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EUROPEAN POLICY ANALYSIS

The Implications for FDI Location of Future EU Enlargement

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Summary

Foreign Direct Investment (FDI) integrates countries by encouraging development, trade and employment, so that a key element of future European Union (EU) enlargement is the ability of accession countries to attract this investment. This European Policy Analysis examines this, drawing on the experience of the Central and Eastern European (CEE) countries that acceded to the EU in the mid-2000s.

It finds that enlargement leads to a greater increase in FDI in the more-liberalized accession countries, occurring prior to accession negotiations from Association Agreements. It reduces investment in the existing Member States as the CEEs serve as a platform from which to export to these countries within the enlarged Single Market. The motives for FDI in the CEEs include EU market proximity, low production costs and good transport links, so that the CEE border regions receive a disproportionately large FDI share.

In terms of future enlargement, the analysis concludes that the western Balkans countries are likely to attract FDI by acting as an export-platform within the enlarged Single Market. This may have greater implications for the CEEs due to their relatively lower costs, but less so for the 'old' Member States due to their distance from this market.

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1. Introduction

Following the fifth European Union enlargement of the mid-2000s to include the countries of Central and Eastern Europe (CEE), the number of EU Member States has remained more or less stable, save for the accession of Croatia in 2013 and the United Kingdom withdrawal in 2020. However, this belies the possible future EU enlargement, with nine recognised candidate countries, of which six are currently negotiating: Montenegro (since 2012), Serbia (2014), Albania and North Macedonia (2022) and Moldova and Ukraine (2024). A further three countries have candidate status, of which two are undergoing screening: Bosnia and Herzegovina (2022) and Georgia (2023); while Turkey had its negotiations frozen in 2016. Accession will have major implications for the political and economic development of these countries, and for Europe more broadly, of which a key element is likely to be their ability to attract Foreign Direct Investment (FDI). This investment helps to integrate these countries, and in addition to the opportunities that it poses, adjustments will also occur from the new patterns of economic activity and trade that follow from this.

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Formally, FDI is cross-border investment, by which an investor that is resident in one country takes a lasting and significant influence over an enterprise in another country. To distinguish it from portfolio investment in equity, it is usually taken to involve at least a ten percent share in the voting power of the enterprise. It could be a joint venture, possibly with a domestic investor, or the acquisition of an existing enterprise that could already be foreign owned. Inward FDI creates long-lasting links between economies and it is important for economic development, since it a source of international trade (Carstensen and Toubal, 2004) and creates income and employment. It can also transfer technology, depending on the 'absorptive capacity' of the host country, although it may have negative effects. These include the displacement of activity, a loss of national influence, a failure to establish supply chains or to meet domestic demand. Inward FDI varies from year-to-year, but under a broad definition, UNCTAD puts the EU stock of FDI in 2023 at USD 12,454 billion. This is about two-thirds of annual EU GDP, of which only about ten percent is located in the CEEs.

To assess the likely effects of FDI location for the future enlargement of the EU it is possible to examine the recent experience of the fifth enlargement. Under this, ten CEEs acceded to the EU that had earlier been under the influence of the former Soviet Union. The purpose of this European Policy Analysis is to examine this experience drawing on work carried by the author and his associates. A collection of these papers can be found in Jones and Wren (2016). In considering this work, the effect of accession on FDI location in the enlarged union is examined, drawing-out the likely implications for the candidate countries. FDI involves the movement of capital, which is one of the so-called four 'freedoms' of the Single Market, although it is supported by the other freedoms, including the movement of goods and possibly people.

Three aspects are considered in this briefing note:

- The first is the *timing* of FDI in relation to the accession process. This is to understand when FDI locates in response to accession, both before and after EU membership.

- The second is the *motive* for FDI location. This determines what drives FDI location in the new accession countries and how it differs from the 'old' Member States.

- The third is the *geography* of FDI location. This considers how FDI locates at a sub-national level, and in particular in relation to the newly-internalised EU border.

We begin by setting out the nature of the fifth EU enlargement and describe the data that is used as the basis for the analysis. This is the Ernst and Young *European Investment Monitor*, which over the period covered identifies 35,105 observations on cross-border investments within the 'old' and 'new' Europe. We draw out the implications for future enlargement.

2. EU Accession Process

The fifth EU enlargement took place in two rounds, with eight Central and Eastern Europe countries joining in 2004, followed by Bulgaria and Romania in 2007. The fifth enlargement included Malta and Cyprus, but due to their special nature these are omitted. The process of membership is set out in Article 49 of the 1992 Maastricht Treaty, while the conditions for eligibility are given by the 1993 Copenhagen Criteria, that were developed in the wake of the collapse of communism. The criteria include the acceptance of EU law and conditions for political and economic liberalization, of which the former is satisfied before the negotiations and the others form part of the negotiations and must be implemented by membership. The political criteria are a stable institutional set-up to guarantee democracy, rule of law and protection of human rights, while the economic criterion is a fully-functioning market.

The CEEs were screened in the run-up to a 1997 Luxembourg Summit of European Ministers, at which it was decided that negotiations could proceed with five of these, known as the 'Luxembourg Group': Estonia, Czech Republic, Hungary, Poland and Slovenia (Resmini, 2000). The other CEEs were deemed not to be sufficiently liberalized to meet the economic criteria in the medium-term (in one case political liberalization), so that their negotiations followed a 2000 Helsinki Summit, known as the 'Helsinki Group': Latvia, Lithuania, Slovakia, Bulgaria and Romania. In fact, negotiations were accelerated with the first three of these, so that along with the Luxembourg Group they formed the commitment to enlarge at the December 2001 Laeken European Summit, with their negotiations finishing a year later. A commitment to enlarge did not occur until December 2002 for the other two Helsinki Group members, Bulgaria and Romania, and their negotiations concluded two years later. The Luxembourg and Helsinki Groups form a useful distinction between countries that are regarded as more- or less-liberalized by the EU in the period before enlargement. All ten CEEs had Association Agreements in place over 1994–99, which provided the basis for trade links by removing the EU tariffs on industrial goods. These agreements became defunct at EU membership.

The *European Investment Monitor* gives details of distinct and individually-separate FDI projects. A project is either greenfield or brownfield in nature, where the former is a new start-up and the latter is either an expansion at an existing plant or a co-location of activities at the same site (Defever, 2012). Each project involves new facilities or jobs, so for practical purposes it does not include mergers or acquisitions. Ernst and Young claim to monitor 20,000 sources, and they identify 35,105 cross-border projects over 1997–2010 for the ten CEEs and fifteen Member States that immediately preceded the enlargement (the 'EU15'), where this includes the UK but not Croatia. Together we refer to the CEEs and EU15 as the 'EU25'. About 60% of total FDI projects are in manufacturing, for which the source country is the EU15 (46%), followed by the Americas (34%; mainly U.S.) and Asia (12%: mainly Japan). The CEEs receive about 20% of total EU25 projects, whereas just 1% of EU25 projects arise from these countries. The data do not give comprehensive information on the investment scale, but by value it is up to 5% of GDP.[1] The data are analysed as inward investment only, but typically outward FDI from the newly-integrated countries takes longer to arise and may involve the acquisition of firm-specific assets to increase competitiveness.

The number of the projects for the EU15 and CEEs is given in Table 1 on page 4, distinguishing between the Luxembourg and Helsinki Groups, before and after their EU membership. It shows that the Luxembourg Group received more FDI projects per annum than the Helsinki Group both before and after membership, reflecting their greater liberalization and size, but the Helsinki Group experienced a greater proportionate increase in the number of projects. This is felt across all countries, with the exception of Bulgaria only. FDI location in the EU15 fell in absolute terms after enlargement, which is 10% as an EU25 share. This is the context of an overall increase in the number of FDI projects for the EU25 as a whole.

3. Timing of FDI Location

Jones *et al.* (2018) examine the effect of accession events under the fifth EU enlargement on FDI location in the CEEs. Four events are considered:

[1] This is under the FDI definition used by UNCTAD, which includes the disposal of equity capital. It varies year-to-year, but as a GDP share for Europe as a whole it ranges from 2.3% to 4.6% over our period of study.

Table 1: **FDI location in the CEEs and EU15, 1997–2010**

	Before EU membership*		After EU membership*		Total1997-2010	
	No.	%	No.	%	No.	%
Luxembourg Group	267	10.8	381	14.8	4,530	12.9
Helsinki Group	133	5.3	248	9.7	2,350	6.7
CEEs	400	16.1	629	25.5	6,880	19.6
EU15	2,086	83.9	1,935	75.5	28,225	80.4
EU25	2,486	100.0	2,564	100.0	35,105	100.0

* Annual averages calculated for the countries within each group.

the commencement of negotiations; the commitment to enlarge; conclusion to negotiations; and EU membership. The number of FDI projects is regressed as a logarithm using annual data for all EU25 countries over time, both in absolute terms and as an EU25 share of investment projects in each year to allow for fluctuations in FDI due to world events.[2] The regression allows for possible under-reporting of FDI in the CEEs due to their weaker institutional environment for data collection, while a range of country variables are included to capture factors that affect FDI location, where these are estimated separately for the CEEs and EU15. Each accession event is included as a binary variable that takes a value of unity for all years after an event, including the year of the event if it is in the first six calendar months, but no time lags are used since the events may have been anticipated. No accession event has the same date across all CEEs, so that these are not purely temporal. Variables are included for one, two and three years after EU membership to understand how FDI location responds post-accession.

The estimates for the EU25 share and absolute number of FDI projects in response to each accession event are evaluated in Table 2 on page 5. Only statistically significant effects are reported. They are expressed as the percentage increases relative to 1997, which is when the dataset starts, and so just before the commencement of the EU accession negotiations. The effects are given for the Luxembourg and Helsinki Groups, which are more- and less-liberalized CEEs in terms of meeting the EU accession criteria before the negotiations, as described above. This differentiates between the CEEs according to their institutional development, such as their state capacity or level of corruption. EU25 FDI increases over time, so smaller effects are found for the FDI share than for the absolute effect, but there is a similar pattern. The estimates show that FDI peaks at EU membership and that it is above the level before the negotiations three years later.[3] The commencement of negotiations leads to a small increase in FDI, but there is no significant effect at the end to negotiations, as what is important is the commitment to enlarge made at the European Councils. Larger effects are found for the Helsinki Group, which are the less economically-liberalized CEEs before the negotiations.

> 'The main effect at EU membership is for less-liberalized countries, for which the EU commitment to enlarge is an important event.'

Overall, the results indicate important differences in the timing of FDI location relative to the EU accession process, which differs according to the degree of liberalization of the country, as captured by the accession criteria. More-liberalized countries experience a greater increase in FDI location prior to negotiations, which arises from Association Agreements. The main effect at EU membership is for less-liberalized countries, for which the EU commitment to enlarge is an important event. The effects are long-lasting, so that the number of projects is about twice as great three years after membership relative to the start of the negotiations.

[2] Essentially a regression fits the best statistical relationship between a dependent variable (i.e., FDI location) and a range of explanatory variables. It must satisfy certain assumptions about the nature of the unexplained component, for which the logarithm of the dependent variable is necessary in this case.

[3] To interpret these, the 213.9% estimate for the Helsinki Group at membership means the level of FDI location is three-times higher than before the negotiations, while three years later it is still more than twice as great.

Table 2: **FDI Estimates for EU Accession Terms, Percentage Effects**

	Share of EU25 projects			Absolute number of projects		
	All CEEs	Lux.	Hel.	All CEEs	Lux.	Hel.
Negotiations commence	22.0	0.0	34.7	11.6	0.0	25.3
Commitment to enlarge	60.2	20.1	87.9	37.9	0.0	76.3
Negotiations conclude	60.2	20.1	87.9	37.9	0.0	76.3
EU membership	127.2	75.6	160.9	172.6	131.6	213.9
+ 1 year	100.2	37.0	160.9	156.5	93.4	213.9
+ 2 years	52.2	8.9	86.6	121.4	93.4	139.2
+ 3 years	52.2	8.9	86.6	121.4	93.4	139.2

Luxembourg Group (Lux.): Estonia, Czech Republic, Hungary, Poland and Slovenia; Helsinki Group (Hel.): Latvia, Lithuania, Slovakia, Bulgaria and Romania. Percent annual increase in FDI location relative to the period before commencement of negotiations from 1997. Significant effects at the 10 percent level or higher.

4. Motive for FDI Location

Jones *et al*. (2020) examine the motives for FDI location in the CEEs, comparing it with those for the existing Member States of the EU15. The framework is the eclectic paradigm, which was developed by Dunning (1998), and that defines three broad motives for FDI location of market-, resource- and efficiency-seeking. The first two, market- and resource-seeking, are explored for greenfield FDI, which is basically a new foreign-owned start-up plant. The third is explored for brownfield FDI, which is an addition to an existing investment that is either in the plant's primary function or as a co-location of different functions, representing efficiency gains from economies of scale or scope respectively. Of the 35,105 projects, two-thirds are greenfield FDI, of which 47% of projects are in manufacturing and 38% in services. The same market and resource terms are used to explain the location decision for both greenfield and brownfield FDI, where these are measured at the country level, as follows.

The market terms comprise the national market size, the GDP growth rate, market potential, urbanisation and ease of access. The first two, national market size and the GDP growth rate, capture domestic demand and its prospects. Market potential is the closeness of a host country to the main EU market, as measured by the distance-weighted GDP across all EU25 countries.[4] Urbanisation is the population density, where a negative sign implies congestion, and ease of access is the motorway density, which is correlated with other infrastructure. Resource terms comprise production costs, labour market rigidity, labour skills and taxation. Costs are measured by the manufacturing wage rate and labour rigidity by the rate of unemployment. High- and semi-skilled labour is captured by educational attainment for each of the tertiary and secondary levels, where unskilled labour implies negative effects for both of these. Taxation is the corporation tax rate.

The effects are estimated using a conditional logit model, which captures the probability of the location choice for an individual FDI project across all EU25 countries, so that in principle there are over 500,000 observations on greenfield FDI, depending on whether the project locates or not in each of the 25 countries.[5] In addition to the above variables, terms are included for the accession events and for controls, such as adoption of the single currency, industrial specialisation and Structural Funds support. The regressions not only estimate the magnitude and significance of each motive term for each of the CEEs and EU15, but

[4] For each country it is the sum of GDP for all of the other EU25 countries, but divided by the distance between the respective capital cities in each case to give a lower weight to more distant markets. An adjustment is made for the geographical size of each country to reflect the ease or difficulty of accessing its market.

[5] The conditional logit model is used to analyse the FDI location decision in terms of the country characteristics in which a project either locates or not (a total of 25 observations for the EU25 countries). This involves specific assumptions and is non-linear to constrain the estimated probabilities to lie between zero and unity.

Table 3: **Role of Market and Resource Motives in Greenfield FDI Location**

	Greenfield FDI		Brownfield FDI			
			Expansions		Co-locations	
	CEEs	EU15	CEEs	EU15	CEEs	EU15
Market-seeking terms:						
market size	-*	0.48	0.77	1.03	-	1.30
growth rate	0.06	-	-*	0.09	0.11*	-
market potential	2.56*	0.83	2.83	2.14	-*	0.60
urbanisation	-1.14*	-	-2.70*	-0.58	-	-1.01
access	0.47*	0.07	0.73*	0.13	-	0.23
Resource-seeking terms:						
production costs	-0.50	-0.89	-*	-1.48	2.09*	-1.15
market rigidity	-0.32	-0.35	-*	-	-	-
semi-skilled labour	-1.02*	0.34	-3.54*	-0.39	-	1.25
high-skilled labour	-0.99*	0.92	-1.93*	0.40	-	1.18
taxation	-0.93*	-0.68	-0.83	-0.75	-1.16*	-0.89

Marginal effects expressed as elasticities, e.g., a 1% increase in market potential leads to a 2.56% increase in the probability of greenfield FDI location in CEEs. - = insignificant, * = significantly different between CEEs and EU15.

they reveal if the effects differ significantly between these two country groups. Integration terms are included to pick-up the liberalization of each country during the accession process.

The results for greenfield and brownfield FDI location are summarised in Table 3, expressed as elasticities for the marginal probability, given the non-linear relationship.[6] For greenfield FDI they show the importance of market potential for location in the CEEs, suggesting that exports to the main EU market in the west of Europe is a key motivation for investment, so that the CEEs act as an 'export-platform' within the enlarged Single Market. Less-urbanised countries in the CEEs are more attractive, while access in terms of a good road network is also important. The effects differ significantly from the EU15, where the country market size is important. In terms of resources, lower production costs and a less-rigid labour market are important for greenfield FDI location in the CEEs. This is the same as the EU15, but unskilled labour and lower taxes are more attractive for FDI in the CEEs. In the EU15 an educated workforce is significant, but corporate taxes are less important.

The results for brownfield FDI in Table 3 are disaggregated between the expansions and co-locations, which are viewed as efficiency-seeking from economies of scale or scope. The results for expansions in the CEEs are similar to greenfield FDI, albeit with larger effects, so that these also act as export-platform in the enlarged Single Market. We find (not reported) that these investments are more likely to occur at EU membership, so it is a reinforcement of the existing investment pattern described above. However, co-locations exhibit a different pattern as higher-cost and growing economies in the CCEs are more attractive, and market potential is insignificant, suggesting that these represent a deepening of investment in these plants that is not primarily concerned with exports. Manufacturing and service greenfield FDI were separately examined (not reported), and the results for the former are like those in Table 3. Service FDI reveals some differences, as market potential is unimportant, indicating that this FDI is more local in nature, although unskilled labour is important. The wage costs have a positive effect, but this is measured for manufacturing and it could be a substitution effect, while labour market rigidity and corporate taxes again have negative effects.

[6] Given its non-linear nature the estimates of the logit model are evaluated at the mean values of explanatory variables, i.e., marginal effects. These are elasticities, and so give the percentage change in the probability of FDI location from a one percentage change in the relevant motive term.

Overall, the results highlight significant differences in the motives for FDI between the CEEs and EU15. The market potential and cost terms suggest that the CEEs are a relatively low-cost location for FDI to meet demand arising from the EU15, so that the CEEs are an export-platform within the enlarged Single Market. A similar phenomenon is observed in relation to the Southern EU enlargement of the 1980s (Krugman and Venables, 1990). Re-investment at membership mainly increases the scale of existing operations, but the faster-growing CEEs attract subsequent FDI in new activities, representing a deepening of this investment.

5. Geography of FDI Location

Serwicka *et al.* (2022) investigate FDI location in relation to the newly-internalised border between the CEE accession countries and existing EU15 Member States. This is at the sub-national level for 260 NUTS-2 regions, of which 54 are in the CEEs. The effect of a border for industrial location is *a priori* uncertain, since from the perspective of theory it lessens the demand for a firm's output at the border, but it also makes the country's interior regions less attractive as a shelter from foreign competition (Brülhart *et al.*, 2004). The fifth enlargement has features that suggest that the CEE border regions are attractive to FDI location since it abolished border checks that led to lower administration costs and shorter waiting times, which reduced trade costs with the EU15 by up to 20 percent (Hornok, 2008). Further, given the role of the CEEs as an export-platform for the enlarged Single Market, the border regions may be particularly attractive for FDI location given their relative proximity to the EU15.

To examine this issue, two different measures of proximity are used for the distance of the CEE regions to the newly-internalised 'West-East border' (i.e., 'WE-border') with the EU15. The first is contiguity, which is measured using common edges for the first-, second- and third-order contiguity to the WE-border.[7] These regions are mapped in Figure 1, from which it can be seen that the WE-border has three parts: the westernmost border with Germany, Austria and Italy ('GAI-border'); the northern border of Estonia with Finland ('FIN-border'); and the southern border of Bulgaria with Greece ('GRK-border'). The GAI-border is closest to the main EU15 market, and aside from the earlier German reunification, it follows the path of the old 'Iron Curtain'. The FIN-border has sea-links across the Gulf of Finland and it is a prime route for Estonian exports. The GRK-border arises from the accession of Bulgaria in 2007. The second measure of proximity is the shortest road distance between the main city of a region and the nearest WE-border crossing. Roads are used as these are the preferred method for transporting goods within the union, but alternatives were considered.

After EU enlargement, the mean annual number of FDI projects per NUTS-2 region increases from 7.0 to 11.7 for the CEEs, which is similar for the EU15 at 8.0 to 11.6. Table 4 on page 8 shows that the increase occurs in every CEE country, but that it is greatest for the Baltic States, Romania and Slovakia. Since these are not contiguous to the GAI-border, it does not offer *prima facie* support for the export-platform argument, although the table shows that the countries that are closest to the GAI-border tend to be more attractive to FDI prior to EU membership.

The border effect is estimated with temporal and spatially-lagged dependent variables to allow for agglomeration and spillover effects, such as through regional supply chains.[8] The accession and motive terms are included, with the latter measured at a regional level where the data permits. Table 5 on page 9 summarises the marginal effects for the distance and first-order contiguity terms, giving the level of statistical significance. It presents the short- and long-run effects for the direct and total effects, where the latter includes the spillover effects from linkages with neighbouring regions. It separately gives the results for manufacturing and greenfield FDI, as defined above. The estimates are elasticities, so that, for example, in the short-run the first entry in Table 5 indicates that a 15.8% increase in road distance from the WE-border leads

[7] First-order contiguity means a region shares a land border with the EU15, while second-order contiguity means the region borders a region that shares a land border with the EU15, but not directly, and so on.

[8] This is a spatial autoregressive model. Agglomeration effects are captured by the FDI received by the region in the previous year and spillover effects by the average FDI location in all first-order contiguous regions.

to a 1% reduction in FDI location within the region, which is 14.1% when the indirect effect is included. In the long-run these effects are much stronger, at 3.3% and 1.6% only, which suggests that the increase in FDI location from EU membership is extremely localised, occurring in the CEE regions that are first-order contiguous with the WE-border.

Indeed, we find that the effects of EU membership on FDI location in the second- and third-order contiguity terms are each insignificant, so that the West-East border effect is confined to the regions adjacent to this border. These estimates are presented in the second part of Table 5, so that, for example, in the short-run the regions within the CEEs that are first-order contiguous with the WE-border receive an additional 27.8% in FDI location, which is 31.4% if the indirect effect is included. In the long-run, these are 132.7% and 257.2% respectively.

The effects in relation to the WE-border are in addition to a 'national border effect' that may be present between all countries (Capello *et al.*, 2018), including between the CEEs. It is also not a product of 'boundary-hopping' by foreign investors for FDI that would otherwise have located in the WE-border regions of the EU15, possibly from the closure of existing facilities. This is because these border regions are unattractive to FDI before enlargement. In fact, the first-order contiguity

Figure 1: **Contiguity with the West-East Border for the CEE Countries**

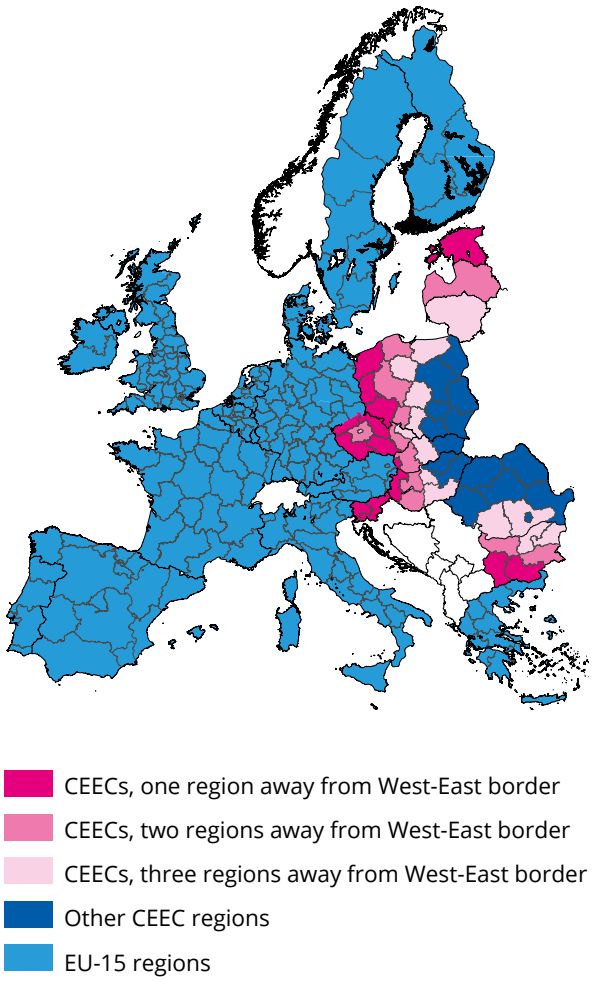

Table 4: **FDI Projects in CEE Regions and EU Membership**

	Total regions	Total projects	Mean projects per region per annum		Mean minimum road distance to WE-border (km)		
			Pre-EU†	Post-EU†	GAI	FIN	GRK
Czechia	8	1,152	9.07	11.50	23	1,460	1,263
Hungary	7	1,413	13.55	15.29	51	1,602	786
Poland	16	1,613	5.05	9.35	14	899	1,341
Slovakia	4	529	4.75	14.14	5	1,516	1,098
Slovenia	2	118	1.43	7.00	20	2,009	1,073
Estonia	1	234	15.00	18.43	1,370	89	2,627
Latvia	1	181	9.57	16.29	1,063	398	2,321
Lithuania	1	239	12.29	21.86	905	690	2,119
Bulgaria	6	470	4.85	7.46	917	2,385	144
Romania	8	931	6.24	13.50	452	1,936	387

Number of regions and FDI projects for NUTS-2 regions over 1997-2010. †EU membership.

Table 5: **West-East Border Distance and Contiguity Effects**

	Distance (%)			First-order Contiguity (%)		
	All FDI	Manuf. FDI	Greenfield FDI	All FDI	Manuf. FDI	Greenfield FDI
Short-run:						
Direct	-15.8**	-17.2*	-17.5*	27.8***	35.0***	22.2**
Total	-14.1**	-15.2*	-16.6**	31.4***	40.4***	24.8**
Long-run:						
Direct	-3.3**	-5.0*	-5.2**	132.7***	120.3***	73.5**
Total	-1.6**	-3.0*	-3.5*	257.2***	209.6***	109.5*

Manuf. = manufacturing. ***, ** and * = 1%, 5% and 10% significance level for marginal elasticities.

effect in the CEEs is strongest for the GAI-border, which is closest to the main European market, while it occurs after the removal of border checks at enlargement and not before. These suggest that it is to do with improved market access, which offers further support for the 'export-platform' argument for FDI location in the CEEs (see Pusterla and Resmini, 2007). It is notwithstanding that FDI tends to be attracted to the capital cities of countries in the early stages of the accession process, which possibly because these areas are most developed, while the presence of risk is also an issue.

Overall, across the CEEs, FDI location is significantly greater in the areas that are in proximity to the newly-internalised border of the enlarged EU, and in particular, the western border of the CEEs with Germany, Austria and Italy that is close to the main European market. Since it occurs after enlargement, and not before, then it is associated with the removal of border checks, suggesting that it reflects improved market access within the Single Market. As the CEEs form a relatively low-cost location from which to export to the rest of the EU, it offers further support for attractiveness of the accession countries as an export-platform.

6. Implications of the Prospective EU Enlargement

This European Policy Analysis finds that the candidate countries that are more economically and politically liberalized experience a greater increase in FDI location prior to the accession negotiations, arising from the Association Agreements. The major impact at EU membership is in less-liberalized countries, for which a European Council commitment to enlargement is an important event. The effects are long-lasting, so the absolute number of FDI projects is about twice as great three years after membership compared to the start of negotiations. The motives for investment differ between the accession countries and the 'old' Europe of the EU15. Access to the main European market and low production costs are important for FDI location in the CEEs, suggesting that that they are a base from which to export to the EU15 within the enlarged Single Market, i.e., an 'export-platform'. Indeed, the CEE regions that share a land border with the EU15 and lie closest to the main EU market attract a significantly greater share of this investment. This occurs after enlargement when the border checks are removed, so that it reflects the improved market access and again it supports the importance of an export-platform as a motive for FDI location in the CEEs.

The results reported here draw on recent research on the fifth EU enlargement under which ten Central and Eastern European countries acceded in the mid-2000s. The findings relate to inward investment, but outward FDI from the CEEs is unimportant given their early stage of integration. By value, FDI is up to 5% of GDP for Europe as a whole using a broader UNCTAD definition in net terms. The results concern three aspects of FDI location in the CEEs – the timing of the investment relative to the accession process; the motive for investment in the CEEs compared with the EU15; and the geography of investment in relation to the newly-internalised border of the EU following enlargement. In each analysis,

terms are included to control for institutional factors that follow from the political and economic liberalization of countries, such as state capacity and the level of corruption. The results can be applied to assess the likely implications of future EU enlargement for FDI location for the candidate countries, which geographically and politically fall into two distinct groups. These are: the western Balkan countries of Montenegro, Serbia, Albania, North Macedonia and Bosnia and Herzegovina; and the countries further to the east of Moldova, Ukraine and Georgia.[9]

In the case of the western Balkans, these countries are more-advanced in their accession process, but in geography they are less remote to the EU, with Member States contiguous to the north, east and south, while Italy lies across the Adriatic Sea to the west. In this sense they are analogous to the Luxembourg Group (Estonia, Czech Republic, Hungary, Poland and Slovenia), suggesting that they will receive FDI leading-up to their EU membership, and act as a platform to export to the main European market in the EU15 following membership. This follows from their lower costs and good international transport links, although as their costs are lower than the CEEs they may also serve as an export platform for these, perhaps drawing investment away from the CEEs in the same way that the fifth EU enlargement drew FDI away from the EU15. In fact, the western Balkans may have a limited impact on the EU15 if they serve as a cheaper location from which to export to the EU15 compared to the CEEs. The effect is likely to vary across the western Balkans and their regions as their access varies, and it may be staggered as Montenegro and Serbia have been negotiating since 2012–14, whereas Albania and North Macedonia have done so only since 2022.

In the case of the countries further to the east, these have only recently entered screening or been granted candidate status, so that there is uncertainty regarding their eventual EU membership, compounded by the ongoing conflict in Ukraine. They have had Association Agreements in place since the mid-2010s, but they lie to the far east of the continent and only Moldova and Ukraine are contiguous with existing Member States, of which none are in the EU15. For the purpose of FDI location they may be regarded as analogous to the Helsinki Group (Latvia, Lithuania, Slovakia, Bulgaria and Romania), being less-liberalized and unlikely to receive substantial FDI location until membership or at least a strong guarantee of their future political and economic liberalization. Their distance from the main EU market by road means that export-oriented FDI is likely to locate around their main ports. In border regions the implications may again be greater for the contiguous CEEs rather than the EU15.

To conclude, FDI location is important for economic development, modernising countries through technology transfer and raising their prospects from employment and higher wages. It is also an important means by which to integrate countries, including forging links with existing Member States through international trade. The analysis of this briefing paper draws on the experience of the fifth EU enlargement, which integrated ten CEE countries. Overall, it shows that enlargement generates new patterns of activity and trade, but that in the case of the candidate countries it argues that the implications may be greater for the CEEs that acceded in mid-2000s.

[9] It excludes Turkey, whose negotiations are frozen, Bosnia and Herzegovina, which is a candidate country only, and Kosovo, which is an applicant.

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