

Foreign investments as the main determinant growth factor for the Asian countries and regions

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Abstract

The paper considers the main drivers of Asian growth and connects them with three groups of analyses tracks. The FDIs, as the elective factor incorporating the main trends and perspectives, both at economic and financial level as well in the social and political framework. Second, the regional approach, resulting more and more as the key, crucial factor in developing openness and international competitiveness, at the appropriate scale of convergence and integration in the world wide system, has been presented in its EU connections and in the Asian peculiarities. For both the two groups, the classic literature of Alberto Alesina, Robert Barro, Dani Rodrik, Olivier Jean Blanchard and Danny Quah has been called as reference. Finally, as third are of analyses, the new theories of Growth and the capabilities already achieved to measure phenomena that were still not affordable only twenty years ago. Paul Romer, its influential inspirer, is quoted as an obliged point of reference. The final results of FORMEL G and the connected, applied elaborations by the Deutsche Bank Research has almost figured out the proximity to an alternative theoretical scientific and modelling “corpus” for the existing Growth analyses, specifically considering the Asian and emerging countries recent jump into a high rates trend development, with the focus on China and India. In all these three analyses, the relevance for Asia to consider the experiences and successful steps of the European “efficient laboratory”, in a real integration towards the union of economies, societies, currencies and security policies, has been investigated from different point of view.

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The real factors dominating the present world-wide transition stage of economic, financial, political, strategic, institutional and cultural perspectives are mainly related to the high degree of integration of the industrial and services sectors, on the one hand, and to the conditionality of the financial sector, which has always been based on a global dimension, on the other. "Re-thinking European Integration and East Asia Cooperation" - as discussed in the workshop promoted in Beijing by ASEF- Asia-Europe Foundation, based in Singapore, the China Foreign Affairs University and China National Association for International Studies at the end of 2006 – had been an appropriate framework in which to make clear how integration and correlated public/private choices, for many different and even opposite reasons, results as the “core” of governing the Asia Europe relations in the complexity of our age.

While Europe has acquired considerable knowledge of the “optimal” regions and the monetary union has been successfully built up, the integration process has been extraordinarily implemented through an operative, regional approach. Even if the Union is still lacking in some crucial institutional prerogatives, transnational economic, monetary and political integration has finally been established, resulting *de facto* not in the continuity of the “nation state” architecture, as shaped by the founders in the Rome Treaty, but in a different still-evolving institutional design.

In many other parts of the world, the same approach has almost unanimously met with widespread political support and favour in the public opinion. The results are still at a preliminary stage, but are enough to encourage the more determined countries and the international community, first of all in Asia, the EU’s neighbouring Mediterranean countries, and in Latin America. Unfavourable geopolitical situations must be considered as one of the major obstacles to a strategy perceived as the virtuous itinerary toward an alternative international order, so much pursued by the main emerging and transition countries, where the case of Asia represents the most amazing growth and change.

A wide fan of different regional initiatives, cooperation agreements, free trade zones, security networks, monetary convergences, even currency unions is on the way to be operatively finalized between Asian and Middle East countries. While currency unit is an issue for Eastern Asian regions, the monetary union will be effective starting 2008 for the small countries in the Persian Gulf.

But a credible comparative analysis must take into account all the variables in play, rather than imagining that the European Union model can be in some way “exported” as a kind of “ready to be applied” architecture, as for instrumental goods, investments or technologic innovation. Even so, we have to admit that Europe is the most successful integration story written in many centuries and represents a natural point of reference and qualification for similar initiatives and processes, where the conditions are promising, as Asia seems to be at this stage.

One conclusion might be commonly shared: a certain degree of regional approach is indispensable for the global governance, where the “different speeds” of convergence must take into account specificities and backgrounds of the starting conditions. No simplification or optimistic enthusiasm helps to overcome these conditionalities. The main route is a pragmatic approach, accompanied by well-founded proposals, confidence measures, reciprocal acceptance, pluralistic cultural and religious values, security agreements, policy reforms, openness, transparency, human capital accumulation, citizenship, just to mention the most relevant factors of growth incorporated in the regional approach, both in theory and in practice.

As there are favourable conditions for Asian countries – from the former NICs to the new great emerging global players, such as China, India and the already “emerged” Japan – to make some

other steps forward in this direction, an effective partnership with Europe becomes indispensable both on the economic, financial side and in political, cultural and international relations. Many indicators show a positive outlook and some relevant, concrete achievements. Regional approach, on the one hand, and multilateralism on the other, are increasingly seen as the only alternatives to the clash of civilizations.

Fatally, even if no country really wishes it, we look as though we are moving towards a catastrophic danger, following a “Magic Flute” syndrome. If policy vision and far-sighted international behaviours do not prevail, the risk of “shocks” is around the corner. The past does not help with its heritage of conflict and atrocities. For this reason we have to look forward, remembering history without unearthing the phantoms of confrontations, tensions, lack of confidence at continental and global level.

In this sense Europe and what has been achieved through the integration process in the last half century could represent a real positive, stabilizing factor. There are so many options offered by the extremely dynamic economic, financial and innovative present trends that the time seems appropriate to work up a tentative, concrete agenda for the near future. New theories of growth are trying to give a methodological background to such a change in international relations. We are very close to a methodology turning point that is providing appropriate tools for international governance in a regional environment.

Complexity, economics and FDIs

The most intriguing aspects of the foreign direct investments – where the acronym FDI tries to simplify the interrelations and the real privileged role in the capital formation, innovation, institutional and market reforms intimately connected with these flows – refer not only to the quality and quantity of economics, finance, international trade, rate of exchange issues, but also to the political, strategic and social implications. In one word, FDIs are the most relevant factor incorporating the main systemic variables and structural factors. I disagree with the minimalist views regarding foreign investments, explaining the phenomenon as an obvious consequence of the mobility of factors, where the country best endowed with a particular factor – be it labour or capital or technologies – is attracting foreign investors to a wide range of industrial or services sectoral fields. The distance between these technical assumptions and the entrepreneurial decision making processes, confidence and the public institutions strategies of governance is so relevant to oblige all the players to face the conditionality and implications of a growth base on an open system and free movements of the factors.

Europe itself has experimented this complexity and conditionality in different periods. Even today we observe that capital flows to the different countries of the Union are far from following a generic uniform strategy. There are many regions of the Union where it is attractive to locate FDIs while in many others it is much less so. This explains the success of Germany, France, Sweden, Finland hosting inflows of international capital on the one hand and, on the other, the growing competitiveness of Italy, Spain, Austria, The Netherlands investing abroad. Mainly in Europe after the *big bang* of 1989 but now year after year increasingly in the emerging regions of the world, with a priority to Asia and China. Again the regional approach matters. Europe’s architecture has been created on the basis of this concept and therefore it belongs to the assumption of the successful development of the Union. But also Asia is now looking with less scepticism to the same approach; a premise that could influence and speed up a real new international governance.

The regional approach in Europe, in Asia and world wide

In fact, the implications of the regional approach on the global economy – where global does not mean “unique” but recalls the pluralistic concept of “openness” and the worries of a kind of

universal homologation of the five continents belongs exclusively to a rudimental, radical, fundamentalist vision of the integration processes – are of great magnitude and are changing the substance of the implied problems, even with the continued existence of many conflicts. On the other hand, the clerics of the “mythological globalisation paradise” should be more aware of the differences in cultural roots, political and social systems, religious heritages: they have differentiated and, fortunately, will continue to differentiate the world community. The market economy has dominated the world system of production and distribution of goods and income not because it is perfect, but because it offers the best available aggregate system of checks and balances to promote the growth of nations together with their policy advancement, democratic transition, the interpretation of different cultures and values that enrich our humanity. We do not have models to impose, only examples to show.

Every year, the leaders of ASEM, APEC or SCO partners meet wearing their country’s traditional costumes or wearing their usual business suits. In Helsinki the ASEM summit concluded at the beginning of September. APEC recently celebrated its Annual meeting in Hanoi. Old and familiar faces dominate these meetings, but at the same time new personalities appear. Each year the venue for these conferences changes, new issues are discussed, urgent policies are agreed. But one issue remains in the shadow, year after year: the more courageous fostering and advancement of Regional Cooperation in Asia, a continent rapidly becoming a major player in the global economy. It now accounts for about a third of the world’s GDP, about a quarter of world trade, and more than half of the world’s international Central Bank reserves. Over the past decade, there has been an increase in trade flows among Asian economies and a growing interdependence between them. The world’s decision-makers now realize how economy and finance are highly mutually supporting, and new policies are needed to advance wide-scale cooperation initiatives.

What explains this growing awareness for economic partnership in the region? What are the complexities that challenge this undertaking? And while these countries aim to promote and strengthen partnerships, what should be done to seize these opportunities? From different perspectives, we are discussing the factors behind this increased sense of economic and political collaboration in the region: identifying the projects that correspond to this endeavour, and recommending possible drivers and proposals. If a European comparison might be introduced, at this point, we could say that Asia incorporates some “optimal world regions” in the main crucial aspects of their states’ sovereignty, such as monetary policy, international trade, exchange rate, innovation, higher education, logistics and security.

To underline the importance of the regional approach, I would like to quote a few lines from by Florence Jaumotte’s paper (1) “Foreign Direct Investment and Regional Trade Agreements: The Market Size Effect Revisited”, published in 2004 in the Working Papers series of the International Monetary Fund. *“We tried to analyse whether the market size of a regional trade agreement (RTA) is a determinant of foreign direct investment (FDI) received by countries participating in the RTA. This hypothesis is tested on a sample of 71 developing countries during the period 1980–99. Evidence is found that the RTA market size had a positive impact on the FDI received by member countries, even more so in the 1990s when such agreements were revived and became more widespread. The size of domestic population also seemed to matter, possibly because of its effect on the availability of the labor supply. It appears, however, that not all countries in the RTA benefited to the same extent from the RTA: countries with a relatively more educated labor force and/or a relatively more stable financial situation tended to attract a larger share of FDI at the expense of their RTA partners. This evidence suggests it is essential for all RTA countries to improve their business environment to the best available in the region. Finally, a partial negative correlation between the FDI received by RTA countries and that received by non-RTA countries possibly reflects a diversion of FDI from non-RTA to RTA countries”.*

But even before the correlation between growth and regional dimension had been deeply analysed by the same Alberto Alesina and Dani Rodrik (2), in “Distributive Politics and Economic Growth”, where the Authors study the relationship between politics and economic growth in a simple model of endogenous growth with distributive conflict among agents endowed with varying capital/labor shares. They establish several results regarding the factor ownership of the median individual and the level of taxation, redistribution, and growth. Policies that maximize growth are optimal only for a government that cares solely about pure 'capitalists.' The greater the inequality of wealth and income, the higher the rate of taxation and the lower growth. The Authors present empirical results that show that inequality in land and income ownership is negatively correlated with subsequent economic growth. And even before, Olivier Jean Blanchard and Danny Quah (3) in "The Dynamic Effects of Aggregate Demand and Supply Disturbances" examined the macroeconomic effects of Technology, Employment and the Business Cycle, wondering if the Technology Shocks explain aggregate fluctuations at international and regional level. And in Robert J. Barro and Silvana Tenreyro(4) “Closed and Open Economy Models of Business Cycles with Marked Up and Sticky Prices”

We enter in this way into the real growth process incorporated in the foreign direct investments and their implications.

Looking for new theories of growth

New theories of growth are already knocking on the door and will soon come into play. Keynes has been surpassed, Milton Friedman has been rather quickly forgotten, the neo-classical Solow and his school is now undergoing a metamorphosis towards new growth theories, in which the traditional, well-known equation of the equilibrium in internal and external markets and the function of production used in the university text books will be deeply revised and modified.

We need some formal but simplified equations to show the results. The fact is that we are assisting, also in the research field, at the innovation effect of new quantitative tools and statistical improved methodologies. Also the set of data are more reliable for the majority of the countries world wide and in any case for the more relevant ones. Political and Social factors, through appropriate indexing and proxies, could approach the effective, real relevance of each single variable. Public and private choices, in this stage, are more and more supported by methodological and decision making instruments of analyses.

Let us start from the production function in the Solow model:

Production function in the Solow model:

$$Y_t = K_t^\alpha \cdot (A_t \cdot L_t)^{1-\alpha}$$

It could easily become

Production function in the Mankiw/Romer/Weil model:

$$Y_t = K_t^\alpha \cdot H_t^\beta \cdot (\bar{A}_t \cdot L_t)^{1-\alpha-\beta}$$

But soon afterwards we could arrive at the most recent new step forward taken by the Research Unit of the Deutsche Bank and its brilliant Chief Economist Norbert Walter, where the equation becomes more close to the complexity but also to the correspondence of the process of growth nowadays:

**Production function
in Formel-G:**

$$Y_t = K_t^\alpha \cdot H_t^\beta \cdot (P_t \cdot \hat{A}_t \cdot L_t)^{1-\alpha-\beta}$$

I need to add some short explanations of the relevance of these six crucial variables for growth, because Europe and Asia, starting from the extraordinary and quite unique model of China, will soon face the conditionality of the many other variables that these six incorporate and transform into the true drivers of future developments, where the FDIs are major players if well managed both by the investors and the hosting countries. I quote the analyses prepared by Stefan Bergheim, in a joint project with Jan Hofmann, Marco Neuhaus and Ingo Rollwagen of the Research Unit of the Deutsche Bank and a recent brain-storming with Gregorio De Felice, Chief Economist of the Italian Banca Intesa, one of the leading European banks.

From wishful thinking to structural models

The lacking aspects of the previous Growth theories were characterized by the absence of consistent quantitative and rigorous models. It is really from this need that the before mentioned researchers of the DB Chief Economist Unit moved their steps with the Foresight Model for Evaluating Long-term Growth-FORMEL-G (5) new conceptual modelling approach. The out come of their analyses, accompanied by a large econometric elaboration, represents a real tool for the applied macroeconomic and policy choices. Let's follow the crucial passage of the model. *Growth forecasts must have a solid theoretical foundation. The basis of most growth analyses is the neoclassical production function in which output Y is a function of labour input L, capital input K and the level of technology A (Solow residual; usually called "total factor productivity"). Growth decompositions divide actual growth into these three components. However, over the long-term, the sole driver of any growth of per capita output is the progress of technology A. It also is crucial for long-term increase in capital stock per capita. Therefore, forecasts of economic growth with the help of simple growth decompositions require more or less arbitrary assumptions on technological progress.*

They do not explain the really interesting variable A, but bury it in an assumption. Therefore, simple growth decompositions are not suitable for forecasting. The often-assumed absolute convergence of income levels between countries (i.e. poor countries' GDP grows faster than that of rich countries) also lacks theoretical and empirical support. There is no automatism: higher income levels do not fall from heaven like manna but require hard work.

The GDP of a country only converges to the country-specific income level that is determined by that country's growth drivers. Therefore, any useful model of the future has to explain technological progress. This is easier said than done, however. Mankiw/Romer/Weil made a path-breaking contribution in 1992 by incorporating human capital H as a measure for the quality of labour input into the empirical growth analysis. Human capital describes a person's ability to produce output efficiently and to develop new products. This important additional variable helped significantly in explaining historic income differences across countries.

For empirical growth analysis, this has been a great step forward, but not yet fully satisfactory. Both the theoretical and empirical work of the last ten years has tried to model the remaining, unexplained share of technological change after human capital is taken into consideration. The objective is to explain economic growth as fully as possible in the model by incorporating a further policy variable P (or several variables).

Exogenous, unexplainable influences are to be minimised. The search for P has given rise to a flourishing literature dealing with the role of politics, institutions, knowledge and innovation. In their overview, Durlauf, Johnson and Temple (2004) identify 42 “growth theories” using a total of 102 variables – which may be combined in different variations. Although theory does not produce a clear conclusion regarding the “correct” growth model (the “correct” P), it helps us identify potential growth drivers. The decision as to which additional variables really have a statistically and economically significant link with growth will have to be based on econometric analysis.

We are assisting to the blossoming of a third generation theory of Growth as Paul Romer (6), its brilliant inspirer, describes in “The Concise Encyclopedia of Economics”: “Economic growth occurs whenever people take resources and rearrange them in ways that are more valuable. A useful metaphor for production in an economy comes from the kitchen. To create valuable final products, we mix inexpensive ingredients together according to a recipe. The cooking one can do is limited by the supply of ingredients, and most cooking in the economy produces undesirable side effects. If economic growth could be achieved only by doing more and more of the same kind of cooking, we would eventually run out of raw materials and suffer from unacceptable levels of pollution and nuisance. Human history teaches us, however, that economic growth springs from better recipes, not just from more cooking. New recipes generally produce fewer unpleasant side effects and generate more economic value per unit of raw material”.

China’s peculiarities and their international relevance

Why is China so relevant in this process? It is leading a special challenge where the different implications of its growth (from FDIs, to technology transfer, from international trade to Central Bank policy or reserves, from exchange rates to internal reforms, from security to multilateral cooperation) are all converging in an architecture that could become equally influential as the European Union has become in the last forty years. The Balassa-Samuelson effect is pending over many countries riskily playing with the rate of exchange policies. Starting from the main work of Bela Balassa (7) “The Purchasing Power Parity Doctrine: A Reappraisal”, a lot of works had been devoted to the developments of the implications of these assumptions, covering a wide area of economic applied theories. Even if the correlation among productivity, Purchasing Power Parity and Real Exchange Rates shows evidence (see in Froot, Kenneth and Kenneth Rogoff (8) “Perspectives on PPP and Long-Run Real Exchange” or Jack Strauss (9) “Productivity Differentials, the Relative Price of Non-Tradables and Real Exchange Rates”).

Many recent analyses had introduced some conditionalities and new approaches. Menzie D. Chinn and Louis D. Johnston (10), in “The Impact of Productivity Differentials on Real Exchange Rates: Beyond the Balassa-Samuelson Framework”, demonstrate how weak is the “effect” on the real exchange rates of the developed countries. “We apply the Stock-Watson (1993) cointegration test to the tradable/nontradable relative price-productivity differential relationship, and the associated real exchange rate-productivity differential relationship, on a currency-by-currency basis, and find some evidence of cointegration for the former, but little for the latter. Using panel data, we detect cointegration for both relationships; however, we find that the productivity-exchange rate coefficient is too large to be rationalized by the Balassa-Samuelson hypothesis. We conjecture that tradable productivity differentials appreciate the relative price of home versus foreign tradable goods, suggesting that models of homogeneous goods and perfect competition in international trade are inappropriate for describing the behavior of developed country currencies. An other contribution related to some European transition countries should be mentioned: “The Balassa-Samuelson effect in Central Europe: a disaggregated analysis”, by Dubravko Mihajek and Marc Klau (11).

The next few years represent the span of time in which we need to measure the success or the decline of very ambitious policies – as the growth in an international integrated environment

implies – following a regional approach. A positive exit will extend the same drivers of pluralistic growth that prepare the ground for Free Trade Areas together with the Asian Currency Unit involving a large group of Asian countries, the first step in “synchronizing” the monetary policies in a very volatile environment and with incumbent monetary tensions. Masahiro Kawai, head of the Asian Development Bank-ADB's office of regional economic integration, confirmed few months ago the Manila-based institution was studying how the basket should be compiled, including how to set the weighting of each currency, and would unveil it early this year. He said the plan was to use a basket of currencies from the ASEAN- Association of Southeast Asian Nations members (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) +3 (China, Japan and South Korea). Such an index is compared by many to the European Currency Unit, which represented a basket of European Union countries prior to monetary union there and evolved into the euro.

Without this “fourth generation” of transnational cooperation tools at a regional level no result achieved will be granted in the long term, because too many obstacles and shocks, crises and deadlocks are incumbent. South East Asia is a crucial region to be involved in the process. Japan is a leading country at the world-wide level both in industrial and technologic competitiveness and financial capabilities. Now China is leading in the ratio of investments on GNP, and India is also performing well. But we still have to wonder about the conditionality and the interdependences to be faced in the next decade. To assume competitiveness as a main point of reference is not an invention of economists or of the academic community or of technocrats in research centres, but a real, driving endogenous variable of the international system.

Monetary implications and rates of exchange

As we are talking of shocks, we must underline that the twin deficits of the US economy, both in the public budget and in the current account, are not promising. We really do hope that a severe policy of reduction of this disequilibrium in the next two-four years might soften the danger of a further devaluation of the dollar versus the main currencies, a situation that might have devastating consequences for the emerging countries' economies, first of all, but also for Europe. The Euro – which after only six years from its introduction as a common currency for the 12 members has become the current international currency for almost 20 other countries in the Eastern, South-Eastern, Mediterranean and West Africa regions – is acting as a shield against imbalances and inflation, assuming a wider role in international financial transactions. But again the span of time to consolidate, enlarge and give stability to the European currency will be measured in the next twenty to thirty years. The long term is the only measure to show a stable and sustainable outlook for financial choices, policies, governance strategies all over the world.

But the private sector and dynamic entrepreneurs have a different span of time to consider: they need to invest, produce, get returns, reinvest and diversify their capital management at the same time, especially when they do this job on a transnational scale, as is the case of FDIs. They need, as mentioned above, special conditions of openness and attractiveness to move increasingly important capital flows, with the support of banks and financial service institutions and agencies, sometimes with grants from governments, but always taking risks. Corporate management would not be such a difficult job in absence of the parallel risk management linking conditionality.

What set of indicators and ranking do the entrepreneurs – both the big TNC, controlling two-thirds of the world's industrial production, and the medium-sized but very dynamic companies – start looking at first when deciding to go ahead with feasibility studies on FDIs? Obviously they consider factor costs, logistics, legislation on foreign investments, the level of legal and illegal environment but then they look also at many other factors which are very often forgotten even by expert practitioners. Openness and confidence are crucial.

But a multiplicity of factors comes into play and are all together determining the final results, after a first season of opportunities that bring easily capital to low labour cost countries. An example can be seen by reading the AT_Kearney Report on Confidence Index 2005 (12). A large part of the comments are devoted to China (the highest ranking country in terms of entrepreneurial confidence), India, Asian former NIC's and Brazil.

Foreign Investments: the real engine of growth in CEECs

Now we take another step, addressing the issues of the relevance of FDIs in the reforms of the Eastern European transition and the countries of the EU enlargement that has brought them inside the 25, soon to be 27, members and not very late growing to more than 30. And do not believe the negative views being circulated and endorsed also by the Commission in Brussels, regarding further steps. The EU will enlarge further, at least to the Balkan countries, while Turkey is negotiating and pending for membership but with a medium-term horizon and avoiding to push for quick and not yet acceptable terms and deadlines with the *aquis communautaire*. The Middle East, the Caucasus and Central Asia are in this moment the hazardous region where Turkey is playing an increasingly "soft" role, with options that range from economy, finance trade to military capabilities.

Foreign direct investments have been a widely discussed topic in the assessment description of the successful transition process of many Central and Eastern European countries (CEECs) into market economies. Foreign direct investment in the CEECs rose almost tenfold between 1994 and 2003 – from USD 20 bn to USD 197 bn. In terms of FDI in relation to GDP, there was an impressive increase from 6.9% to 33.2%.

There is broad consensus that foreign direct investment has a favourable effect on the transition process and especially on economic growth. Against this background the surge in foreign capital investment has prompted a raft of analyses dealing with economic and political factors which either support or hamper foreign direct investments in the CEECs. The analyses focus on why some countries have been more attractive for foreign direct investment than others, drawing conclusions on the successful itinerary of the transition process. It was tacitly assumed that higher foreign direct investment flows have pushed up economic growth and still contribute in a significant way to the "convergence" of these partners to the main EU parameters. The studies and reports provide strong analytical evidence.

Recent research now confirms that foreign direct investment has been the engine of growth in Central and Eastern Europe in the last 10 years. It contributed almost 2.3 percentage points to economic growth of 3.5% on average (i.e.74%). Furthermore, the results of the analyses show the growth contributions of FDIs in each individual country of Central and Eastern Europe and how quickly foreign investments have been absorbed. With these findings, their impact gets a quantitative dimension and underscores its enormous importance for the economic upswing in Central and Eastern Europe as a region and also in each individual country. For the future, this means that foreign investors will shift their partial focus from the more advanced countries to the next EU candidate countries and also beyond the enlargement.

Local entrepreneurship and FDIs

The European experience is giving relevance also to another aspect to be taken into account. FDIs could become a real engine of growth if local human capital is available, if the fertilisation on the local entrepreneurs is high, if the components and services sectors motivate local enterprises to jump into the job, if the productivity of labour soars in a convergent way with the high ratio of unit for labour for unit of product that characterize the international company, if the regional approach

helps a country to spread the benefit of growth induced by foreign investments into the neighbouring regions inside the country and at a transnational regional level.

FDIs are successful when they are managed to develop an industrial system where the output of tradable goods and services grows in a relative short time and the price/quality ratio almost equals that of the more advanced countries. Only tradable, in fact, are driving the positive side of the Balassa-Samuelson effect on the rate of exchange and the central banks' market-oriented policies. In other terms, we have to assume a production more or less at the same standard for the same goods manufactured anywhere in the world. Eastern Europe has shown that this mission is possible and sustainable. The cost of labour for unit of production may diversify, but the rule of "one price" and quality technological standards are becoming widely assumed by the investors in the five continents. So productivity becomes a need also for the new emerging great players in the world-wide economy. Tradable implies, by the way, an upgrade in the infra sectoral productions versus the traditional horizontal ones. The former are bringing more technology and higher capital accumulation, diffusing entrepreneurship and knowledge at the optimal levels, relative to different countries and start-up departure stages.

For the local market, the persistence of non tradable goods will accompany the tradable production for a medium term but will finally increasingly converge on tradable. This implies transforming the local producers into real entrepreneurs with technology and capability of application getting closer to the top ranking industrial countries. Only at these conditions, the technology transfer will become a reality and not an academic assumption.

This is the virtuous circuit we wish to all the new great emerging countries where China has already progressed in an impressive way. But still the transition time will be long and the frictional and critical problems that high growth rates entail both at structural and social level cannot be ignored. Human capital formation is therefore becoming the crucial factor for the future progress of growth. As we have said, FDIs will look soon also to Asia for the most endowed countries in this precious accumulation, which will overtake capital and labour as main important economic factors in the world system by the year 2020. And human capital cannot be imported; it is not as mobile as capital flows, and must be produced within the individual countries. We therefore fully support the efforts the Chinese government is making in this direction. The investment of today will become a value added of tomorrow.

Does Europe-Asia cooperation matter? With China as well? For sure, very much. How can a quick upgrade of the higher educational standards and the specialised skills take place otherwise? Again, the result depends on the openness towards international partnerships, upgrade of the syllabus, intensification of foreign visiting professor schemes, introduction of English teaching on a large scale: in other words, consistent budget investments from the public sector. Europe is in this moment very advanced in the higher education experience and the Bologna Process will implement the comparative advantage of European knowledge and research capabilities even more, covering the gap that has characterized the past.

The fact that we are systematically discussing the EU versus the Chinese and Asian experiences, underlining in some specific parts and similarity of processes means that we are on the right way. I really believe that the common initiative of China Foreign Affairs University, China National Association for International Studies and Asia-Europe Foundation is of the utmost relevance. What the scientific community and the top ranking managerial decision-makers need are the opportunities for real brainstorming and reciprocal debates rather than the hagiography, the superficial and very often "déjà vu" stories about the transition performances of the main emerging great countries in the last years, in Asia or Europe or elsewhere. A serious consideration must be maintained versus the

analytical approach and the outlook in the short and medium term. Our value added is discovering and reinforcing the reciprocal knowledge on issues and problems

China escalates foreign investments abroad

China and Europe are facing in different directions on a common ground that is becoming more relevant as China assumes an important position as foreign investor abroad. And there are encouraging data in this sense. Again we refer to an other recent Report of the Deutsche Bank showing how much China is already at work and could become a main investor abroad in the near future. We read in the “Global champions in waiting. Perspectives on China's overseas direct investment”, Deutsche Bank Research, 2006, an up dated picture of the new developments on China ODI.

While China's leading position as recipient of global FDI flows has been extensively documented, the overseas investment activities of Chinese companies have traditionally received much less attention. However, a recent spate of high profile cross-border merger and acquisition (M&A) deals involving Chinese companies – primarily within the resources, manufacturing and IT sectors – has brought increased interest in the issue of Chinese overseas direct investment (ODI). These transactions have included: Lenovo of IBM's personal computer business in December 2004; an unsuccessful USD 1.3 bn bid by China's largest household appliance manufacturer Hai'er for US rival Maytag in May 2005; as well as the highly-publicised bidding war that unfolded during mid-2005 between US oil major ChevronTexaco and state-owned Chinese CNOOC for control of the smaller California-based industry rival Unocal. Such developments point to the emergence of China as a global investor, reflecting not only the country's increasing integration into the world economy but also its need to find overseas markets.

As a consequence of its increasing economic power driving it to target overseas investment opportunities, Chinese ODI flows have undergone a remarkable expansion over the past 25 years, with particularly strong growth posted since the country's entry into the WTO in 2001 (see charts 3 and 4). For 2004 and 2005, growth in ODI registered at 93% and 26%, respectively. Further supporting this pattern of expansion are Ministry of Commerce (MOFCOM) projections suggesting annual increases in Chinese ODI stock in excess of 20% between 2005 and 2010, translating into an additional USD 60 bn of ODI over this period.

A glance at the FDIs trends in Asia and world wide

The key role that foreign direct investment (FDI) can play in fostering development is well known, but collecting reliable statistics when flows are so liquid and multi-directional is a huge task. Over the years the United Nations Conference on Trade and Development (UNCTAD) has acquired a reputation as the most authoritative source for such data, and its flagship *World Investment Report* consequently receives a great deal of attention. The final data and analysis for 2005 (Table 2 and 3 in Annex), were released at the end of 2006, and the report shows that total inflows amounted to some USD 916 bn, up 29% on 2004. The latter year was itself up 27% on 2003.

The 2005 findings corroborate data that individual countries had previously released. Even after this impressive growth, the inflows are still a long way off the record USD 1.4 trillion witnessed in 2000. FDIs into South, South-East and East Asia amounted to an impressive USD 165 bn in 2005, which equates to 18% of all FDI inflows globally. Around one-half of all inflows came from developing economies, most from within the Asia region. The 2006 will show, at the end, a similar trend and enhancement.

The major share went to China (USD 72 bn) and Hong Kong (USD 36 bn), with USD 37 bn going into South-East Asia, where Singapore (USD 20 bn) proved the main draw, and just USD 10 bn

going into South Asia. The significant disparity in FDI inflows between China and India remains clear, with India netting a meagre USD 7 bn. That said, we have to expect both countries will take notable steps to open up their economies further, with China taking measures in the coming months for its banking and travel sector and India opening up construction and retail to greater foreign participation.

Inward Flows of Foreign Direct Investment (USD millions)											
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
World	340,336	392,424	489,709	712,032	1,099,919	1,409,568	832,248	617,732	557,869	710,755	916,277
Europe	133,651	131,123	153,833	296,663	522,512	721,614	393,143	314,168	274,095	217,696	433,628
North America	68,027	94,089	114,925	197,243	308,119	380,798	187,124	96,613	60,761	123,910	133,265
Africa	5,642	5,861	10,948	9,280	12,455	9,577	19,894	12,999	18,513	17,199	30,672
Latin America and the Caribbean	30,251	50,246	76,259	90,312	114,108	108,993	89,397	54,340	46,137	100,506	103,663
Middle East	2,495	4,208	4,246	3,536	1,799	3,518	7,220	6,019	12,314	18,581	34,461
Asia-Pacific	77,423	89,717	101,526	91,714	109,486	144,474	104,825	90,106	97,823	138,041	165,093
South-East Europe and CIS	4,803	6,308	12,101	10,652	10,471	9,062	11,529	12,911	24,192	39,577	39,679

Source: UNCTAD World Investment Report 2006

Manufacturing FDIs were notably increasing into the whole region, while within the region itself, changes in patterns of manufacturing FDI have been registered as countries have moved up the value-added ladder. Sectors that continue to attract large amounts of FDIs include automotives, electronics, steel production and petrochemicals. Interestingly, although all three subsets of the region are emerging as sources of FDIs, this percentage dropped by 11% year-on-year (y/y) to USD 68 bn. Nevertheless, the report's authors regard this as a fillip, particularly given that Chinese outflows for 2006 look set to increase, with no change in this pattern expected.

While much of the growth in 2005 was driven by an exceptional pattern of mergers and acquisitions (M&As) among wealthy economies (up 88% over 2004 to USD 716 bn), it is encouraging to see that flows picked up in all sub-regions. Total FDI to developing countries was a record USD 334 bn in 2005, while in developed countries the total stood at USD 542 bn. This is not to say that all countries benefited similarly: 74 of the 200 countries covered showed no growth or decline.

Surprising European capital flows

But how was Europe performing in late 2005? A release from Eurostat (tables 4 and 5 in annex) shows a lot of interesting details. In 2005, EU25 FDIs in extra-EU25 countries (outflows) increased by 19%, to 153 bn euro compared to 129 bn in 2004, while FDI into the EU25 from the rest of the world (inflows) increased by 23%, from 57 bn in 2004 to 70 bn in 2005. These increases were strongly influenced by EU25 flows with North America. In 2005, the EU25 invested 26 bn euro in the US and 9 bn in Canada, compared with 7 bn and 2 bn respectively in 2004. The US invested 18 bn in the EU25 in 2005 and Canada 7 bn, compared with US investment of 15 bn and Canadian disinvestment of 3 bn in 2004. Excluding North America, EU25 investment in other extra-EU25 countries fell by 2% in 2005, while investments coming from the rest of the world excluding North America remained stable.

In 2005, intra-EU25 FDIs flows increased by about 80% from 2004.

These figures, recently published by Eurostat, the Statistical Office of the European Communities, come from first results for 2005 and revised data for 2004 for FDI. The UK, France and Luxembourg are main actors in extra-EU25 FDI flows. The UK, with outflows of 56 bn euro, and a 37% share of the EU25 total, was the largest investor in extra-EU25 in 2005, followed by France (19 bn or 12%) and Luxembourg (16 bn or 10%). With regard to extra-EU25 inflows, the UK, with

17 bn, and a 24% share of the EU25 total, was the main recipient of FDI, ahead of Luxembourg (14 bn or 20%) and France (13 bn or 19%). The role of Luxembourg in EU FDI is mainly explained by the importance of its financial intermediation activity.

In 2005, the EU25 was a net investor in the rest of the world, with outflows higher than inflows by 83 bn euro (0.8% of GDP). In 2004, outflows were higher than inflows by 72 bn (0.7% of GDP). Among the Member States, the UK was the highest net investor outside the EU25 in 2005, with a difference of 39 bn. With inflows higher than outflows by 1 bn, Poland was the largest net recipient of FDI from extra-EU25, The Netherlands was the main investor, the UK was the main recipient of intra-EU25 FDI. The Netherlands (87 bn euro), France (61 bn) and Luxembourg (49 bn) were the main investors inside the EU25 in 2005. The main recipients of investments from other Member States were the UK (115 bn), Luxembourg (43 bn) and The Netherlands (30 bn), while Ireland recorded disinvestment of 20 bn. The real point is that Europe's market and monetary union was a powerful engine to push capital flows among its member countries.

Conclusion

One conclusion might be anticipated right now: a certain degree of regional approach is indispensable for the global governance. The different speeds of countries developing this strategy belong to the pluralism of their background and starting conditions not to discriminatory policies. Any simplification or wishful thinking could help in overcoming these problems. The main tracks are closely tied with pragmatic approaches, accompanied by confidence measures, reciprocal acceptance, pluralistic cultural and religious values acceptance, security agreements, international openness and human capital accumulation, just to mention the most relevant. Production of tradable goods must enlarge and infra sectoral manufacturing should be enhanced to the benefit of a more efficient technology transfer, as the knowledge diffusion into the increased human capital accumulation will effectively accompany growing local and national entrepreneurship, both in the large enterprises and in the medium and small.

We are in a stage where Asian countries, and China first of all, could propose some steps forward in this direction. This paper demonstrates how the present conditions in Asia and world wide are forcing regional cooperation to come into action. Even multilateralism returns as the only alternative to the clash of civilizations. Europe in this sense could represent a real positive, stabilizing factor. What has been achieved by the EU with the deep, irreversible integration process in the last half century belongs to the entire international community and represents a precious heritage for the future.

There are so many options offered by the extremely dynamic economic, financial and innovation outlook that the time seems appropriate to elaborate a tentative, concrete agenda for 10-15 years. New theories of growth are trying to give a methodological background to such a change in the international relations.

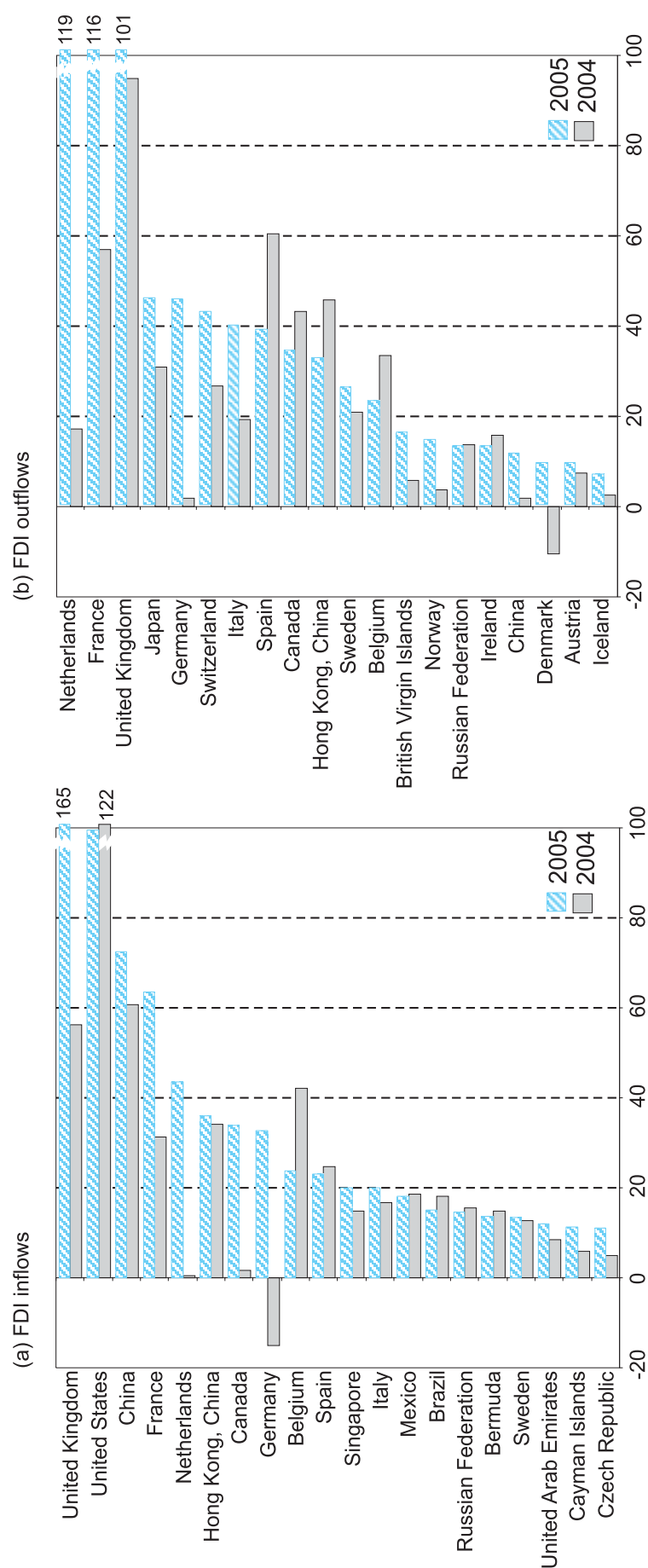
FDIs represent the most effective factor incorporating the main systemic variables. Contrary to a superficial appearance, foreign capital flows are very much related to political, social and strategic risk evaluation and therefore become a clear sign of confidence or dissatisfaction. Asia and China are now ranking at the highest level of confidence and must take profit for implementing reforms and further openness by the governmental and monetary authorities. Extension of outflow investments and regional economic cooperation, at a continental level, will represent the basic condition for Asian countries to match the challenge of long-term sustainable growth.

Table 1. FDI flows, by region and selected countries, 1994-2005
(Billions of dollars and per cent)

Region/country	FDI inflows					FDI outflows								
	1994-1999 (Annual average)	2000	2001	2002	2003	2004	2005	1994-1999 (Annual average)	2000	2001	2002	2003	2004	2005
Developed economies	373.9	1 133.7	599.3	441.2	358.5	396.1	542.3	486.6	1 097.5	684.8	485.1	514.8	686.3	646.2
Europe	220.4	721.6	393.1	314.2	274.1	217.7	433.6	326.5	871.4	474.0	281.7	317.0	368.0	618.8
European Union	210.3	696.1	382.0	307.1	253.7	213.7	421.9	304.2	813.1	435.4	265.8	286.1	334.9	554.8
Japan	3.4	8.3	6.2	9.2	6.3	7.8	2.8	22.8	31.6	38.3	32.3	28.8	31.0	45.8
United States	124.9	314.0	159.5	74.5	53.1	122.4	99.4	114.3	142.6	124.9	134.9	129.4	222.4	- 12.7
Other developed countries	25.1	89.7	40.4	43.4	25.0	48.3	6.5	22.9	51.9	47.6	36.2	39.7	64.9	- 5.7
Developing economies	166.4	266.8	221.4	163.6	175.1	275.0	334.3	64.9	143.8	76.7	49.7	35.6	112.8	117.5
Africa	8.4	9.6	19.9	13.0	18.5	17.2	30.7	2.5	1.5	- 2.7	0.3	1.2	1.9	1.1
Latin America and the Caribbean	65.2	109.0	89.4	54.3	46.1	100.5	103.7	18.9	60.0	32.2	14.7	15.4	27.5	32.8
Asia and Oceania	92.9	148.3	112.2	96.2	110.5	157.3	200.0	43.5	82.2	47.2	34.7	19.0	83.4	83.6
Asia	92.4	148.0	112.0	96.1	110.1	156.6	199.6	43.5	82.2	47.1	34.7	19.0	83.4	83.6
West Asia	3.1	3.5	7.2	6.0	12.3	18.6	34.5	0.4	1.5	- 1.2	0.9	- 2.2	7.4	15.9
East Asia	58.5	116.3	78.8	67.4	72.2	105.1	118.2	32.3	72.0	26.1	27.6	14.4	59.2	54.2
China	40.7	40.7	46.9	52.7	53.5	60.6	72.4	2.2	0.9	6.9	2.5	- 0.2	1.8	11.3
South Asia	3.4	4.7	6.4	7.0	5.7	7.3	9.8	0.1	0.5	1.4	1.7	1.4	2.1	1.5
South-East Asia	27.4	23.5	19.6	15.8	19.9	25.7	37.1	10.7	8.2	20.8	4.6	5.4	14.7	12.0
Oceania	0.5	0.3	0.1	0.1	0.4	0.7	0.4	0.0	0.0	0.1	0.0	0.0	0.0	0.0
South-East Europe and the CIS	7.8	9.1	11.5	12.9	24.2	39.6	39.7	1.6	3.2	2.7	4.7	10.7	14.0	15.1
South-East Europe	2.2	3.6	4.2	3.9	8.5	13.3	12.4	0.1	-	0.1	0.6	0.2	0.2	0.5
CIS	5.6	5.4	7.3	9.0	15.7	26.3	27.2	1.5	3.2	2.5	4.1	10.6	13.8	14.6
World	548.1	1 409.6	832.2	617.7	557.9	710.8	916.3	553.1	1 244.5	764.2	539.5	561.1	813.1	778.7
Memorandum: percentage share in world FDI flows														
Developed economies	68.2	80.4	72.0	71.4	64.3	55.7	59.2	88.0	88.2	89.6	89.9	91.7	84.4	83.0
Developing economies	30.4	18.9	26.6	26.5	31.4	38.7	36.5	11.7	11.6	10.0	9.2	6.3	13.9	15.1
South-East Europe and the CIS	1.4	0.6	1.4	2.1	4.3	5.6	4.3	0.3	0.3	0.4	0.9	1.9	1.7	1.9

Source: UNCTAD, World Investment Report 2006: FDI from Developing and Transition Economies, annex table B.1 and FDI/TNC database (www.unctad.org/fdistatistics).

Figure 1. Global FDI flows, top 20 economies, 2004-2005^a
(Billions of dollars)



Source: UNCTAD, World Investment Report 2006: FDI from Developing and Transition Economies, annex table B.1 and FDI/TNC database (www.unctad.org/fdistatistics).

^a Ranked on the basis of the magnitude of 2005 FDI flows.

EU25 FDI flows: 2005 preliminary results by main partner, billion euro

	Outward flows to:						Inward flows from:					
	Intra-EU25	Extra-EU25	of which:				Intra-EU25	Extra-EU25	of which:			
			US	CH	JP	CA			US	CH	JP	CA
EU25³	354.5	152.5	26.1	5.9	-1.2	9.3	324.4	69.8	17.5	7.3	4.2	6.9
Belgium	11.8	9.6	5.4	-0.3	1.5	0.1	13.9	8.6	6.1	0.9	0.2	0.1
Czech Republic	0.2	0.5	-	-	-	-	8.3	0.5	0.1	0.2	0.1	-
Denmark	4.7	1.6	1.2	-0.1	0.1	0.1	2.3	1.8	-1.7	0.9	-	0.1
Germany	25.4	11.3	-5.6	4.8	-1.6	2.3	23.8	2.4	0.4	3.3	-0.1	0.8
Estonia	0.3	0.2	-	c	-	-	2.2	-	-	-	-	-
Greece*	0.1	0.7	-	-	-	-	-0.3	0.1	-	-	-	-
Spain	20.7	10.5	2.6	3.6	0.1	0.1	15.6	2.9	2.2	-0.3	0.3	-
France	60.5	19.4	8.0	5.1	0.8	0.6	27.5	12.5	8.3	2.1	-0.6	-0.1
Ireland	9.0	1.9	-3.9	0.1	c	0.1	-20.4	-4.7	0.5	-1.5	1.7	-0.7
Italy	27.4	6.1	1.1	0.4	-	-	14.1	1.6	1.0	0.4	0.1	-
Cyprus	0.2	0.2	-	-	-	-	0.5	0.4	-	-	-	-
Latvia	-	0.1	-	-	-	-	0.3	0.2	-	-	-	-
Lithuania	0.1	0.1	-	-	-	-	0.6	0.2	-0.1	-	-	-
Luxembourg**	48.9	16.0	0.7	0.2	0.1	0.7	42.8	14.0	2.1	0.2	-0.2	4.3
Hungary	0.3	0.7	-	-	-	-	4.7	0.5	0.2	0.1	0.2	-
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands***	87.1	10.0	1.4	3.0	-0.2	0.5	29.5	6.1	2.9	-3.4	-0.1	0.7
Austria	3.6	3.8	-	0.4	-	-	6.3	0.9	0.3	0.2	-	0.1
Poland	0.9	0.4	0.1	0.1	-	-	5.1	1.5	0.4	0.2	0.2	-
Portugal	1.7	-0.7	0.1	-	-	0.2	3.0	-0.4	-0.1	-	-	0.3
Slovenia	-	0.5	-	-	-	-	0.5	-	-	-	-	-
Slovakia*	0.1	0.1	-	-	-	-	1.4	0.3	0.1	-	-	-
Finland	4.4	-2.2	0.4	c	-	0.9	3.2	0.5	0.1	0.1	-	-
Sweden	5.4	15.6	-2.1	1.2	-	-	0.3	10.7	-0.2	-1.3	-	0.3
United Kingdom****	25.8	55.5	24.0	-2.0	-1.5	4.4	115.4	16.9	8.5	0.6	2.0	0.5

Minus sign stands for disinvestment

US = USA, CH = Switzerland, JP = Japan, CA = Canada

: Data not available

- Less than EUR 50 million

c Confidential

* Data without reinvested earnings.

** Data including Special Purpose Entities (see footnote 3).

*** Data excluding Special Purpose Entities.

**** Estimate

EU25 FDI flows: 2004 revised data by main partner, billion euro

	Outward flows to:						Inward flows from:					
	Intra-EU25	Extra-EU25	of which:				Intra-EU25	Extra-EU25	of which:			
			US	CH	JP	CA			US	CH	JP	CA
EU25³	211.3	128.9	7.2	-15.8	4.7	1.6	162.7	56.9	15.3	14.6	6.5	-2.5
Belgium	24.2	2.8	-2.9	-1.1	0.6	-0.1	24.9	9.0	3.5	-0.2	0.4	0.1
Czech Republic	0.2	0.6	-	-	-	-	3.2	0.8	0.4	0.1	-	-0.1
Denmark	:	:	:	:	:	:	:	:	:	:	:	:
Germany	2.6	-1.0	-7.1	1.3	0.4	0.4	-12.7	0.6	2.7	0.1	0.6	0.3
Estonia	0.2	-	-	-	-	-	0.7	0.2	-	-	-	-
Greece*	0.3	0.2	0.1	-	-	-	0.9	0.2	0.1	0.1	-	-
Spain	37.1	11.6	-0.4	1.5	0.1	-0.5	17.8	2.2	-0.4	1.1	0.2	0.6
France	36.1	2.4	-1.0	0.9	-0.4	0.1	18.6	1.0	4.7	1.3	-0.3	0.5
Ireland	8.6	6.0	1.5	0.1	c	0.1	3.4	-12.0	-8.4	0.3	1.8	-0.1
Italy	15.1	0.5	0.5	-0.9	-	-	11.1	2.5	0.7	1.2	0.2	-
Cyprus	0.3	0.2	-	-	-	c	c	c	0.1	-	-	-
Latvia	-	0.1	-	-	-	-	0.4	0.2	-	-	-	-
Lithuania	0.2	-	-	-	-	-	0.5	0.2	-0.1	-	-	-
Luxembourg**	58.9	6.9	4.9	2.7	-	0.3	42.0	20.2	7.5	1.6	-	-5.8
Hungary	0.6	0.3	-	-	-	-	2.1	1.6	-	0.3	0.1	-
Malta	:	:	:	:	:	:	:	:	:	:	:	:
Netherlands***	8.4	5.6	-4.5	-0.8	0.3	0.5	6.9	-6.5	-7.7	1.9	0.6	0.5
Austria	2.9	3.0	-	0.2	-	0.1	2.5	0.5	0.1	-0.2	-	0.1
Poland	0.3	0.3	-	0.2	-	-	9.7	0.6	0.1	0.3	0.1	-
Portugal	5.4	1.0	0.2	-	-	-	-0.3	2.2	0.1	0.1	-	-
Slovenia	0.2	0.1	-	-	-	-	0.5	0.1	-	0.1	-	-
Slovakia*	-	:	-	-	-	-	0.6	-	-	-	-	-
Finland	-1.5	0.6	0.5	-0.6	-	0.1	2.6	0.2	0.1	0.3	-0.1	0.1
Sweden	10.8	6.1	0.7	-1.6	-0.1	0.2	5.5	4.7	5.2	0.2	-	0.1
United Kingdom	17.1	59.2	19.9	-10.2	0.1	1.9	36.5	8.7	-5.4	4.5	1.3	c

Minus sign stands for disinvestment

US = USA, CH = Switzerland, JP = Japan, CA = Canada

: Data not available

- Less than EUR 50 million

c Confidential

* Data without reinvested earnings.

** Data including Special Purpose Entities (see footnote 3).

*** Data excluding Special Purpose Entities.

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