Source: Authors' calculations

Note: Robust standard errors in parentheses. Asterisks indicate variables whose coefficients are significant at the 10% (*), 5%(**), and 1% (***) level, respectively. All regressions include constant and country dummies (not reported in the table).

[a] There is no precise counterpart to R^2 in the generalized regression model. The R^2 from the transformed model is purely descriptive (see Greene 1999).

Turning first to the results for the control variables, we noted that the variables displayed the correct sign. FDI is positively related to GDP p/c and was always statistically significant except in model 5. Therefore, larger markets, which recorded faster economic growth, offered better opportunities for service industries to make use of their ownership advantages, which in turn led to a greater FDI inflow into this sector. Surprisingly, wages were insignificant although they had the expected sign in all the models. A possible explanation could be the use of average wages in the analysis, rather than the wages in the industry, since such data were not available for all the observed countries. Moreover, one of the possible explanations was that cheap but relatively skilled labour, although a favorable factor for investment, characterized most of the transition economies that competed with each other for foreign investment. Therefore it could not be a specific advantage of any of these economies individually, and could not help attract foreign investors. Inflation manifests statistical significance at the level of 1-5% and has the negative algebraic sign, as initially presumed. Macroeconomic instability, traditionally determined on the basis of the persistent rise of price levels, increases the commercial risk of investment. High inflation weakens the foreign investors' confidence in capability and readiness of the recipient country government to maintain a consistent monetary policy, stable prices and currency should their economies be exposed to turbulence of a greater scope. The fear of shock therapy which could cause losses inevitably affects the decision on possible investment in service industries. Openness was always a highly significant variable that exerted a positive influence on the FDI in the service sector of CEE countries.

The analysis of significance and impact of the institution-related variables on the FDI stock in service sector covered a series of progress indicators in the process of transition, developed on the basis of EBRD methodology. All of the five analyzed indicators in the model showed a considerable statistical significance (1%, and 5%) and, as expected, positively influenced FDI, thus empirically confirming the main initial hypothesis that establishing and strengthening institutions of market economy leads to the increase of FDI inflow into the service sector of the CEE countries.[4]

CONCLUDING REMARKS

The purpose of this paper was to assess correlation between factors influencing FDI level, based on the referenced literature, but in the area of services. Since there are significant differences between goods and services there is a need to find possible differences between the factors influencing FDI inflow in the service area. The main goal of the research was to find the factors which countries

[4] Given that the eight countries of Central and Eastern Europe are highly convergent in terms of their level of economic performance as well as in terms of achieved structural reforms, some of the analyzed institution-related variables BR and SM did not manifest sufficient variability (within standard deviations<0,05). The coefficients on variables with small within standard deviations may not be as well identified as the others. Given coefficients and standard errors for mentioned variables are high and that is the consequence of the problem that was observed.

could use as the basis for development of policies and strategies to promote and attract FDI in services.

We have found significant positive relation and influence of GDP and market openness on the level of FDI inflow in the service sector, which was the relation confirmed in econometric analyses of the total FDI inflow, as well as FDI inflow in the manufacturing sector. Significant negative correlation between inflation rate and FDI inflow has been found; this was also expected, since it implied inadequate macroeconomic environment as one of critical variables likely to affect the location of FDI. However, we found atypical relations - compared to FDI inflow in the manufacturing sector - between the level of average wages and FDI inflow: the average level of wages had a negative, though not significant influence on the decision about a possible sector for investment. A probable explanation for this type of connection could be found in theories and motives for investment in the service sector. Motives for this type of investment do not include cheap labor, since service companies trying to transnationalise look for professional and skilled employees, and they are by no means motivated with the level of wages.

In the research we have found significant positive relation between tested variables: competition policy, banking reform and interest rate liberalisation, securities markets & non-bank financial institutions. It means that Hypothesis 1 and Hypothesis 2 have been confirmed completely, while Hypothesis 3 was partially confirmed. Practically, we rejected a part of Hypothesis 3 pertaining to the level of average salaries as a motive for investment in the service sector.

These conclusions indicate that CEE countries that want to promote and attract FDI in services should follow results and correlation between the factors tested in the research, but at the same time, insist on improvement of the lower-ranked areas:

- Looking at the price liberalization and competition policy, there is a pattern of the activities CEE countries are involved in. They are ranked fairly high in the price liberalization area, which means that they have created relatively open markets for domestic and international supply, in line with the neo-liberal arguments for creating a relatively or completely free market without government influence. At the same time, all countries are ranked below average in the competition policy, which in turn implies that there is a negative perception about their ability to compete on the CEE countries' markets. A possible reason for these results is the fact that some of the CEE countries try to protect the domestic service area. A specific example of this pattern may be Slovenia, the country insisting on controlling the level of FDI inflows into the banking and financial sector. There are several other countries trying to keep at least a part of the service sector (public services, or financial services) domestically owned. Until all of them accept the request for privatization and deregulation of all these sectors, both levels and ranks will remain low. If CEE countries want to attract a high level of FDI inflow in services, they have to accept strong deregulation of the service sector. It is a kind of global interventionism aiming to globalize and transnationalise these services.
- Further implementation of banking reforms and liberalization of financial services market is important for all countries in the region, except for Czech Republic, Estonia and Hungary. They are marked with 4 in 2005 and 2006 and very close to achieve standards and performance norms of advanced industrial economies: full convergence of banking laws and regulation with BIS standards; provision of a full set of competitive banking services.
- Development of securities markets & non-bank financial institutions. This is owing to the fact that in most of the researched countries, financial sector consists mainly of banking institutions, which implies that they have to further develop other dimensions and subjects in this area, as

well as to create securities markets. The recommendation practically applies to all the countries in the region, except Hungary, which was marked with 4 in the last year of the assessment.

- Looking at the overall infrastructure reforms, the ranking of average reform indicators in the electricity sector, researched countries have got the lowest indicators compared to the average of assessed areas. Based on them one could conclude that there is a need to continue the reforms.

- Looking at the telecommunication sector, excluded from the infrastructure reforms, the situation is much better. Most of the countries were marked 4 or 4+ since they have implemented complete commercialization, including the privatization of a dominant operator; comprehensive regulatory and institutional reforms, extensive liberalization of entry or effective regulation through an independent entity, coherent regulatory and institutional framework to deal with tariffs, interconnection rules, licensing, concession fees and spectrum allocation, and consumer ombudsmen function.

- Strengthen further legislative frameworks to ensure consistency with international standards and conventions. Ensure that policies in the CEE countries are in line with the OECD Guidelines for Managing Conflict of Interest in the Public Sector, and that appropriate resources are allocated for implementation. Strengthen public procurement institutions through regular training of public officials and monitoring of procurement cases. Implement and regularly monitor anticorruption policy, focusing on the evaluation of the effectiveness of policies in place and on the use of risk assessment techniques to identify future priorities. Institutionalize regular, sustainable consultation mechanisms, with representatives of businesses for policy development, implementation and monitoring in all countries.

These results, which are confirmed by econometric studies and surveys on firms' investment intentions, are useful pointers to governments wishing to attract such investment. They also suggest that these same governments need to pay constant attention to upgrading and reconfiguring their own unique, location-bound advantages (both actual and potential) and to focus on attracting the kind of FDI that might help them best accomplish this objective.

REFERENCES

Banga Rashmi, Trade and Foreign Direct Investment in Services: A Review, Working Paper No. 154, *Indian Councile for Research on International Economic Relations*, February 2005, pp 22

Baum C.F. (2006). An *Introduction to Modern Econometrics Using Stata*, A Stata Press Publication, StataCorp LP, College Station, Texas

Beck, N & Katz J.N. (1995). What to Do (and Not toDo) with Time-Series-Cross-Section Data, *American Political Science Review* 89(3): 634–47.

Bevan et. al. (2004). Foreign investment location and institutional development in transition economies, *International Business Review* 13 (2004) 43–64

Bevan, A. & Estrin, S. (2000). The determinants of foreign direct investment in transition economies, CEPR *Discussion Paper No. 2638*. London: Centre for Economic Policy Research

Bhagwati, Jagdish (1996) International Trade in Services and Its Relevance fr Economic Development, in Bhagwati-Jagdish, *Political economy and international economics*. Edited by Douglas A. Irwin. Cambridge and London: MIT Press, 1996; 235-69, previously published. 1987

Bhagwati Jagdish (1991) Trade in Services and the Multilateral Trade Negotiations", Bhagwati Jagdish, *Political economy and international economics*. Edited by Douglas A. Irwin. Cambridge and London: MIT Press, 1996; 282-306, previously published. 1987

Blattner, T. (2002). Foreign Direct Investment in Transition, paper presented at the seminar on '*Europaische Kapitalmarkte im Wandel: Theorie und Empirie*', Free University Berlin, Department of Economics, Institute for Economic Policy and Economic History

Bhagwati Jagdish (1989), Is Free Trade Passe after Al?" *Weltwirtschaftliches-Archiv*; 125(1): 17-44

Buch, C.M. (2000), "Why do Banks Go Abroad? Evidence from German Data", *Financial Markets, Institutions and Instruments.*

Buckley, P.J. and Casson, M.C. (1976), "*The Future of the Multinational Enterprise*", Homes & Meier: London

Buigues, P. and Jacquemin, A. (1994). Foreign Direct Investment and Exports to the European Community, in M. Mason and D. Encarnation (eds.) Does Ownership Matter: *Japanese Multinationals in Europe*, Oxford and New York: Oxford University Press

Chanda Rupa (1997), Trade Liberalization and Foreign Direc Investment in Producer Services: A Theoretical and Empirical Study", *Working Paper, IIM Bangalore,* September 1997

Chanda Rupa (2000), "Impact of Trade Liberalization of Foreign Direct Investment in Producer Services", *working paper 103, IIM, Bangalore, September*.

Delali, A. (2003). The Determinants and Impacts of Foreign Direct Investment, *MPRA Paper No. 3084*, http://mpra.ub.uni-muenchen.de/3084/, (30/01/09)

Dunning, J. H. (1981), "Explaining the International Direct Investment Position of Countries: Towards a Dynamic or Developmental Approach", *Weltwirstchaftliches-Archiv. 117(1): 30-64*

Dunning, J.H. (1988). The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions, *Journal of International Business Studies*, vol.19, pp.1-31

Dunning, J.H.,, (1989), “Trade and Foreign-Owned Production in Services: Some Conceptual and Theoretical Issues”, Giersch-Herbert, ed. *Services in world economic growth*: Symposium 1988. Tubingen, West Germany: Mohr (Siebeck); Boulder, Colo. and London: Westview Press; 108-50.

Dunning, J.H. (2005). Towards a New Paradigm of Development; Implications for the Determinants of *International Business Activity, Mimeo*, Universities of Reading and Rutgers.

Dunning, J.H. & Buckley. P.J. (1977). International Production and Alternative Models of Trade, *Manchester School of Economic and Social Studies*, vol.45, pp.393-403

Fukao Kyojy and Keiko Ito (2000), Foreign Direct Invesment and Service Trade: The Case of Japan, *Hitotsubashi University, mimeo.*

Gray, J.M and Gray, H. (1981) The multinational bank: A financial multinational corporation?”, *Journal of Banking and Finance* 5(1), 33-63

Gronroos, Ch. (2007), “Service Management and Marketing” 3rd ed., John Wiley & Sons, Ltd

Helpman, E. (1984), “A Simple Theory of International Trade with Multinational Corporations”, *Journal of Political Economy*, June 92(3), 451-71.

Hill P. (1997), “On Goods and Services”, *The Review of Income and Wealth*, Vol. 23. No. 4.

Holland, D. & Pain, N. (1998). The diffusion of innovations in Central and Eastern Europe: A study of the determinants and impact of foreign direct investment, NIESR Discussion Paper No. 137, *London: National Institute of Social and Economic Research.*

Hymer, S. (1976), International operations of national firms: A study of direct investment. *Cambridge, Mass: MIT Press.*

Kinoshita,Y. & Campos N. (2003). Why Does FDI Go Where it Goes? New Evidence from the Transition Economies, *Williamson Institute working paper*, 573.

Lankes, H. P. & Venables, A. J. (1996). FDI in economic transition: the changing pattern of investments. *Economics of Transition*, 4(2), 331-347.

Lansbury, M., Pain, N., & Smidkova, K. (1996). Foreign direct investment in Central Europe since 1990: An econometric study. *National Institute Economic Review*, 156, 104–124.

Markusen,, J.R. et al (1996), “A Unified Treatment of Horizontal Direct Investment, Vertical Direct Investment and the Pattern of Trade in Goods and Services”, *National Bureau of Economic Research, In. NBER Working Papers: 5696*

Miller, S.R. and Parkhe, A. (1998), “Patterns in the expansion of U.S. banks’ foreign operations”, *Journal of international business studies*, 29, 2, 359-390

Moshirian, F. (1997), “Foreign direct investment in insurance services in the United States”, *Journal of multinational financial management*, 7, 159-173

Mudambi, R., Navarra, P. (2002): Institutions and International Business: a theoretical overview, International Business Review.646-635 :(6)11 ,

Neuhaus, M. (2005). The Impact of FDI on Economic Growth, An Analysis for the Transition Countries of Central and Eastern Europe ,'Physica-Verlag, A Springer Company

Podesta, F. (2000). Recent developments in quantitative comparative methodology: the case of pooled time series cross-section analysis, *DSS PAPERS SOC 3-02*

Pournarakis, M. & Varsakelis, N. (2004). Institutions, internationalization and FDI: the case of economies in transition, *Transnational Corporations*, vol. 13 (2), August 2004, pp. 77-94.

Quere, A. B. et al. (2005). Institutional Determinants of Foreign Direct Investment, CEPII, *Working Paper No 2005-05.*

Raff, H. and M. von der Ruhr (2001), Foreign Direct Investment in Producer Services: Theory and Empirical Evidence", *Mimeo, University of Kiel.*

Resmini, L. (2000). The determinants of foreign direct investment in the CEECs: New evidence from sectoral patterns, *Economics of Transition*, 8(3), 665-689.

Schroath, F.W. Korth, Ch.M. (1989) Managerial Barriers to the Internationalization of U.S. Prop-er5ty and Liability Insurers: Theory and Perspectives" *Journal of Risk and Insurance*, December 56 (4): 630-48

Sauvant, K.P. (1990), "The Tradability of Services", Messerlin-Patric-A.; Sauvant, K.P. eds. The Uruguay Round: *Services in the world economy. With contributions by Bela Balassa et al Washing-ton, D.C.: World Bank; New York: United Nations Centre on Transnational Corporations*, 114-22.

Vernon, R. (1966), "International investment and international trade in the product cycle", *Quarterly Journal of Economics, May, 80 (2), p. 190-207.*

World Bank. (1996). World development report. Washington, DC: Oxford University Press.

Yamori, N. (1998), "A note on the location choice of multinational banks: The case of Japanese fi-nancial institutions", *Journal of banking and finance, 22, 109-120*