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Nina Bandelj: From Communists to Foreign Capitalists

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Chapter 1

SOCIAL FOUNDATIONS OF THE ECONOMY

IN 1985, THE ECONOMIC order of the day in socialist Central and Eastern Europe¹ was full employment and absence of private property, domestic or foreign. Only fifteen years later, in 2000, the economic systems were based on private ownership and market competitiveness. Numerous postsocialist firms were in the hands of foreign investors, absorbing some of the \$1.4 trillion of that year's world foreign direct investment, which itself has increased more than twentyfold since 1985. In only fifteen years, how did we get from there to here?

This book is about the confluence of two grand processes of economic transformation that define our times: the transformation from command economies of state socialism to liberal market capitalism, and the intensification of transnational flows of capital as the defining characteristic of contemporary economic globalization. The book addresses two broad concerns. On the one hand, how have the economies in Central and Eastern Europe changed over the first decade after the fall of the Berlin Wall? How has market-based activity proliferated, and how do these newly established markets operate? On the other hand, what patterns global economic exchange? What influences whether a nation is more or less integrated into global capital flows, or whether a firm is controlled by foreign or domestic owners? Examining the determinants of foreign direct investment in Central and Eastern Europe is a strategic research site that allows me to simultaneously engage both sets of issues.

Foreign direct investment (FDI) is investment made by a company in the investor country in a foreign, host country. FDI refers to business transactions and does not include contributions from foreign governments, such as foreign aid. The objective of FDI is to obtain a lasting interest and an active role in a host company. The lasting interest implies the existence of a long-term relationship between the investor and the host and a significant degree of influence by an investor on the management of a company in a host country. Hence, FDI is usually classified as investment leading to ownership of 10 percent or more of the host firm, as opposed to portfolio investment, which refers to purchase of smaller equity shares.² FDI can take the form of foreign acquisition, in which the investor obtains partial or full ownership in an existing company. On the other hand, foreign investors can establish new companies in the host country, referred

