a significant upswing in the rate of FDI flows into states to be in the 'first wave' of EU enlargement (Czech Republic, Estonia, Hungary, Poland and Slovenia), while states excluded from the first wave but included in the 'second wave' (Bulgaria, Latvia, Lithuania, Romania and Slovakia) at that time experienced a smaller upswing in FDI inflows, and those excluded altogether generally exhibit little or no change. As Table 4 indicates the 'first wave' countries with about 40 percent of the European transition economy market had received 65 percent of the cumulative stock of FDI by 2000. They clearly benefited because of their stronger transition progress and, hence the operation of a virtuous circle in combination with their closer geographic proximity to the EU.

Table 4. – Classification of Central and Eastern European countries: comparative shares of FDI and GDP (2000)[11]

Subregion	FDI (%)	GDP (%)
Baltic states	5.8	3.3
Central Europe	70.4	45.0
South-East Europe	9.3	9.9
East Europe	14.5	41.8
Total	100.0	100.0
Central Europe + Baltic states + Romania	82.1	53.4
Rest of South-East Europe and East Europe	17.9	46.6
”1st Wave” EU accession countries	65.3	40.1
”2nd Wave” EU accession countries[12]	16.0 (19.6)	12.3 (15.0)
Long-term excluded[13]	18.7 (15.1)	47.6 (44.9)

The ’second wave’ entrants, with about 12 percent of the market attracted almost 14 percent of the FDI and one could say that the upswing in FDI in the late 1990s was connected with their inclusion in the ’second wave’ of EU enlargements. This has begun to counteract the vicious circle tendencies of former likely exclusion, as also has probably the trend towards greater stability in the Balkans (affecting Bulgaria and Romania) and the fact that, although excluded from the ’first wave’, these ’second wave’ countries lie in close geographic proximity to EU member states (i.e. Bulgaria next to Greece, Latvia and Lithuania close to Sweden and Finland), and certainly lie close to or neighbour ’first wave’ accession states (Romania next to Hungary, Slovakia between the Czech Republic, Hungary and Poland, Lithuania next to Poland). On the other hand the CIS states continue to suffer the disadvantages for FDI of a vicious circle and longer-term exclusion from the EU as well as greater distance from it. The former Yugoslav states (except Slovenia which is in the ’first-wave’ group) are excluded from both stages of accession and continue to suffer the consequences of the 1990s ethnic conflicts and on-going political instability. However, Croatia is an exception, which has attracted rising FDI inflows, peaking in 1999 (EBRD, 2001; UNECE, 2000). Recent stabilisation and privatisation policies of the new (post-1999) government have contributed to this trend, as its proximity to the EU and adjacency to Hungary and Slovenia.

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[11] Based on *Agenda 2000*, 1997; EBRD *Transition Update* 2000; Bevan and Estrin, 2000; (own calculations).

[12] ’First-wave’ accession countries as classified in *Agenda 2000* (1997) were: Estonia, Czech Republic, Hungary, Poland and Slovenia.

[13] Figures in brackets relate to the case where Croatia might be incorporated into the ’second-wave’ EU accession countries with Bulgaria, Latvia, Lithuania, Romania and Slovakia, rather than being ’long-term excluded’ (other ex-Yugoslav republics, Albania, Belarus, Moldova, Ukraine)

Indeed, the sustenance of inward FDI may also be in anticipation of Croatia's inclusion in the 'second wave' EU accession countries.
The fourth predictable feature concerns the source-country headquarters' location of firms investing in Central and Eastern Europe. One can make several hypotheses about the pattern. The first is that leading investor nations in the region will be the home bases of large numbers of major MNEs and vigorously internationalising small and medium enterprises (SMEs). Such nations tend to fall into two distinct groups: (a) those with large and diversified economies and firms such as the USA, Japan, Germany, France, Italy and the UK; or (b) those with small economies with a high propensity to generate FDI through a few major specialised 'lead' MNEs such as Austria, Denmark, Finland, The Netherlands, Sweden or Switzerland. The extent to which MNEs from such source countries actually do invest will be determined in large measure by how far their demand for investment in the region can be matched by the host country supply of brownfield and greenfield opportunities. The second dimension is that investor (nation) firms are likely to be located in close geographic or psychic proximity to the transition economies in which they invest so as to reduce transaction and transport costs. This applies especially to those EU states adjacent to or very close to transition economies (Austria, Germany, Italy, Sweden, Finland) and those with historical cultural, linguistic or economic ties with them.

Table 5. – Geographical sources of FDI in Central and Eastern Europe (*1998*)[14]

Geographical sources	%
European Union (EU)	61
Germany	19
The Netherlands	15
Austria	7
UK	6
France	5
Other EU countries	9
United States	15
Rest of the World	22
Central and Eastern Europe	2
Total FDI in Central and Eastern Europe	100

Several publications reveal the actual importance of various FDI source-countries, especially UNCTAD (1999) for the entire region, Hunya (2000) and Meyer (1998) for Central Europe, and Hamilton (2000) for Poland. Table 5 provides an overview for the whole region. In keeping with modern global FDI

[14] UNCTAD, 1999, p. 72.

patterns, the region plays host to investors from a plurality of locations. Yet it also reveals the dominance of the EU as a source region, and particularly that Germany, the largest economy within the EU and one located adjacent to Central Europe, is the biggest single source of FDI. The prominence of the USA comes as no surprise although its true importance may be masked by the fact that some USA investments have actually been conducted through European subsidiaries, as *Opel* (Germany) for *General Motors*. Even so, it can be argued that US investment has been somewhat restrained by the barriers to transaction costs of both geographic and psychic distance from the region. Those barriers certainly explain the relative underrepresentation of the UK as a source country given that British firms have long rivalled the US and recently actually 'outperformed' the USA in global FDI.

Table 6. – The top five sources of FDI stock in individual Central and Eastern European countries (1998)[15]

	'Top five' source countries of FDI				
Host Countries	1st	2nd	3rd	4th	5th
Baltic states					
Estonia	S (32%)	SF (27%)	DK (5%)	CH (5%)	USA (5%)
Latvia	DK (16%)	USA (11%)	RU (9%)	D (8%)	UK (8%)
Lithuania	S (22%)	SF (19%)	USA (16%)	D (7%)	UK (5%)
Central Europe					
Croatia	USA (42%)	A (24%)	CH (6%)	S (4%)	D (3%)
Czech Republic	D (31%)	NL (28%)	A (10%)	USA (6%)	UK (5%)
Hungary	D (25%)	USA (15%)	NL (14%)	A (11%)	UK (8%)
Poland	NL (22%)	D (19%)	USA (15%)	F (10%)	Korea (7%)
Slovakia	A (20%)	D (19%)	UK (13%)	USA (11%)	NL (8%)
Slovenia	A (31%)	D (14%)	CRO (14%)	I (8%)	F (8%)
South-East Europe					
Bulgaria	B (18%)	D (16%)	USA (7%)	NL (7%)	Cyprus (7%)
Bosnia-Herzegovina	Kuwait (21%)	D (17%)	CRO (17%)	A (4%)	F (3%)
FY Ro Macedonia	GR (39%)	A (21%)	D (17%)	S (5%)	I (3%)
Romania	NL (15%)	D (10%)	I (8%)	F (7%)	USA (7%)
East Europe					
Belarus	D (25%)	NL (25%)	USA (17%)	I (9%)	A (3%)
Moldova	RU (29%)	USA (19%)	D (6%)	B (6%)	GR (4%)
Ukraine	USA (18%)	NL (9%)	D (8%)	UK (8%)	CH (6%)
Russian Federation	USA (30%)	Cyprus (26%)	D (8%)	UK (4%)	SF (3%)

Abbreviations: A=Austria; B=Belgium; CH=Switzerland; CRO=Croatia; D=Germany; DK=Denmark; F=France; GR=Greece; I=Italy; NL=Netherlands; RU=Russian Federation; S=Sweden; SF=Finland.

[15] UNCTAD, *World Investment Report 1999*; Hamilton, 2000, p. 106; (own calculations).

By contrast, the Netherlands, a very small economy which is highly accessible to Central and Eastern Europe (but not so close geographically) has become the second biggest source of FDI in Europe and rivals the USA. Hamilton (2000) suggests that this reflects a combination of capitalising on the information available through trading networks established in the socialist period between the Netherlands and Central and Eastern Europe, and vigorous expansion into the region in the 1990s by lead Dutch firms in a diversity of manufacturing, consumer and producer service sectors. Significantly, Austrian firms are major investors, too, as a result of close geographic and cultural proximity. On the other hand there is one major absentee – Japan, which still has very limited investments in Central and Eastern Europe, a situation reflecting the coincidence of business caution towards a rather unpredictable region at a time of domestic Japanese crisis in 1990s.
Table 6 sheds more light on the geographic sourcing pattern, listing the top five sources of FDI for most of the countries in Central and Eastern Europe. It reveals that firms from the largest and most diversified economies in the world (Germany and USA) have made significant investments most widely while Japanese FDI is unimportant everywhere. The data and information, however, also indicates much geographic clustering of FDI in host countries close to source countries. The high proportions of German and Austrian FDI concentrated in neighbouring Central European countries, of Scandinavian and Finnish FDI in the Baltic states, or Greek FDI in FYRO Macedonia, and Italian FDI in neighbouring Slovenia and relatively nearby FYRO Macedonia and Romania are cases in point, signifying the importance of "cross-border regionalisation" and EU-isation. Dutch FDI is most prominent in the four major markets outside the Russian Federation which form a continuous geographic area in Central and South-East Europe: Czech Republic, Hungary, Poland and Romania. Together with Belarus, French FDI makes the top five only in Poland. The key exception of note is South Korean FDI in Poland and Romania where Daewoo has developed the cores of its Central and Eastern European automotive production system.

3. Cities and FDI Location

Foreign firms locate and operate most of their investments in Central and Eastern Europe in the cities or their immediate hinterlands. Available UNCTAD data indicates that FDI in primary sector activities is insignificant, with only 5 percent of the region's cumulative inward FDI stock at the end of 1990s (UNCTAD, 1999; see also Table 1). Rural locations (i.e. FDI in farming or forestry) are only important locally in Romania where such investment accounts for 11 percent. Rather more foreign money has been sunk into natural-resource extraction in mining or oil-drilling towns across the region, but mainly in Belarus (54 percent) and the Russian Federation (13 percent). Most FDI stock in Central and Eastern

Europe has gone into manufacturing (41 percent) and services (47 percent) (UNCTAD, 1999; see also Table 1). Thus it can be inferred that FDI is overwhelmingly city-located. Services are wholly so, although public utilities serve networks of cities and their regions and some small-scale 'workbench' type industry has been also funded in villages in some regions.

Manufacturing and services have absorbed FDI in approximately equal measure in the city systems of Czech Republic, Poland and Ukraine. FDI is restructuring mainly manufacturing in Bulgarian, Croatian and Romanian cities, far less so services. By contrast service functions are the main targets of FDI in other Central and Eastern European countries. Yet, given the sharp international contrasts in FDI inflows discussed earlier (see Table 2), it is clear that foreign firms are most active in restructuring the forms and functions of cities in, most notably Czech Republic and Hungary, followed by Poland.

The location and character of FDI are very diversified between several types of cities: (i) leading metropolitan capital-city regions; (ii) other capitals; (iii) major provincial cities, industrial centres, and small towns.

3.1. FDI in Metropolitan Capital City Regions. – Capital cities throughout Central and Eastern Europe have attracted the biggest shares of FDI flowing into the states they administer. However, leadership in transformation emanating from the four capitals in the region that are classified as 'world cities' (see Beaverstock et al, 2000) – Budapest, Prague, Warsaw and Moscow, has been instrumental in making their respective states the leading hosts for FDI. The three Central European capitals had already asserted themselves by 1992 as major competitors in the replace to attract FDI. In that year, Budapest concentrated 57.5 percent of all FDI in Hungary, Prague 45.5 percent in Czechoslovakia (60 percent of that in the Czech Republic), and Warsaw 39 percent of FDI in Poland. Moscow entered the market for FDI rather later on account of the socio-economic and political upheavals rooted in the simultaneous collapse of Communism and break-up of the Soviet Union. Nevertheless, by 1999 it was estimated that Moscow concentrated 49 percent of all FDI in the Russian Federation.

The magnetism of capital cities for foreign investors, however, resides in their unrivalled advantages within their state territories and in the perception and 'eye of the beholder'. Rey (1998) proposed a 'capital-city hypothesis' to explain that in the initial stages of FDI inflows into a host country, foreign investors tend to cluster their activities in the capital city because it offers the least risky environment, managements gain in confidence and seek advantages and opportunities elsewhere, so eroding the pre-eminence of the capital city as a location for FDI. Conditions specific to the transition economies require qualification of this hypothesis as the initial importance of the capital city might be less than expected, and several factors may combine to maintain or enhance the role of the capital city as a location for FDI, since transition began. Some

foreign MNE managements already had contacts with enterprise facilities, employees, markets and supply sources in the region during the socialist period and hence possessed a 'ready' stock of information and knowledge pertaining to a range of locations inside and outside the capital region. In most states, the capital city offers major advantages to foreign investors, advantages which combine:

(i) the largest regional market, best transport access to the biggest segment of the national market, and the best telecommunications and transport connectivity with facilities or headquarters abroad for transactions and managerial control;

(ii) concentration of state-governmental and private agencies or institutions with which foreign investors need to negotiate, or lobby, regarding brownfield joint ventures, or acquisitions or greenfield development (Sýkora, 1994);

(iii) the most diversified manufacturing and service opportunities for new investment, and hence scope for exploiting agglomeration economies in supporting and related activities (Porter, 1990; Hamilton, 1991);

(iv) the largest labour market with the widest range of skills that is usually further enhanced by major universities and training establishments which assist recruitment of human capital resources for the more knowledge-intensive and deficit sectors that can attract FDI;

(v) unrivalled cultural and other 'quality-of-life' amenities to attract and hold expatriate and indigenous skilled employees of foreign firms. And yet, each capital city is unique and has an ambience of its own.

The timing of privatisation of specific sectors and enterprises also shapes the spatial pattern of FDI acquisition or merger opportunities in any year in any transition state. So, in all three Central European states, foreign acquisitions of key industrial enterprises privatised early on resulted in substantial FDI flows into non-metropolitan locations (e.g. *Fiat* in Bielsko, southern Poland; *Volkswagen* in Mlada Boleslav, north of Prague, Czech Republic), as well as into the capital city. On the other hand, delayed privatisation of other state-owned enterprises, public utilities or producer services (such as banking, electricity, telecommunications) has led to more recent upsurges of FDI into the capital cities. Thus, for example, the Budapest metropolitan region was estimated recently to localise two-thirds of all FDI in Hungary (Barta et al, 1997) while the Warsaw metropolitan region actually increased its concentration of FDI in Poland from 38 percent in 1994 to 48 percent in 1998 (Hamilton, 2000). Yet one must bear in mind that the amounts of FDI quoted as located in a capital city reflect the location of a foreign firm's host-country or regional-international headquarters and not necessarily the actual location of investments. Nevertheless, the clustering of FDI in a capital-city region does express the locus there of command and control functions and the city's ability to match the locational requirements for such functions by foreign investors

both within the host country and the wider Central and Eastern European region.[16]

FDI has been transforming the functions and space economy of the capital-city regions in several ways. First, the preceding socialist regimes endowed these cities with national leadership roles in industrialisation and technological modernisation, through development of key engineering and other producers' goods sectors. Thus the capital cities have offered foreign investors scope to restructure manufacturing in the 1990s through rationalisation of existing enterprises and through 'reindustrialisation' by building new enterprises to serve deficit markets.

The results, however, have been rather patchy; many foreign firms have shunned saving or restructuring metal, machinery, textile, clothing, footwear and other enterprises which now present rather desolate zones of de-industrialisation in wedges of Warsaw, Budapest or other cities. Nevertheless, foreign firms have targeted selected enterprises to serve local deficit markets or to export competitive products across Europe. For example, Warsaw has experienced expansion of the automotive sector and related supply industries, with major investments by *Daewoo* of South Korea in the old *Fiat* Zeran plant to make it a hub in the firm's Central European production network (Chae, 1999; Hamilton, 2000). Italian FDI has modernised the Warsaw steelworks to supply the automotive industry with high-quality sheet. These investments have helped stimulate a 'snowball' effect, with a range of smaller-scale foreign investments in automotive components supply in the suburban zone, together with growth of food-processing (e.g. *Cadbury*) and consumer electronics (e.g. *Thomson*).

Second, the main impact of FDI, however, has been the growth, modernisation and diversification of consumer and producer services. These are transforming the city centres and, to a lesser – yet accelerating rate, the socialist residential neighbourhoods and urban fringes. Given the quantitative and qualitative deficiencies in service provision in the socialist city (Hamilton, 1976; French and Hamilton, 1979), the scope for foreign development of services is huge, notwithstanding the vigorous growth of indigenous private entrepreneurship in some of these activities. In fact, FDI is making a major contribution to the (re)creation and consolidation of Central Business Districts (CBDs) which now begin to resemble those of Western metropolises. The transformation of the central zones of the four leading capital cities had been fostered by in-movement of very large numbers of foreign firms to satisfy services demand and their simultaneous exploitation of the huge 'rent-gap' (Sýkora, 1994)

[16] For instance, FDI by General Electric (GE) of the USA in Hungary's Tungsram electrical enterprise is registered as located in Budapest although only one of four Tungsram facilities is actually located in the city.

between what Hamilton (1995) described as the previous socialist ’use value’ and the new potential ’commodified’ and best ’exchange values’ of sites in the city. One piece of evidence for this lies in the contrasting yields on investments in prime office or shopping centre sites. In most West European capitals these are currently about 5–7 percent, whereas in Central and Eastern European capitals they range from 10–25 percent (Jones Lang LaSalle, 2000). Property restitution in the 1990s opened up possibilities for foreign firms to acquire or lease property at attractive rates and for multinational real-estate firms and commercial facility developers to move in and, given prevailing local land, labour and materials prices, to refurbish existing or build new premises at low cost, often speculating on future demand. As a result, substantial growth of new office, retail and warehouse space has occurred, as Table 7 shows, most of it financed by FDI (Enyedi and Szirmai, 1992; Dingsdale, 1997).

Table 7 reveals the attraction of Budapest, Prague and Warsaw for new services space, indicating that these three cities are spearheading ’the service revolution’, while the South-East and East European capitals such as Bucharest and Moscow, lag in new services provision. Yet, second, all capitals in Central and Eastern Europe lag far behind their West European counterparts in modern office space.

Table 7. – Modern commercial service space in Central and Eastern European metropolitan capitals (*2000/2001*)[17]

Cities	Offices		Retail (Shopping) Centres		Industrial/ Warehouses	
	Volume (000 sq.m)	sq.m per 1000 pop	Volume (000 sq.m)	sq.m per 1000 pop	Volume (000 sq.m)	sq.m per 1000 pop
Bucharest	390	186	20	10	95	45
Budapest	1.570	785	600	300	145	68
Prague	1.130	920	970	790	360	296
Warsaw	1.815	800	1.195	525	780	471
Moscow	2.515	270	305	33	600	65

Delays in property restitution and privatisation have meant that new office construction has been concentrated in a very short period, mostly since 1996, in contrast to much longer incremental growth in West European capitals. Even in Budapest, where the process began earlier, 50 percent of modern office space is rather new. Constraints exist on the supply of sites suitable for new construction, especially in the older, densely built-up pre-1914 areas of central Budapest,

[17] Jones Lang LaSalle, *City Profiles* (for commercial floorspace data); United Nations World Population ’urban’ data were used for calculating floorspace per thousand population

Prague and Moscow; and on opportunities to modernise offices built in the 1950s or 1960s. Scarcities in supply, especially of attractive modern premises, partly explain the high rent levels in Central and Eastern European capitals as compared with many of their EU competitors for regional headquarters functions, like Vienna or Berlin. Indeed, new office supply has helped reduce rent levels in late 1990s in e.g. Prague (Sýkora and Simonickova, 1994).

Table 8. – *Prime office rent levels in selected European cities 2000* (*USD per sq.m per month*)[18]

EU cities:	Rent level	CEE cities:	Rent level
Amsterdam	25	Budapest	19
Berlin	27	Bucharest	34
Brussels	18	Prague	22
London	94	Warsaw	32
Madrid	23	Moscow	42
Paris	42		
Stockholm	36		
Vienna	20		

On the other hand, buoyant demand by foreign firms maintains high rent levels. According to UNCTAD (1999) Central and Eastern Europe is host to 174.170 affiliates of foreign firms, almost 30 percent of the world total. Most are, in effect, 'branches' which gain their infrastructural support through the corporate networks of facilities located in other European and world cities including the corporate headquarters, and from local supporting clusters of specialist services provided both by clusters of foreign MNEs and local firms; many are little more than 'toe-holds' in the doorway, awaiting better future prospects.[19] Thus most new office buildings constructed in Central and Eastern European cities are for multiple occupancy. Yet large numbers of foreign firms have also found refurbished office space in the older property stock of the extensive CBDs of Budapest, Prague and Moscow (e.g. pace which is not included in the data presented in Table 8). In this connection, it should be noted that the transition towards a market economy and civil society led to substantial 'downsizing' of central government which, while generally still occupying the same pre-socialist or socialist buildings *in situ*, nevertheless did release space for occupancy by private firms, too.

[18] Jones Lang LaSalle, *Warsaw City Profile*, 2000.

[19] Moreover, to meet this kind of demand, a firm like Regus (based in London) for example, manages flexible office buildings in all Central and Eastern European capitals where firms can rent variable amounts of space for as little as a day, a week, a month or for longer periods.

The key force in the transformation of the capital city centres from their socialistic socio-political government, administrative and cultural character into more fully-fledged CBDs is the growth of modern and diverse producer services. Wernerheim and Sharp (1999) have compared 12 sources of classifications and concluded that there is a wide consensus of opinion that 'producer services' include accounting, advertising, architectural services and design, banking and financial services, computer services, employment agencies, engineering and research services, insurance, legal services, management consultancy, real-estate management and sales, security and investigation services, typing and copying services. Many of these are 'new' to the former socialist city functional structure or take on new forms of privatised service activity in the post-socialist city. Much of this growth has involved occupancy of space in refurbished 19th and earlier 20th century properties in Budapest, Prague and Moscow, as well as new office premises. In Warsaw, by contrast, it is associated with occupancy of more spectacular high-rise office blocks and towers which in-fill the extensive open spaces and sites on broad avenues created in the 1950s rebuilding of the heavily-destroyed central city. Foreign MNEs have been as instrumental in actually constructing new office blocks as in equipping them with furnishings, lifts (elevators), computers and telecommunications facilities.

Demand for office space is being stimulated by the perception of increasing numbers of MNE managements that these leading capital cities can perform crucial roles in wider European and global production and service networks. Budapest as a hub between West European and German cities, as well as Vienna, on the one hand and South-East Europe on the other (Rey, ed., 1998); Prague as a hub for cities in Germany, west and southwest Poland, and Slovakia (Barlow et al., 1994); and Warsaw between Rhineland cities and Berlin to the west, Scandinavia to the north, the Baltic states, Russian Federation and Ukraine to the east (Dangschat, 1993). These capital cities and Moscow have strong air transport connections with the global hubs of London, Paris and Frankfurt, particularly for onward global connections.

Budapest has attracted substantial inward FDI because it is no longer just the capital of a small economy, Hungary, but also a growing competitor in the European metropolitan system by virtue of its proximity to Vienna and Bratislava, and possession of a well-educated business and professional community with longstanding trading and transactional experience with former socialist countries, including the CIS (Barta, 1992; Enyedi, 1994, 1997). For example *PepsiCola* has relocated its regional headquarters from Vienna to Budapest to make its new office a 'forward point' for expanding business into South-East Europe (including former Yugoslav markets) and East Europe (Moldova, Ukraine). *Opel*, the German subsidiary of *General Motors*, has established a sales and marketing office in Budapest to serve the same region

and to obviate delays in working through its Austrian and German offices (Nicholls, 1998). *Royal Dutch Shell* and *Lucent Technologies* have also selected Budapest as their Central European headquarters. These examples emphasise the advantages of the city, its proximity and accessibility to an expanding market area.

When viewing the region as a whole, however, Budapest is in competition with Warsaw for 'hub' status as the Polish capital has attracted major MNEs to supply the large national market. Many of them have subsequently promoted their local Warsaw offices to the international-regional level *de facto* to exploit the city's nodality (Gaudray-Coudroy, 1998). American corporations like Colgate or Proctor and Gamble thus use their Warsaw bases to co-ordinate advertising and marketing, at least, more widely across the northern part of Central Europe (Czech Republic, Hungary and Slovakia) as well as Russia. Such in-migration of producer services has contributed to the emergence of business centres like the impressive *Atrium*, which are entirely new elements in Warsaw's urban space. They concentrate almost 90 percent of all new high-quality office premises in Poland and create a dispersed pattern of towers to the west and north of the *Palace of Culture* (Dawson, 1999).

Inward FDI, then, has been a major factor propelling the growth and concentration of advanced producer services in the capital cities and their city centres. In-movement early in the 1990s of a range of management consultancy firms, i.e. *Andersen*, *Coopers Lybrand*, *Deloitte Touche*, *Ernst & Young*, *KPMG and Price Waterhouse* (some of which subsequently merged operations as part of global consolidation) is an example of the way in which foreign MNEs sought to exploit new markets created by the learning and information gaps inherent in the implementation of most aspects of transition. Such in-movement was paralleled by international law firms. Somewhat later, as new governments expanded the spheres of privatisation, the influx of another cluster of foreign firms occurred in financial services, insurance and banking. Leading firms experienced in stock market transactions such as *BZW*, *Goldman Sachs*, *Merrill Lynch*, *JP Morgan*, *Nomura* and others became active in handling enterprise privatisation and in helping raise capital on international markets. Insurance, previously 'guaranteed' or deemed unnecessary or undesirable under socialist state ownership and management, suddenly burgeoned as a new and diversified service sphere and attracted FDI by MNEs like *Allianz* (Germany), *Axa* (France), *Prudential* (USA) and *Winterthur* (Switzerland) and many others. The more protracted process of privatising banking has stimulated a rapid insurge of FDI by foreign banks keen to gain market footholds in the region by acquiring local banks or expanding provision of an underdeveloped service sector: ABN *Amro*, *Citibank*, *Commerzbank*, *Creditanstalt*, *Banque Nationale de Paris* (*BNP*) *and Union Bank of Switzerland* (*UBS*) are just a few. Although the growth of producer services is localised mainly in the CBDs, the sheer

dynamism of their expansion has led to inroads into adjacent areas as a result of the scarcity of suitable central sites and escalating land values and rents.
The most publicised and overt expression of the 'globalising' transformation of CBDs, has been the introduction, proliferation and diffusion along main streets and around squares of the 'fast food' revolution, with the capital cities becoming the 'forward points' for the '*McDonaldisation*' of Central and Eastern European urban societies, thereby serving and reshaping consumer demand. While the opening of the world's largest McDonald's on Red Square in Moscow opposite the Kremlin is the most blatant expression of the arrival of this new landmarka, the cityscapes of all four capitals are now liberally peppered with competing fast-food outlets including, besides *McDonald*'*s*, also *Burger King*, *Dunkin*' *Donuts*, *Kentucky Fried Chicken* (*KFC*), *Pizza Hut*, *Subway* and others. But they merely form part of the broad 'cosmopolitanisation' of restaurant and catering facilities also being fostered by indigenous entrepreneurs and new immigrant populations.
Prestigious locations for retail space which commanded prime rents of about 40 USD per sq. m. per month in the mid-1990s now range between 75 USD and 80 USD per sq.m. per month in Budapest, Prague and Warsaw and can reach 150 USD per sq.m. per month in Moscow in comparison to 350–380 USD per sq.m. per month in London or Paris (Jones Lang LaSalle, 2000). Such locations like the largely pedestrianised *Vaci* street in Budapest, *Arbat* in Moscow, or *Nowy Swiat* in Warsaw have attracted some of the world's leading brand names in clothing, leather goods, footwear, cosmetics and luxury goods while every commercial premises in the city centre of Prague are geared to Western wallets! This reflects the marked growth and concentration in the capital cities of purchasing power from tourism (especially in Prague), the rising volume of business travellers, the expansion of profitable local entrepreneurship (mainly in selected services) and the emergence of some richer echelons of society. These trends are interrelated with the growth of FDI in or near the city centre in new hotel construction for chains such as Holiday Inn, Ibis, Intercontinental, Marriott, Novotel, Radisson and Sheraton.
With time, however, FDI has been flowing increasingly into other zones of these capital cities both because property scarcities and high rents in the city centres are encouraging investors to look elsewhere and because economic growth has been creating demand for more diversified, high-quality offices and services also in the 'mid-town' and suburban locations. In Budapest, for example, the new office space under construction in year 2001 outside the CDB (500,000 sq.m.) exceeds that being built within the city centre (430,000 sq.m.). A more marked shift appears to be occurring in Warsaw where office floorspace in the city centre will rise from 500,000 to 740,000 sq.m. while that in the rest of the city will increase to 880,000 sq.m. Much of this more decentralised development is in response to pressure of demand from foreign manufacturers

(e.g. *PepsiCo*, *Nokia*), telecommunications firms, insurance companies, advertising agencies, management consultants and IT service providers for prestigious facilities at lower rents (Jones Lang LaSalle, 2000).

The trend towards decentralisation of FDI and service modernisation within these metropolitan areas is being further reinforced by retail developments. FDI is fostering major expansion of shopping and leisure facilities in 'mid-town' locations in the extensive socialist residential neighbourhoods which were characterised by very basic consumer services and in 'out of town' suburban sites. New retail facilities essentially comprise two forms. The first involves small or medium-scale 'in-fillings' between housing blocks and in open spaces along major streets. These generally include: supermarkets by foreign firms such as *Makro*, *Meinl or Spar*; petrol stations and mini-markets by *AgiP*, *BP*, *Exxon*, *Mobil*, *Shell*, *Texaco* and others; car dealerships for all European and Japanese makes, and *Daewoo* (South Korea); and the conversion of former small state stores at street level under the housing blocks into new specialised retail outlets such as *Blockbuster* (video).

Second, the most striking change consists in the construction of spacious new shopping centres, malls and leisure complexes along major avenues and near key transport intersections sewed by buses, trains, metro stations and, in suburban zones, rail stations and good highways. These facilities are both financed by foreign money (direct or indirect investment by individual firms or by consortia) and 'populated' by leading foreign enterprises. For example, the *Central European Property Fund*, sponsored by Jones Lang LaSalle, Lehmann Brothers and Bouggues, was established in 1999 to fund 8 to 10 shopping centres in Poland, the Czech Republic and Hungary, with one to be located in each of the capital city regions. Examples of such centres in Budapest include the *Duna Centre* (Virgin Megastore, Kookai etc.) built on derelict industrial land to the north-northeast of the CBD, Europark, Albertalva and the Plus Center (Tesco) in the outer northeast of the city. All have a mix of clothing, footwear, furniture, consumer electronics and bookstores as well as fast-food restaurants and some have integrated gas station facilities. Prague has attracted the Swedish furniture firm IKEA, which invested 101 million USD in a retail strip mall west of the city while the Swiss retail chain *Intershop* has opened *Centrum Černý Most* to the east, complete with cinemas, a bowling alley, pool hall and theatre, so contributing to the transformation of the city's suburbs (Kok and van Weesep, 1996). Similar centres exist in Warsaw, notably *Galeria Mokotów* to the south of the city centre and others have opened in Praga and *Siekierki* on the 'working class' east bank of the Vistula river. The gradual eastward diffusion of shopping centres is illustrated by the opening of the first IKEA centre in Moscow in 2000.

Yet the largest retail developments are occurring in greenfield 'out of town' locations on the metropolitan fringes to take advantage of open land and

cheaper rents (Wasiuk, 1998) as well as the suburbanisation of wealthier households, improved roads and rapidly rising car ownership. Thus the French firm *Carrefour* and German chain *Metro* have opened hypermarkets on the outskirts of Warsaw while the French chains *Auchan* and *Cora* have down likewise to the east of Budapest beside the ring road and motorway facilities and close to new executive housing estates which combine apartments, terraced housing and single villas. It is these large-scale developments in particular which help to explain the high levels of retail floorspace per thousand population, especially evident in Prague and Warsaw in comparison with West European capitals that concentrate a much bigger stock of older and relatively smaller stores, often arranged along inner-city and suburban shopping 'high streets'. Although Budapest has more of this type of retail facility, especially within pre-1914 Pest, the higher figures for the Central European capitals express contemporary 'catch-up' to eliminate their historic deficits of modern shopping provision under socialism.

A substantial growth of modern warehousing has occurred especially in Warsaw and Moscow, followed by Prague and Budapest. This is new space and does not include conversions of vacated industrial premises which is more evident in Budapest than elsewhere, following with more severe de-industrialisation. Two points are important here. First, under socialism, warehousing services were neglected. This was because, under socialist ideology, services were treated as 'non-productive' sectors, were thus starved of investment and so became 'deficit' sectors. The socialist economy was intended to be fully planned and to operate on the basis of direct factory-to-store (or market) delivery. In the socialist shortage economy goods were always sold as soon as they were received; that tended to make warehouses redundant (except that consumer 'choice' was between to buy or not to buy the goods on offer and goods rejected did fill warehouses or decayed in the open). Transition and privatisation had led to the proliferation of firms, fragmentation and lengthening of the supply chain and, with open borders and rising foreign trade, the multiplication of longer international supply lines. Warehouses have become necessary and, of course, have been developed as an integral part of the market economy culture and organisation. Thus, for example, already by 1996 foreign-owned stores and manufacturers in Warsaw were utilising more than 2,500 retail warehouses in and around the city. Similar conditions prevail in the other capitals.

The significantly greater expansion of modern warehousing space in Moscow and Warsaw has been a response to two main factors: greater national market size and greater distance from alternative logistics centres. Moscow and Warsaw are the major distribution centres for the two largest Central and East European economies. With its eastward location in Poland, Warsaw also functions as a distribution centre for foreign firms selling in Lithuania, Belarus and Ukraine. Moreover, both Warsaw and Moscow are much more distant from

the EU so that air freight is proportionately more important and hence foreign (and local) firms require greater local warehouse space – in contrast to Budapest and Prague where firms serve the Czech, Hungarian, as well as the Slovakian, Slovenian and Croatian markets, can be more quickly and efficiently supplied from logistics centres located in Austria, Germany and Italy.

3.2. FDI in Other Capital Cities. – The remaining Central and Eastern European capital cities perform a key gateway function for channelling FDI into their respective states. Bratislava, new capital of Slovakia, consistently drew in about 60 percent of the country's foreign investment throughout the 1990s (Pavlinek and Smith, 1998). Sofia localised FDI in Bulgaria: three-fifths of all foreign-owned producer services was located there between 1989 and 1993, while in 1998 the capital still pulled in 58 percent of the country's FDI (Carter, 1999). Bucharest dominated inflows into Romania, with more than half of all foreign firms in Romania located in the city between March 1990 and February 1997 (Guran-Nicu, 1999). The situation is similar in Slovenia's capital Ljubljana where almost half of total country's FDI in 1990s were located. However, in the Baltic states more than 70 percent of all FDI at the end of 1990s were absorbed by their respective capital city regions of Tallinn, Riga, Vilnius.

Yet none of the other capitals have been able to attract major FDI. A range of factors explain delayed or limited FDI. Apart from Bucharest and Sofia, all are administrative seats of newly-independent states where people have had to try to climb a very steep learning curve to establish national political and economic stability and international credibility. Most capitals are smaller in size, serve national markets of very limited size and purchasing power, so that any significant scale of foreign investment requires open borders and an environment of international cooperation to facilitate exports. Most often, however, foreign firms have been deterred because post-socialist governments have pursued controversial policies or have failed to engender international credibility.

For example, Ljubljana, capital of Slovenia, has pulled in FDI despite the sluggishness of the privatisation process since 1993. To an extent this disadvantage has been outweighed by the city's excellent location, the inheritance of a more advanced technological base which was embedded from the early post-Second World War socialist period and the presence of a community skilled in dealing with other regions of the former Yugoslavia. These factors persuaded *Siemens* from Germany to establish its local headquarters in Ljubljana as early as 1991 and to supply household appliances and consumers' goods, and IBM to open a subsidiary with a Systems Support Center and Personal Computer Institute to bolster IBM Austria's trade with the former Yugoslavia. Indeed, the city has also attracted a software cluster with *Microsoft* and *Oracle* establishing centres to serve the Bulgarian, Hungarian, Romanian and Slovakian markets.

A more extreme case is Bratislava, the capital of Slovakia. Its city region ought to be among the leading locations of FDI in the region. True, leading firms like *Henkel*, *K-Mart*, *Volkswagen and Unilever* have invested there in manufacturing (vehicles, chemicals) and retailing. Yet when the city became capital of the newly-independent Slovakia in 1992, leading foreign management consultancy firms assessed the Bratislava region to have the best location for FDI in the whole of Central Europe, located between Vienna and Budapest, near the borders of four states – Slovakia, Czech Republic, Hungary and Austria (which in 1995 became the EU border), and equidistance between Berlin, central and southern Poland to the north, and Slovenia, Croatia with the Adriatic coast to the south. However, the city has been unable to exploit this potential in large measure because the Vladimir Meciar government of Slovakia (1992–1998) pursued a rather nationalistic policy which engendered domestic ethnic tensions, friction with Hungary and discouraged investors. If that were not enough, this government attempted to deflate the capital role and advantages of Bratislava, a multi-ethnic city, by trying to foster key state, university and financial services functions in Banska Bystrica, a town beneath the low Tatras mountains. Now, though, Bratislava's attraction for FDI is likely to be restored because Slovakia's new government has created political and market confidence through recent reforms, enabling Slovakia to attain Standard & Poor's award of an investment grade rating for the first time since independence (Carter, 1998, 1999).

The lion's share of FDI in the Baltic capitals of Tallinn, Riga and Vilnius come from either Scandinavia (Sweden, Finland, Norway, Denmark) or other northern European countries such as Germany, the Netherlands, and the United Kingdom. Foreign investments also tend to focus on certain sectors of the local economies. The new capital was targeted towards what traditionally were underdeveloped sectors during the Soviet period, and gone hand in hand with a break-up of old economic dependencies. Many of FDI were made through take-overs of old manufacturing industries, which assists higher productivity and important spillover effects from foreign companies to domestic ones. For example, in Tallinn more than 30 percent of all FDI between 1992 and 1996 were made in manufacturing, while 25 percent were made in the wholesale and retail trades. Another 18.0 percent went into transportation and telecommunications. The investments by Swedish *Telia AB and Finnish Telecom* in Eesti Telefon and EMT AS mobile telephone companies in 1996 were being two major undertakings. A similar pattern can be noticed in Riga as well as in Vilnius, although investments in trade play a more prominent role relative to other sectors compared to the case in Tallinn.

By contrast FDI is being hindered in Bucharest (as in other Romanian cities) because 'two facts tarnish Romania's regional reputation. The country is waiting to join the EU. And it is unique among that group in terms of repeatedly failing to fulfil any of the agreements it has entered into with the International

Monetary Fund (IMF). Unfavourable political environments have had the most detrimental effects in stifling FDI into the other capital cities of South-East and East Europe. Preservation of state control and political centralism in Belarus has ensured that Minsk, its capital, is virtually 'foreign investment free' (apart from a small *Ford a*ssembly operation), while unconvincing reform, slow political democratisation and economic pauperisation in Ukraine have restricted Kiev's attractiveness. For much of the 1990s FDI in Zagreb, capital of Croatia, was deterred by late President Tudjman's politics, but, of course, the ethnic conflicts made Belgrade, Sarajevo, Podgorica and, to a lesser extent, Skopje, very unattractive for investment. The same is true of Tirana, the Albanian capital. Despite introduction of a privatisation programme managed by a National Privatisation Agency in 1995, foreign investors have stayed away. While regional political and military instability associated with ethnic conflicts and tensions in Kosovo and FYRo Macedonia have been a factor, it is internal conditions which are most detrimental, local corruption, industrial obsolescence, lack of basic urban infrastructure, intense rural to urban migration after 1992, when free population movement was permitted for the first time in half a century, an influx of refugees from the former Yugoslavia; and the explosion of shanty towns on the urban fringe (see also Carter, 1999).

So FDI has changed the face of the other Central and Eastern European capital cities much less dramatically than in the leading 'world cities' in the region. FDI is directly evident in new hotels, some restructured industries, public utilities such as telecommunication, refurbished offices and some consumers' services. But generally there has not been the proliferation of foreign consumers' goods outlets, hypermarkets, shopping centres, office and warehouse construction found in Budapest, Prague, Warsaw, or Ljubljana. In Sofia, for example, small private businesses have flourished as ground-floor flats were converted by their owners to small retail outlets, boutiques and cafés and some residents rented out property to foreign traders busy introducing Western and Asian goods to the Bulgarian market. Bucharest, like Sofia, escaped the direct effects of the Balkan regional wars of the 1990s and its wide tree-lined boulevards endow the city with a deceptively prosperous appearance unmatched elsewhere in Romania, clearly a potential future factor in the city's competitiveness.

3.3. FDI Beyond the Capital Cities. – Most foreign investment located outside capital cities has been targeted at rationalising, modernising and expanding manufacturing and boosting the provision of consumer services. That FDI has led to relatively limited producer services' growth outside capital cites underlines the continued functional division of labour within the city network. In addition, FDI shows substantial geographical bias between both individual cities and levels of the urban hierarchy. Most is localised in larger provincial cities, regional and some industrial centres or agglomerations; and occurs to a

much lesser extent in medium and small towns except near borders with the EU member states.

Given the international flow pattern of FDI, foreign firms are having much greater, deeper, more widespread restructuring effects in the city systems of the Czech Republic, Hungary, and Poland than elsewhere. The impacts are far weaker and less diffuse in East and South-East Europe. Thus, for example, towns in north, west and central Bohemia (including the Prague city region) dominate FDI in the Czech Republic, with significantly less in east Bohemia or Moravia (except in larger southern cities like Brno and Zlin (Pavlinek, 1998). Foreign investors in Hungary prefer to be in a triangle of Transdanubia lying between Budapest in the east, Lake Balaton to the south, the Austrian border in the west. They appear reluctant to locate east of the river Danube in agricultural towns of the Great Plain or older industrial cities of the northeast. Large regional centres in Poland have benefited most from FDI outside Warsaw, especially Poznan, Szczecin and Wroclaw in the west; the 'Three-city' ('*Trojmiasto*') region of Gdansk-Gdynia-Sopot, with Elblag in the north; Bydgoszcz and Lodz in the centre; Katowice and Crakow in the south (Upper Silesia). By contrast, even larger centres like Bialystok, Lublin, Olsztyn and Rzeszow lying east of the river Vistula have attracted far less investments (Hamilton, 2000). In Slovenia, more than 60 percent of total FDI are concentrated in six largest cities; more than 50 percent of total FDI are clustered in 4 cities in the western part of Slovenia (Ljubljana, Kranj, Novo mesto, Koper). FDI in Romania tends to cluster in major cities in the west (Arad, Oradea, Timisoara), southwest (Craiova), and the Prahova valley to the north of Bucharest. FDI is spread more thinly in the centre, north and east (Guran-Nicu, 1999).

Cities which have been unable to attract much or any FDI usually may suffer from poor accessibility, run by traditional or un-enterprising councils, have less modernised infrastructure from the pre-socialist era, especially in rural regions, or embody predominantly socialist city legacies such as obsolescent state enterprise and a polluted, monotonous, drab and poorly maintained or serviced urban environment. The FDI in manufacturing in the provinces varies enormously in character. At the bottom of the spectrum are relatively short-distance cross-border investments by small foreign firms in 'workbench' facilities which employ just a handful of low cost workers in low value-added assembly or processing operations. For example many German SMEs have located such outsourcing activities in the small border towns and villages of the Czech Republic (Pavlinek, 1998; Pavlinek and Smith, 1998). At the other end of the spectrum are the major plants of large MNEs that embody rising technological sophistication to serve Europe-wide markets and production chains. As the local spillover effects derive from both the quantitative and the qualitative features of FDI, and are liable to change, the provincial cities form

the main stage on which a kaleidoscope of scenarios of MNE strategy and behaviour is played out.

Privatisation of state-owned enterprises in the transition states provided larger, 'global' MNEs with opportunities to achieve 'first mover advantage' and regional monopoly by acquiring the entire national networks of plants in several countries. This enabled firms like *Asea Brown Boveri* (ABB), *Philip Morris*, *Nestle*, *Siemens or Volkswagen* to gain control over multiple locations almost simultaneously and so create a 'splashing effect' of FDI amongst the cities in Central and Eastern Europe. The trend was reinforced by the countermoves of competitors in acquiring or building alternative plants. In this way, FDI has brought cities into new functional relations, competitive or cooperative national and cross-border interdependencies. Unless the plants acquired can absorb output shifted from the EU, some will become surplus to needs and be downsized or closed. Such a scenario, involving MNEs in decisions to select between plants and cities in making investment or divestment, is most likely in sectors selling long-established branded goods in national markets 'protected' by traditional consumer preferences (e.g. chocolate, tobacco) or making engineering goods developed under socialism (e.g. transport equipment). By contrast, the growth of the automotive and electronics industries has occurred to serve real market expansion in Central and Eastern Europe and to help MNEs lower costs and increase competitiveness in European and global markets. This has not only ensured futures for some former state enterprises, but has required the construction of many new greenfield facilities, with direct and indirect spill-over effects, in the region's provincial cities.

While FDI converted the auto industry into the biggest in Central Europe, its position is being challenged by the dynamic growth and development of FDI-funded electronics, most of which locates in provincial cities. This is not surprising because the region since 1990 has been able to offer MNEs in the sector low, competitive costs within Europe which they previously had to seek out in East and Southeast Asia. So MNEs producing consumer electronics, computer hardware and software, and telecommunications equipment, such as *Bosch*, *Ericsson*, *IBM*, *Intel*, *Matsushita*, *Microsoft*, *Motorola*, *Nokia*, *Philips*, *Samsung*, *Siemens and Sony* have all invested in the region. While such FDI often involves low value-added assembly work using cheap, often female labour, there is also evidence that certain cities with electronics industries, mainly in Hungary, are benefiting from plant restructuring out of labour-intensive into more knowledge-intensive activities. In these cases, initial simple assembly was replaced by more integrated manufacturing while more recently on-site functions have been upgraded by the introduction of design, managerial, organisational and even research and development work. Such 'gentrification' of the urban fabric expresses the fierce competition for FDI between cities in Central and Eastern Europe. But because MNEs 'play-off' one city against

another, they often demand concessions or threaten to locate elsewhere. So central or local authorities feel compelled to offer incentives even in very desirable cities which really do not need additional stimuli.

4. Conclusion

The impact of 'globalization' on transformation and city development in Central and Eastern Europe through FDI has been varied, especially between the region's two distinct geographic parts: north and west, and southeast. Economic forces and market opportunities have played the strongest role in the former, geopolitics in the latter.

People in Central Europe have embraced change with more commitment and handled transition more competently, have been rewarded with NATO and OECD membership, and the EU membership in year 2004. The area is favoured by history and geography and receives the bulk of inward investment. There was a large increase of FDI in Czech Republic, Hungary, Poland and Slovakia following the *Essen European Council* (1994), which launched the pre-accession strategy, and the *Amsterdam Treaty* (1997) that reaffirmed the EU commitment to eastward enlargement. The *Agenda 2000* identified 'two waves' of accession and led to a significant upswing in the rate of FDI flows into 'first wave' countries (Czech Republic, Estonia, Hungary, Poland and Slovenia), while states included in the 'second wave' at that time (Bulgaria, Latvia, Lithuania, Romania and Slovakia) experienced a smaller upswing in FDI inflows. Those excluded altogether than from the EU enlargement, as Croatia, Bosnia and Herzegovina, Serbia and Montenegro, Macedonia, Albania (also known as 'Western Balkans'), or East European countries (Belarus, Ukraine, Moldova) generally exhibit little or no change. Conditions in South-East Europe are more perilous, without radical change in political and economic structures, too much of the past lingers on, the new elites containing many old players keen to protect their privileges and anti-democratic way of life. Especially large areas of the former Yugoslavia have experienced an even more tragic decline from a functioning multi-ethnic state until 1991 – into the war, economic collapse, and deprivation in 1990s.

In keeping with modern global FDI patterns, Central and Eastern Europe plays host to investors from a plurality of locations. Most inward investors are likely to be located in close geographic proximity to transition countries in which they invest in order to reduce transaction and transport costs. This applies especially to those EU member states adjacent to or very close to transition economies such as Austria, Germany, Italy, Sweden, Finland, and those with historical cultural, linguistic or economic ties with them (i.e. France). This pattern also reveals the dominance of the EU as a source region of FDI, and particularly that of Germany, the largest economy within the EU. Germany, as a dominant source of capital and

a large market, is vital to many areas in Central and Eastern Europe where FDI has localised. The high proportions of German and Austrian inward investments concentrated in the neighbouring Central European countries, of Scandinavian and Finnish FDI in the Baltic states, or Greek FDI in FYRo Macedonia, and Italian FDI in neighbouring Slovenia and relatively nearby FYRo Macedonia and Romania are cases in point, signifying the importance of economic links and co-operation between neighbouring EU and Central and Eastern European countries, i.e. 'cross-border regionalisation'. By contrast, the Netherlands, a very small economy highly 'accessible' to Central and Eastern Europe (but not so close geographically) has become an important source of FDI in Europe, most prominent in a continuous geographic area in Central and South-East Europe: Czech Republic, Hungary, Poland, and Romania.

The true importance of the USA may be masked by the fact that some US investments have actually been conducted through European subsidiaries. Even so, it can be argued that US investment has been somewhat restrained by the barriers to transaction costs and geographic distance from the Central and Eastern Europe. Those barriers certainly explain the relative under representation of the UK as a source country. On the other hand there is one major absentee – Japan, which still has very limited investments in Central and Eastern Europe. The key exception is South Korean FDI in Poland and Romania where Daewoo developed in 1990s the cores of its Central and Eastern European automotive production system.

All these factors are mirrored in the pace of inter and intra-urban transformation. It is no coincidence that the 'world cities in-making' in the region (Berlin, Budapest, Prague, Warsaw) are all located in Central Europe, and that their development owes much to their capacities to attract FDI. Further south, foreign aid, not FDI and urban 'reconstruction' rather than 'restructuring' are more common. There, the effects of 'globalization' in 1990s were more readily associated with armed conflict, international peacekeeping forces, mass refugee movements and destroyed urban centres.

There are also tendencies towards a division of labour between localised producer services in the capital cities, and greater emphasis on manufacturing or consumer services elsewhere, with preferred location in the west and north of particular country, which enjoy better connectivity with markets and corporate headquarters in EU countries. Property investments and different (re)development projects have had the most direct effect on the intra-city transformation in Central and Eastern Europe. FDI, as an expression of 'globalisation' on transformation of urban land use patterns and built environment of post-socialist cities is most visible in residential, commercial, industrial and leisure property development in city centres, inner-city residential neighbourhoods, brownfield industrial sites and, in the suburban fringes on greenfield sites.

The evidence provided in this chapter supports the uneven spatial patterns of 'globalization' in Central and Eastern Europe. First, it reveals the significant

concentration of inward investments in Central Europe, vis-à-vis South-East Europe, the Baltic states or East Europe. Secondly, confirms the importance of the FDI flow from EU member states to nearby transition countries, and the process of (selective) economic integration of European market(s). Thirdly, highlights the importance of location of FDI in capital cities and larger regional centres, as opposite to other less favoured locations in more remote areas in transition countries. The challenges of global competitiveness are still to be met by post-socialist cities, especially in terms of attracting international property investments, and directing urban development activities in a more strategic and organised manner, to preserve city identity and improve quality of life for local residents.

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УТИЦАЈ ДИРЕКТНИХ СТРАНИХ ИНВЕСТИЦИЈА НА ТРАНСФОРМАЦИЈУ ГРАДА У ЦЕНТРАЛНОЈ И ИСТОЧНОЈ ЕВРОПИ

Утицај ”глобализације” на трансформацију и развој града у Централној и Источној Европи кроз директне стране инвестиције је различит, посебно између два удаљена региона: севера и запада, с једне стране, и југоистока, с друге. Економске силе и тржишне могућности имају најјачу улогу на северу и западу, а геополитика у југоисточном делу Европе.

Становништво у Централној Европи је привржeније прихватило промену и компетентније је управљало транзицијом, због чега је награђено чланством у НАТО и ОЕЦД, а затим и у ЕУ током 2004. године. Овај простор прима велики обим спољних инвестиција. Евидентан је знатан пораст у директним страним инвестицијама у Републици Чешкој, Мађарској, Пољској и Словачкој после одржавања Европског савета у Есену (1994), који је покренуо преприступну стратегију, и Амстердамског уговора (1997), који је реафирмисао привржeност ЕУ ширењу ка истоку. Агенда 2000 је идентификовала ”два таласа” приступања ЕУ и довела до значајног пораста директних страних инвестиција у земље ”првог таласа” (Републику Чешку, Естонију, Мађарску, Пољску и Словенију), док су земље које су тада припадале ”другом таласу” (Бугарска, Летонија, Литванија, Румунија и Словачка) имале мали пораст директних страних инвестиција. Оне земље које су биле сасвим искључене из проширења ЕУ, као Хрватска, Босна и Херцеговина, Србија и Црна Гора, Македонија и Албанија (такође познате као ”западни Балкан”), или земље Источне Европе (Белорусија, Украјина и Молдавија) генерално нису доживеле запаженије промене. Прилике у Југоисточној Европи су ризичније. Без радикалних промена у политичким и економским структурама углавном задржаним из претходног времена, са новом политичком и економском елитом која има многобројне ”старе играче” жељне да сачувају своје привилегије и антидемократски начин живота. Простори бивше Југославије доживели су још трагичније распад функционисања мултиетничке државе (рат, економски колапс и сиромаштво) током 90-их година XX века.

Чињенице презентоване у овом раду илуструју просторну неуједначеност феномена ”глобализације” у државама Централне и Источне Европе, и то: 1) зна-

чајну концентрацију страних инвестиција у Централној насупрот Југоисточној Европи, државама Балтика и Источној Европи, 2) потврђују обим и значај директних страних инвестиција из земаља чланица Европске уније ка суседним државама у транзицији и процес (селективне) економске интеграције европског(их) тржишта и 3) објашњавају значај локације директних страних инвестиција у главним градовима и већим регионалним центрима у односу наостале мање привлачне локације у удаљенијим просторима земаља у транзицији.

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