

DESCRIPTION FOR THE GENERAL PUBLIC (IN ENGLISH)

Description for the general public – the reasons for conducting the research

The economic transformation allowed the Central and Eastern European (CEE) countries to integrate with the global economy in terms of trade and finance. As a result, the CEE region has seen a massive inflow of foreign capital over the last two decades, especially in the form of foreign direct investment (FDI). In economic theory dominates the view that FDI inflows have a positive influence on host country economy, resulting from an assumption that this form of investment leads, on the one hand, to an increase in stock of the existing physical capital and, on the other hand, it boosts the total factor productivity in domestic economy.

However, it should be underlined that the magnitude of FDI's impact on host economy depends on many factors (external and internal) which determines the investment attractiveness of a given country. The most important country-specific characteristics (so-called *pull factors*) are: macroeconomic stability, the quality of institutions, trade and financial openness, the level of technological advancement, the stock of human capital and the level of financial system development. On the other hand, the external determinants of capital inflows (so-called *push factors*) include mainly the economic performance of an investor's country, the risk level on the financial markets and global liquidity. Many studies have tried to examine empirically the macroeconomic consequences of the inflow of foreign direct investment on the recipient country's GDP growth (Borensztein et al., 1998, Alfaro et al., 2004, 2010, Carkovic and Levine, 2005, Bloningen and Wang, 2005). Unfortunately, the results are uncertain and for the time being the expected positive impact of FDI could not be found in the data. For example, Borensztein et al. (1998) find that the impact of FDI on the host country's growth is significant only when the recipient economy possesses high levels of human capital. Moreover, Alfaro et al. (2004) admits that the role of FDI in contributing to economic growth tends to be ambiguous and depends heavily on the financial sector development. In turn, Blomstrom, Lipsey and Zejan (1996) conclude that FDI has a stronger positive impact on growth in high-income economies. What is more, Doucouliagos et al. (2010) show in their meta-study that only 43% of the regressions report a significantly positive coefficient, while 17% are significantly negative and 40% insignificant.

The inconclusive results of the growth-effects of FDI may be also related to the fact that the majority of studies usually rely on aggregate data on capital flows and do not take into account different modes of entry of foreign firms into the host country. In this project we will separate FDI into three major components: greenfield, reinvestment and cross-border mergers and acquisitions (M&A). Greenfield FDI involves building new facilities (manufacturing, services, etc.) under the control of non-resident. Reinvestment means extending the existing facilities (manufacturing, services, etc.) in the host country by, for example, launching a new production line. Cross-border merger and acquisition (M&A) takes place when foreign investor acquires the existing facilities in the host country. There are no reasons to believe that these three forms of FDI have the same effects on growth and investment in terms of the sign and the magnitude. To our best knowledge there are only few empirical studies in the literature that analyse the growth effects of FDI taking into account different modes of entry of foreign investor into the host country (e.g. Calderon et al., 2004; Wang and Wong, 2009; Harms and Méon, 2011) and none of them can resolve the problem of ambiguous net impact.

Current research project refers to the ongoing debate on growth effects of FDI in emerging market economies. It is widely believed that FDI is the most desirable type of foreign investment as it adds to the existing stock of physical capital and boosts the total factor productivity. Therefore the main question is whether FDI enhances the economic potential of the host country and if the answer is positive then how should the economic policy be designed in order to attract foreign investment with high value added. Firstly, the proposed project will focus on Central and Eastern European countries which received the biggest amount of foreign capital in the form of FDI in the last two decades. It is assumed that this group of countries has benefited the most from FDI inflows from the whole emerging market economies. It might be also interesting to draw conclusions particularly for the policymakers in Poland where the new economic policy conducted by the government aims at selecting the FDI projects with respect to the sector and technology advancement. Secondly, the proposed project will extend the existing empirical literature on FDI and growth nexus. By separating FDI into three different modes of entry, we examine how they affect the host country's economic growth. Additionally, we will focus on establishing the stylized facts in terms of time precedence between separated modes of FDI, domestic investment and growth in CEE region.