

## EU Foreign Direct Investment in Croatia and Turkey

*This article gives an overview of the EU Foreign Direct Investment (FDI) in these two Candidate Countries for the period 1999 – 2006. EU FDI outward and inward flows and stocks with Croatia and Turkey have increased considerably since 1999.*

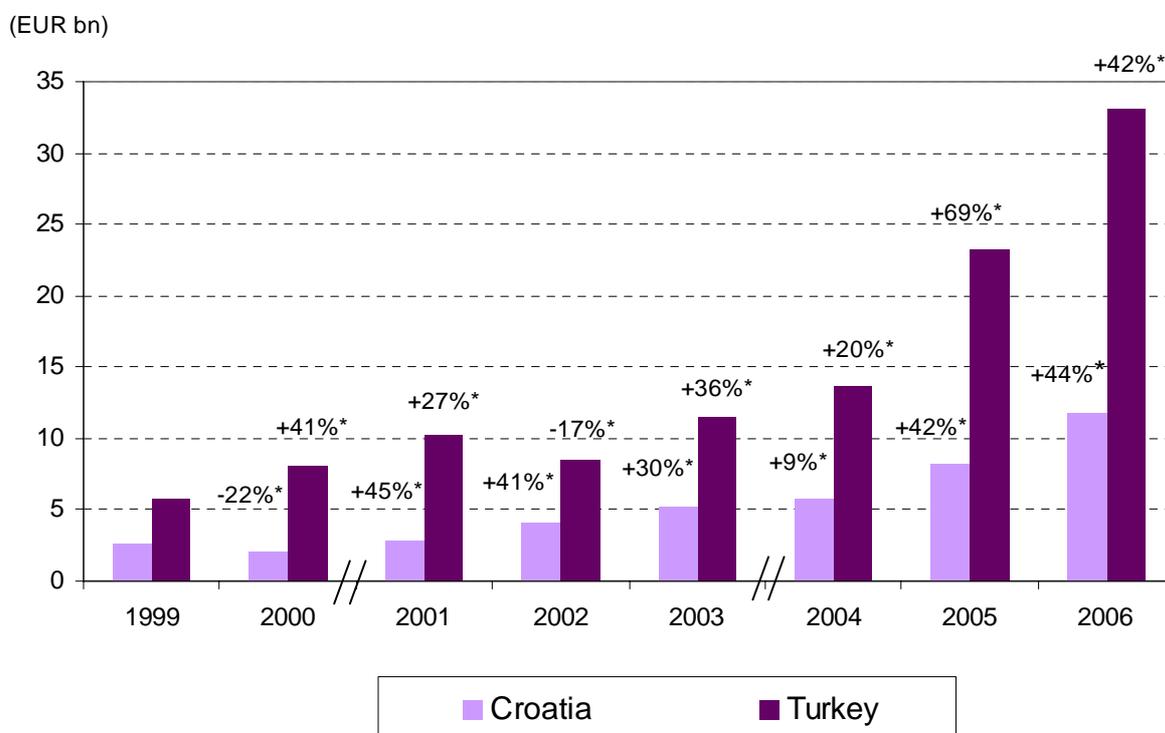
*The outlook in the coming years is also positive, as both countries began EU accession negotiations in October 2005, which traditionally has increased the attractiveness of Candidate Countries in terms of FDI.*

*Although investment is relatively low in absolute values, EU FDI stocks in Croatia have shown steady growth during the period 1999 to 2006. EU-25 FDI outward stocks increased by 308% during the period 2000 to 2006, reaching EUR 11.8 bn in 2006.*

*Turkey recorded a substantial increase in the level of EU FDI stocks from 1999 to 2006. EU-25 FDI outward stocks increased by 223% during the period 2001-2006 (EUR 22.8 bn), reaching EUR 33 bn in 2006.*

**Figure 1: EU FDI outward stocks in Croatia and Turkey and their annual growth rate**

*EU-27 for 2004-2006, EU-25 for 2001-2003, EU-15 for 1999-2000*



\*annual growth rate

## Substantial increase in the level of EU FDI in Turkey

The outflows of EU-25 FDI towards Turkey were fairly stable in 2003 and 2004, at EUR 1.1 bn for both years. Following a sharp rise of 285% in 2005 (to EUR 4.4 bn), EU FDI outflows to Turkey continued to rise, reaching EUR 10.5 bn in 2006.

This increase could be attributed in part to a series of investment-related reforms, plus a programme of privatization which Turkey had introduced in 2003 in order to improve the investment climate and to facilitate the flow of FDI. The major achievement has been the enactment of the new FDI law in June 2003. Among other things, the new law guarantees treatment of foreign investors as national investors, eases restrictions on FDI, abolishes the minimum capital limit, grants foreign investor full convertibility in their transfers of capital and earnings, and allows them to own property without any restriction and recognizes foreign investors' right to international arbitration. Other new policy measures were also introduced which were favourable to foreign

investors. These included the new mining law of 2004, a law adopted in 2004 which lifted some restrictions on ownership in telecommunications, tax policy reform and lowering of the corporate income tax rate from 30% to 20% in June 2006, plus new legislation on insurance adopted in 2007<sup>(1)</sup>. Secondly, heightened expectations with regard to Turkey's EU membership following the EU's decision to start negotiations as of October 2005 and the rapid recovery in the Turkish economy in the past three years helped Turkey to attract the attention of potential investors.

The share of the new Member States in EU-25 or EU-27 flows to Turkey remained very small; the EU-15 countries accounted for almost 100% of EU-25 FDI outflows.

<sup>(1)</sup> Source: UNCTAD *World Investment Report 2004 & 2007*

**Table 1**

EU FDI outward stocks held in Turkey at year end (EUR mn)									EU FDI flows to Turkey (EUR mn)							
	1999	2000	2001	2002	2003	2004	2005	2006	1999	2000	2001	2002	2003	2004	2005	2006
EU-15	5 706	8 056	10 109	8 365	11 389	13 618	23 060	32 891	1 187	2 149	2 975	800	1 126	1 135	4 358	10 581
EU-25			10 223	8 462	11 482	13 733	23 247	33 023			2 940	802	1 164	1 146	4 413	10 492
EU-27						13 734	23 261	33 038						1 150	4 425	10 496
EU FDI inward stocks held by Turkey at year end (EUR mn)									EU FDI flows from Turkey (EUR mn)							
	1999	2000	2001	2002	2003	2004	2005	2006	1999	2000	2001	2002	2003	2004	2005	2006
EU-15	1 119	2 002	2 166	1 780	1 932	2 283	6 095	10 887	330	997	283	- 236	140	103	273	- 595
EU-25			2 295	1 839	2 055	2 580	6 339	11 153			289	- 247	130	176	287	- 516
EU-27						2 909	6 901	11 642						257	408	- 401

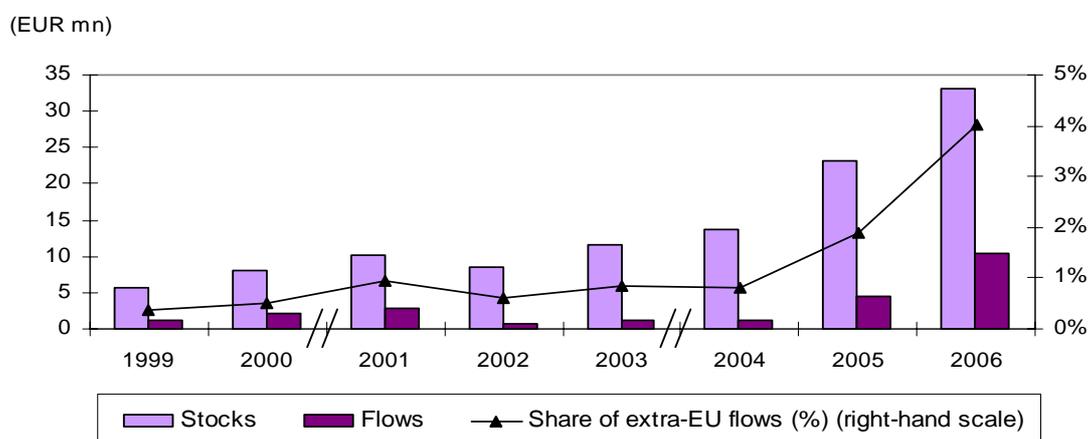
## Turkey took 4% of extra-EU-27 outflows in 2006

Turkey's share of extra-EU-25 outward FDI flows remained at or below 1% until 2004, when the

share started to increase and reached the record level of 4% in 2006.

**Figure 2: EU outward FDI flows and stocks in Turkey**

*EU-27 for 2004-2006, EU-25 for 2001-2003, EU-15 for 1999-2000*



## Greece, Austria and Germany were the biggest EU investors in Turkey over the period 2004-2006

With a share of 22% of EU-27 FDI flows, Greece was the biggest investor in Turkey in 2006 (EUR 2 275 mn), and thus the main investor in terms of cumulated flows from 2004 to 2006. Germany and France were also major investors as far as cumulated flows were concerned.

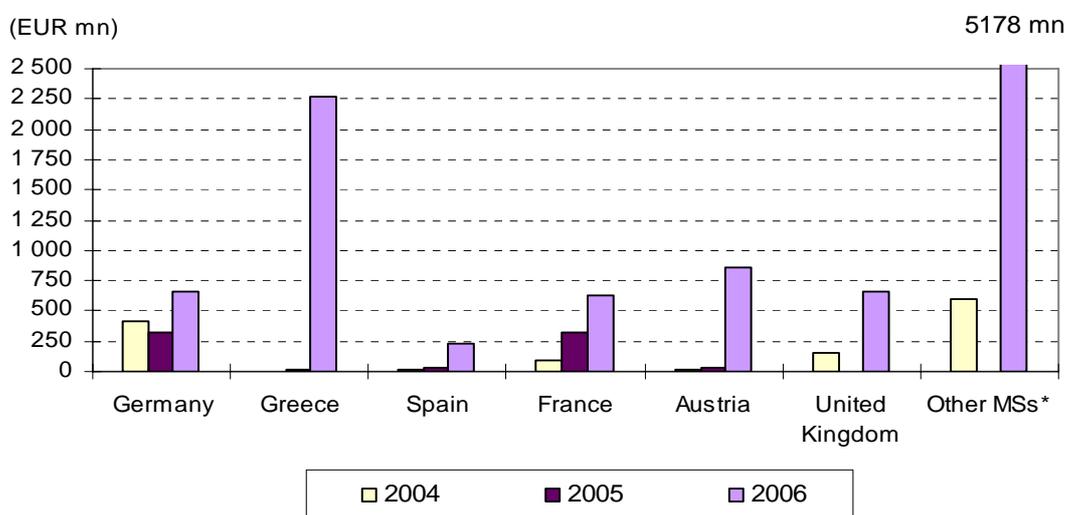
The second main investor in 2006 was Austria with EUR 860 mn, followed by Germany, France and United Kingdom, each of which invested around EUR 650 mn in 2006.

These countries put several strategic deals in place in 2006: two deals completed by the National Bank of Greece to purchase Finansbank AS, the

acquisition of GSM provider TELSİM Mobil Telekomunikasyon by Vodafone Group PLC (UK) and also the acquisition of DenizBank Financial Services by Dexia Participation Belgique, Belgium. In petroleum refining, a significant cross-border acquisition in 2006 in Turkey, involved OMV AG Austria taking a 34% stake in the oil and gas firm, Petrol Ofisi AS. Belgium was the main investor in 2005, with EU 1 161 mn. The acquisition of Türk Dis Ticaret Bankası by Fortis Group, Belgium should also be mentioned. <sup>(2)</sup>

<sup>(2)</sup> Source: UNCTAD *World Investment Report 2007*

**Figure 3: EU-27 FDI flows to Turkey by EU Member State**



\* Other MSs has been computed as the difference between the EU aggregate and the sum of selected reporting countries.

## EU-25 FDI outward stocks in Turkey almost tripled between 2003 and 2006

During the period 1999–2001, EU-15 FDI outward stocks in Turkey almost doubled. In 2001, direct investors from the EU-25 held EUR 10.2 bn worth of FDI outward stocks in Turkey. After falling by 17 % in 2002, EU-25 FDI stocks to Turkey increased considerably over the period 2003-2006, peaking at EUR 33 bn in 2006. As for flows, EU-15 investments accounted for the majority of EU-25 FDI outward stocks in Turkey.

No sectoral breakdown is available for FDI outward stocks and flows to Turkey for the EU aggregates. However, from the data of certain important EU Member States in terms of FDI investment stocks, we can observe the relative importance of *manufacturing* in outward FDI stocks in Turkey in 2004 and 2005.

Germany invested around EUR 1.3 bn in *manufacturing* both in 2005 and 2006. The second most important sector of German investments was *services*, reaching EUR 1 bn in 2005 and EUR 1.2 bn in 2006. In the *services* sector, *trade and repairs* was the predominant activity. *Manufacturing* was also the most important activity for Dutch investors in Turkey. They held stocks of EUR 845 mn in 2006 in this sector. As regards France, the predominant activity was *services*, with an annual growth of 112% between 2004 and 2005 and outward stocks reaching EUR 1.8 bn in 2005. Investors from the United Kingdom invested a considerable amount (EUR 2.6 bn) in *private real estate* in Turkey in 2006, reflecting the change introduced by the new FDI Act from 2003, which allowed foreign investment in real estate in Turkey.

## Turkey's increasingly active role as an investor in the EU

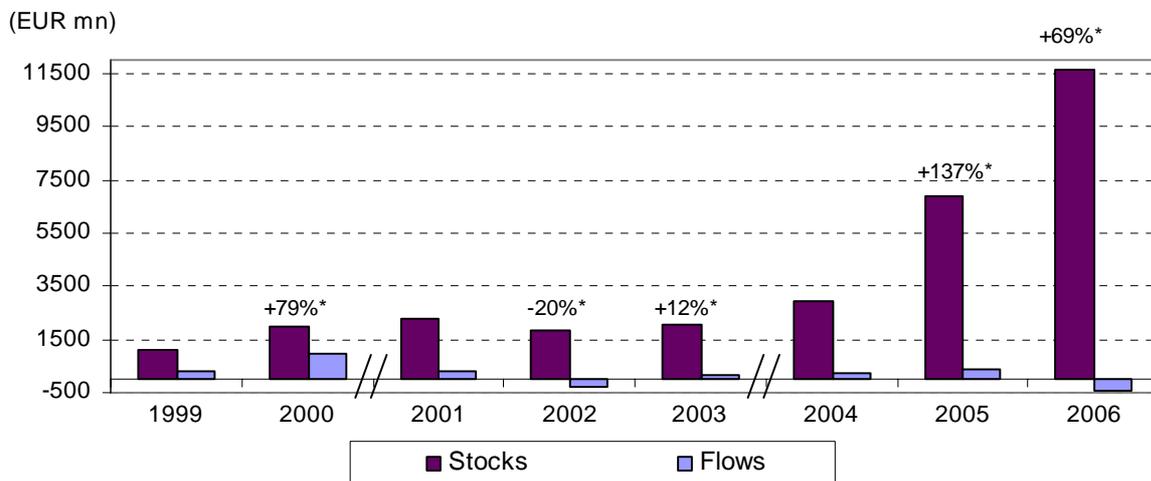
From 2001, EU-25 FDI inward stocks from Turkey increased by 386% (by EUR 8.9 bn) to reach EUR 11.2 bn in 2006. Following the unprecedented 137% growth of stocks from Turkey in the EU-27 in 2005, the momentum continued during 2006 with growth slightly reduced but still strong (+69%), (Table 1). The strong growth was partly related to value changes in stocks.

The majority of Turkish investments went to the old EU-15 Member States during the period 2001-2006.

The share of the new Member States in EU-25 inward flows from Turkey was at its highest in 2004, accounting for 12% of total EU-25 inflows before falling to 4% in 2005 and to 2% in 2006. Investment by Turkey in Bulgaria and Romania represented 11% of the total EU-27 inward stocks from Turkey in 2004, falling to 4% in 2006. During the period 2004 – 2006, Turkey invested especially in neighbouring countries, such as Bulgaria, Romania and Malta within the EU.

**Figure 4: EU FDI inward flows and stocks from Turkey and their annual growth rate**

*EU-27 for 2004-2006, EU-25 for 2001-2003, EU-15 for 1999-2000*



\*annual growth rate

## EU FDI flows to Croatia tripled between 2004-2006

EU FDI flows to Croatia showed a fluctuating trend until 2004, when they started to increase. EU-25 flows in Croatia rose by 89% to EUR 1 128 mn in 2005 and by 37% to EUR 1 548 mn in 2006. Since 1999, Croatia has launched some initial, small privatizations and there has been a recovery in domestic production and infrastructure. During 1999-2004 major privatizations were completed - particularly in banking, telecommunications, energy and transportation - which had a positive effect on EU FDI in Croatia.

Most of the EU investments came from the EU-15 Member States. The share of the new Member States in EU-25 flows in Croatia reached its peak in 2005 (41%), before falling to 11% in 2006. Out of

the total of EUR 1 128 mn in 2005, EUR 466 mn were from the new Member States and EUR 662 mn were from EU-15. Bulgaria and Romania were not involved in the EU FDI outflows in Croatia between 2004 and 2006.

Croatian FDI investment stocks in the EU are at a very modest level, reaching EUR 974 mn in 2006. The share of Croatian stocks held in new Member States of all stocks held in the EU fell gradually to 84% in 2004 and to 52% in 2005. This situation was completely reversed in 2006, when EU-15 Member States took a 70% share in Croatian EU-25 stocks (EUR 680 mn). The major EU target country for Croatian investment in the period 2004-2006 was Germany.

Table 2

EU FDI outward stocks held in Croatia at year end (EUR mn)									EU FDI flows to Croatia (EUR mn)							
	1999	2000	2001	2002	2003	2004	2005	2006	1999	2000	2001	2002	2003	2004	2005	2006
EU-15	2 546	1 985	2 395	3 476	4 301	4 683	6 828	9 778	1 324	534	924	726	1 050	492	662	1 370
EU-25			2 883	4 062	5 262	5 751	8 193	11 763			1 078	739	1 593	597	1 128	1 548
EU-27						5 751	8 193	11 763						597	1 128	1 548
EU FDI inward stocks held by Croatia at year end (EUR mn)									EU FDI flows from Croatia (EUR mn)							
	1999	2000	2001	2002	2003	2004	2005	2006	1999	2000	2001	2002	2003	2004	2005	2006
EU-15	56	41	66	41	49	56	278	680	21	- 17	19	21	- 18	58	108	- 65
EU-25			255	236	439	356	578	973			28	46	- 14	40	119	- 76
EU-27						357	580	974						41	120	- 76

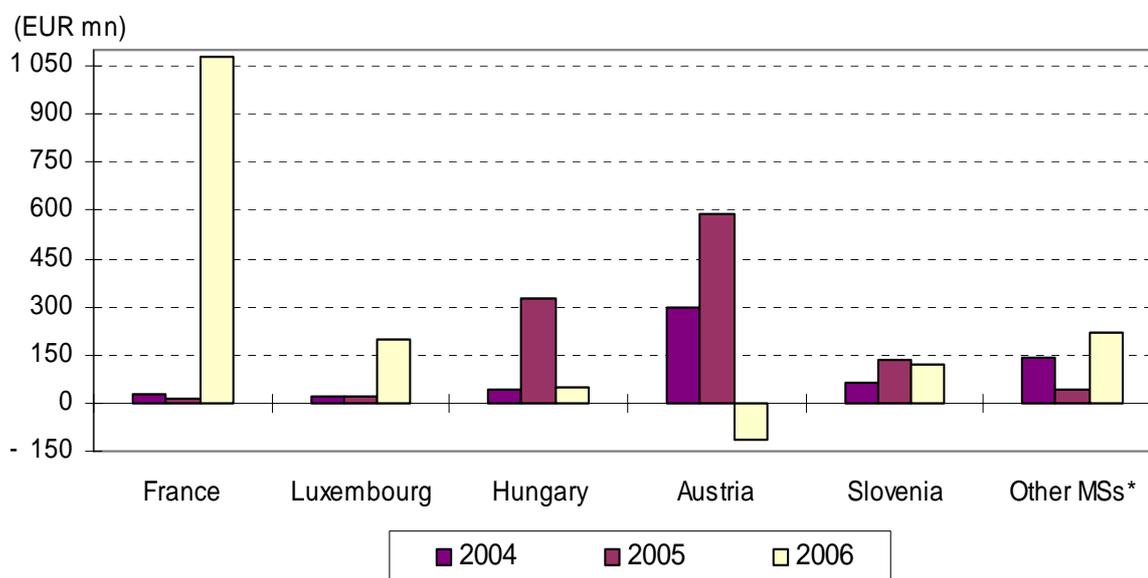
### France tops EU FDI investment in Croatia in 2006

Looking at cumulative flows from 2004 to 2006, French investment accounted for 34% of EU direct investment in Croatia. Austria and Hungary were the second and third largest EU investors, accounting for 24% and 13% respectively. France, with more than EUR 1 bn, significantly increased its investment in 2006, making it the main investor. One contributory deal that can be mentioned is the

acquisition of HVB Splitska Banka dd by Soci t  G n rale SA, France in 2006 <sup>(3)</sup>. In contrast, Austria was the main EU investor in Croatia in 2004 and 2005, but recorded a disinvestment of EUR 113 mn in 2006.

<sup>(3)</sup> Source: UNCTAD *World Investment Report 2007*

Figure 5: EU-27 FDI flows to Croatia by EU Member State



\* Other MSs has been computed as the difference between the EU aggregate and the sum of selected reporting countries.

## Fourfold increase of EU-25 outward stocks in Croatia between 2001 and 2006

During the period 1999–2001, EU-15 FDI outward stocks in Croatia remained relatively stable and at a low level. EU-25 investment stocks in Croatia followed an upward trend, starting from EUR 2.9 bn in 2001 and expanding to EUR 11.8 bn in 2006. The period 2005–2006 saw the biggest growth since Croatia started negotiations with the EU (i.e. 44% from 2005 to 2006). Between 2001 and 2006 the majority of the EU investment came from EU-15 countries. Of the total of EUR 11.8 bn invested in 2006, EUR 2 bn were from the new Member States and EUR 9.8 bn were from EU-15. With the exception of 2002, the share of the 10 new Member States in EU-25 FDI stocks in Croatia has remained fairly stable (fluctuating between 17% and 19%) since 2001.

In terms of comparing EU-25 and EU-27 investment, it should be noted that Bulgaria and Romania were not involved in FDI in Croatia between 2004 and 2006.

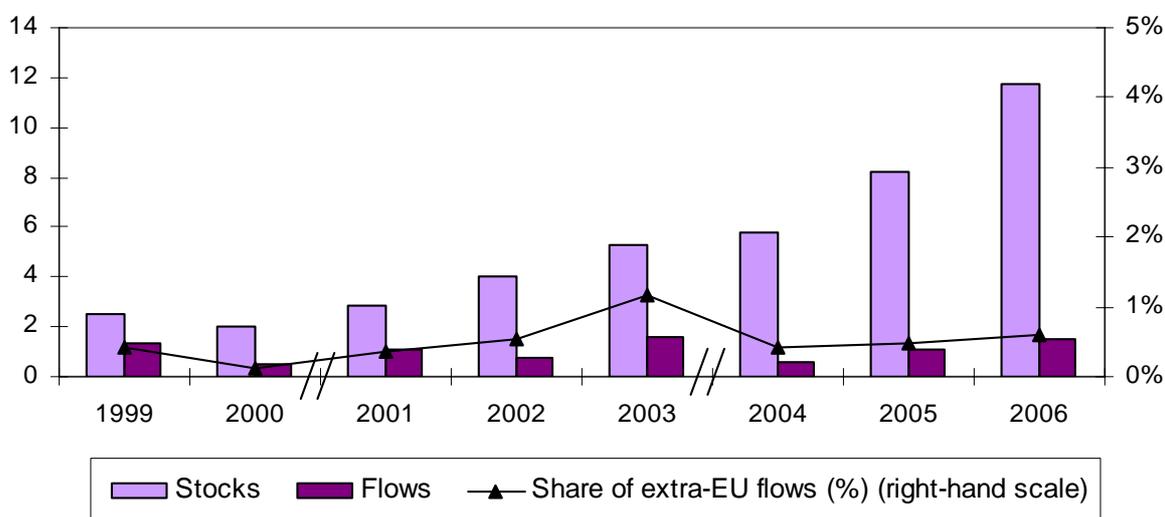
Although Croatia's share of extra-EU-25 outward FDI flows was relatively low, it did increase from 0.35% in 2001 to 1.17% in 2003, its highest level in the period under consideration. The equivalent figure for 2006 was 0.59%.

From the point of view of the sectoral breakdown, the figures for the FDI outward stocks and flows to Croatia for the EU aggregates are not available. However, from the available data for some Member States we can see that most EU FDI outward stocks - especially by German and Slovenian investors - have been concentrated in the *services* sector. Germany held EUR 1.1 bn in *services* in 2004 and 2005 and Slovenia's outward stocks in this sector rose by 66% between 2004 and 2006 (to EUR 572 mn). Italian outward stocks in Croatia were concentrated mainly in the *financial intermediation* sector. The most important activity for Hungarian investors in 2005 was *mining and quarrying*, where they held stocks of EUR 364 mn.

**Figure 6: EU outward FDI flows and stocks in Croatia**

EU-27 for 2004–2006, EU-25 for 2001–2003, EU-15 for 1999–2000

(EUR bn)



## Stocks - income and yield: 7.0% yield on EU FDI in Croatia and 7.6% yield in Turkey in 2006

Figure 7 shows the ratio<sup>(4)</sup> of income to stocks at the beginning of a given period expressed as an indicator of FDI profitability. Until 2006, and with the exception of 2004, the rate of return on FDI in Croatia and Turkey was always higher than the rate of return of FDI in other extra-EU countries.

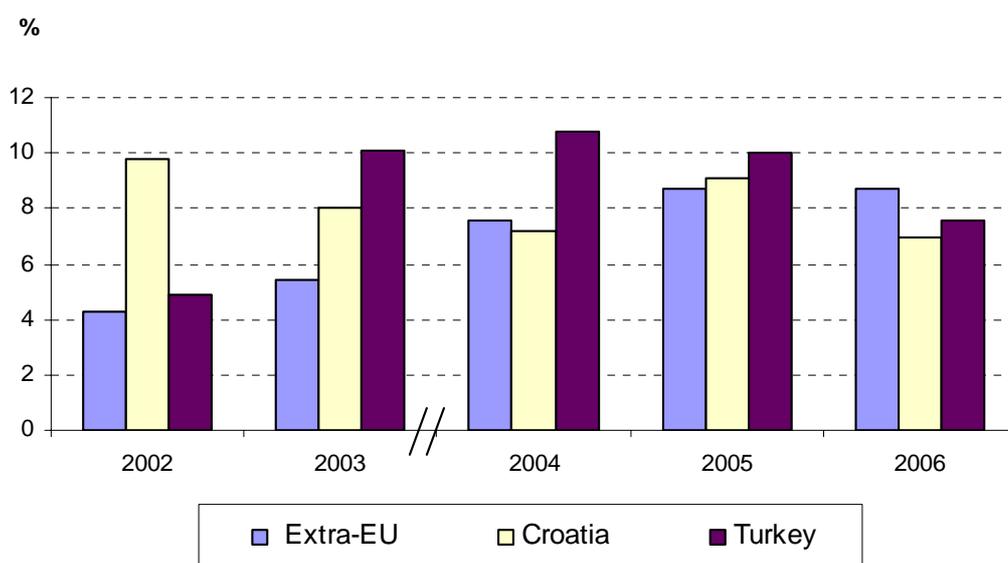
In 2006, the rate of return on FDI capital invested in Croatia and Turkey decreased by around 25% (to

7.0% for Croatia and 7.6% for Turkey), while the rate of return on FDI capital invested in extra-EU countries remained stable at 8.7%.

(4) Rate of return in t = (Income paid in t) / (Stocks at the end of the period t-1).

**Figure 7: Rate of return on EU FDI in Croatia and Turkey**

EU-27 for 2004-2006, EU-25 for 2002-2003



### METHODOLOGICAL NOTES

Foreign Direct Investment (FDI) data analysed in this publication refer to those registered in the Balance of Payments statistics. The EU annual FDI statistics are based on figures provided by Member States to Eurostat nine months after the reference period. The annual data covered in this publication will be revised by the end of this year when revised data will be transmitted by Member States. The figures shown in the tables may not exactly add up due to rounding.

The methodological framework used is that of the OECD Benchmark Definition of Foreign Direct Investment Third Edition, a detailed operational definition fully consistent with the IMF Balance of Payments Manual, Fifth Edition, BPM5.

**Foreign Direct Investment (FDI)** is the category of international investment made by an entity resident in one economy (*direct investor*) to acquire a lasting interest in an enterprise operating in another economy (*direct investment enterprise*). The lasting interest is deemed to exist if the direct investor acquires at least 10% of the voting power of the direct investment enterprise.

**FDI flows, stocks and income.** Through outward FDI flows, an investor country builds up FDI assets abroad (outward FDI stocks). Correspondingly, inward FDI flows cumulate into liabilities towards foreign investors (inward FDI stocks). However changes in FDI stocks differ from FDI flows because of the impact of revaluation (changes in prices and, for outward stocks, exchange rates) and other adjustments such as catastrophic losses, cancellation of loans, reclassification of existing assets or liabilities. FDI flows are components of the financial account of the Balance of Payments, while FDI assets and liabilities are components of the International Investment Position. Finally, FDI income consists of the income accruing to the direct investor from its affiliates abroad. Income earned from outward FDI is recorded among credits in the current account of the Balance of Payments, while income paid to foreign owners of inward FDI stocks is recorded among debits.

FDI flows and positions are recorded according to the immediate host/investing country criterion. The economic activity for both flows abroad and flows in the reporting economy are classified according to the economic activity of the resident enterprise. The same applies to FDI positions in the reporting economy while FDI positions abroad are classified according to the activity of the non-resident enterprise.

This article is based on detailed data that were published in Eurostat database in February 2008. Series for FDI contain data for 1992-2006 with detail by partner country and kind of investment (equity capital, loans and reinvested earnings). Data by Member State, by economic activity and by main partner are available for the period 1992-2006, and from 2001 for EU-25 and from 2004 for EU-27. Data for income cover 1995-2006 and data for FDI stocks go from end 1994 to end 2006.

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