

EU-15 Foreign Direct Investment in the new Member States

This article presents data on Foreign Direct Investment (FDI) from the EU-15 Member States to the 12 new Member States. In 2006, the EU-15 invested EUR 37.2 bn in the new Member States, which was EUR 0.3 bn less than the year before, but still high when compared with 2004 (EUR 19.1 bn). The services sector, particularly financial intermediation, business services and telecommunications, has gained most from the surge in FDI in the new Member States.

EU-15 investment in the new Member states levelling off

After very strong growth in EU-15 investment flows in the new Member States in recent years, with outflows increasing from EUR 5.0 bn in 2003 to EUR 37.5 bn in 2005, investment flows in 2006 stayed at the same level as the year before, at EUR 37.2 bn.

In 2004 and 2005, EU-15 outflows to the new Member States grew at a faster rate than total

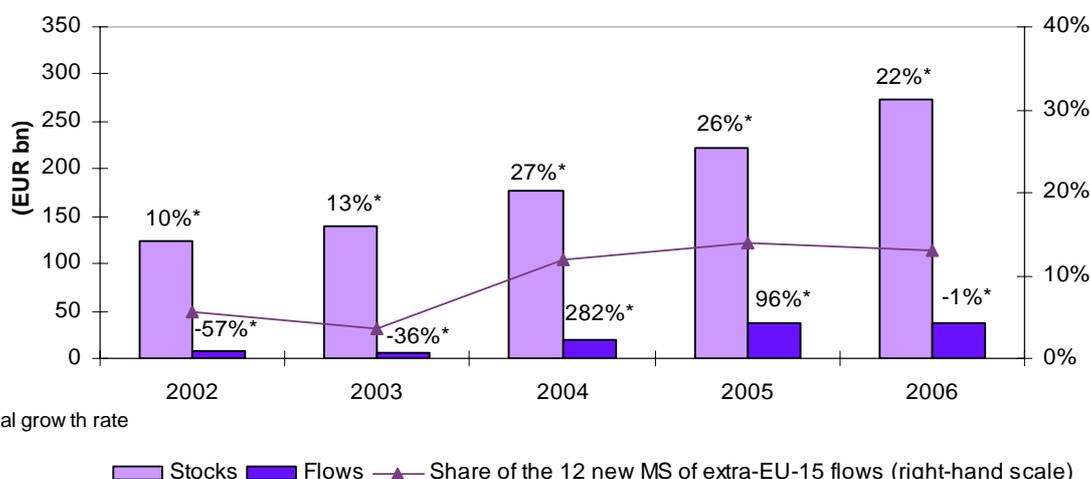
extra-EU-15 flows: in 2005, the growth in total extra-EU-15 flows compared with the previous year was 67 %, while investment in the new Member States increased by 96 %. However, 2006 registered a slowdown in the growth of all extra-EU-15 investment to only +7 %, and for the new Member States a slight decrease was even recorded (-1 %).

The share of the 12 new Member States in EU-15 outward FDI flows jumped to 12 % in 2004 and has remained at that level since.

If Bulgaria and Romania, which joined the European Union in 2007, are taken separately, it can be noted that investment flows to Romania in particular are growing rapidly. In 2006, 22 % of investment in the new Member States was already being channelled into Bulgaria and Romania.

EU-15 outward FDI stocks held in the 12 new Member States reached EUR 273.1 bn at the end of 2006. This was 9 % of all extra-EU-15 stocks and marked a growth of 22 % from the situation at the end of 2005.

Figure 1: EU-15 outward FDI flows and stocks in the new Member States



Malta and Romania the main destinations in 2006

Depending on particular large mergers and acquisitions, FDI flows can fluctuate considerably from one year to another. In 2006, EU-15 outflows to the new Member States were marked by big FDI flows from Germany to Malta (EUR 8.9 bn), coming from the German chemical and financial sectors. These FDI flows made Malta the main investment destination of the EU-15 within the new Member States, with one third of all flows (EUR 12.0 bn). However, this investment could be linked to the activities of Special Purpose Entities.¹

The second main investment destination was Romania, which recorded considerable growth from the previous year as investment flows surged from EUR 3.1 bn to EUR 7.4 bn. The biggest individual transaction behind Romania's figures was the acquisition of the *Banca Comerciala Romana* by *Erste Bank* (Austria) for EUR 3.7 bn.²

The third country to record significant growth was Slovakia, where investment flows from the EU-15 increased from EUR 1.6 bn to EUR 3.0 bn in 2006.

Investment in Hungary and the Czech Republic went down in 2006, and investment in Poland experienced only a moderate growth.

Table 1: EU-15 FDI outflows to the new Member States in 2004-2006 (EUR bn)

| | 2004 | 2005 | 2006 |
|-----------------------|--------------|--------------|--------------|
| Extra-EU-15 | 160.1 | 268.0 | 285.7 |
| Total NMS* | 19.1 | 37.5 | 37.2 |
| Bulgaria | 0.2 | 2.1 | 0.9 |
| Czech Republic | -2.1 | 4.6 | 3.3 |
| Estonia | 0.1 | 2.1 | 0.2 |
| Cyprus | 0.7 | 2.6 | 2.0 |
| Latvia | 0.2 | -0.1 | 0.0 |
| Lithuania | 0.2 | -0.1 | 0.2 |
| Hungary | 7.8 | 15.2 | 4.3 |
| Malta | 1.5 | 2.6 | 12.0 |
| Poland | 6.6 | 3.0 | 3.5 |
| Romania | 3.0 | 3.1 | 7.4 |
| Slovenia | 0.3 | 0.5 | 0.4 |
| Slovakia | 0.8 | 1.6 | 3.0 |

* NMS : New Member States

Germany was the main investor, followed by Spain and Austria

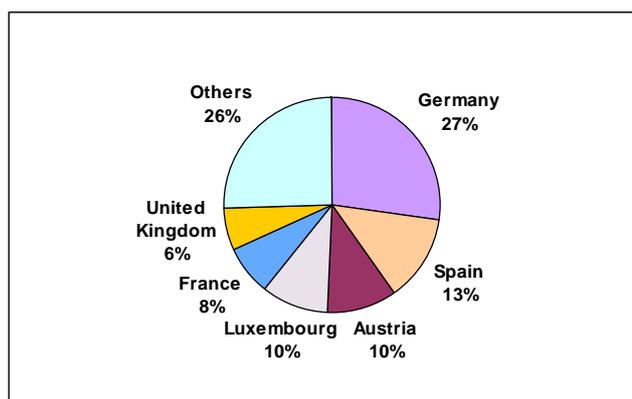
During the period 2004-2006, Germany was the main investor in the new Member States, with a three-year average of EUR 8.5 bn. Germany's outflows to Malta in 2006 greatly affected this average. Outflows to Hungary showed an upward trend, increasing from EUR 1.1 bn in 2004 to EUR 1.6 bn in 2006. Investment in Poland almost doubled between 2005 and 2006, from EUR 1.2 bn to EUR 2.1 bn.

The second largest investor among the EU-15 in 2004-2006 was Spain, with outflows to the new Member States averaging EUR 4.1 bn. Hungary was Spain's main partner, with 42 % of total Spanish outflows, followed by the Czech Republic (34 %).

Austria has traditionally been a significant investor in the transition countries of Central and Eastern Europe. The three-year average of Austrian investment flows to the new Member States was EUR 3.3 bn, Romania receiving the bulk of this investment (73 %). In 2006, Austria was by far the

main investor in Romania, with EUR 4.7 bn, which meant that 64 % of EU-15 outflows to Romania came from Austria.

Figure 2: Main EU-15 investors in the new Member States: flows 2004-2006



¹ SPEs: Special Purpose Entities are mainly financial holding companies, foreign-owned, and principally engaged in cross-border financial transactions, with little or no local activity in the Member State of residence.

² Source: UNCTAD "World Investment Report 2007".

68 % of stocks in Poland, Hungary and the Czech Republic

As regards stocks held by the EU-15 in the new Member States, Poland, Hungary and the Czech Republic were the main partners at the end of 2006, 68 % of all EU-15 stocks being held in these countries. The value of stocks held in Poland was EUR 68.4 bn, in Hungary EUR 64.6 bn and in the Czech Republic EUR 52.4 bn.

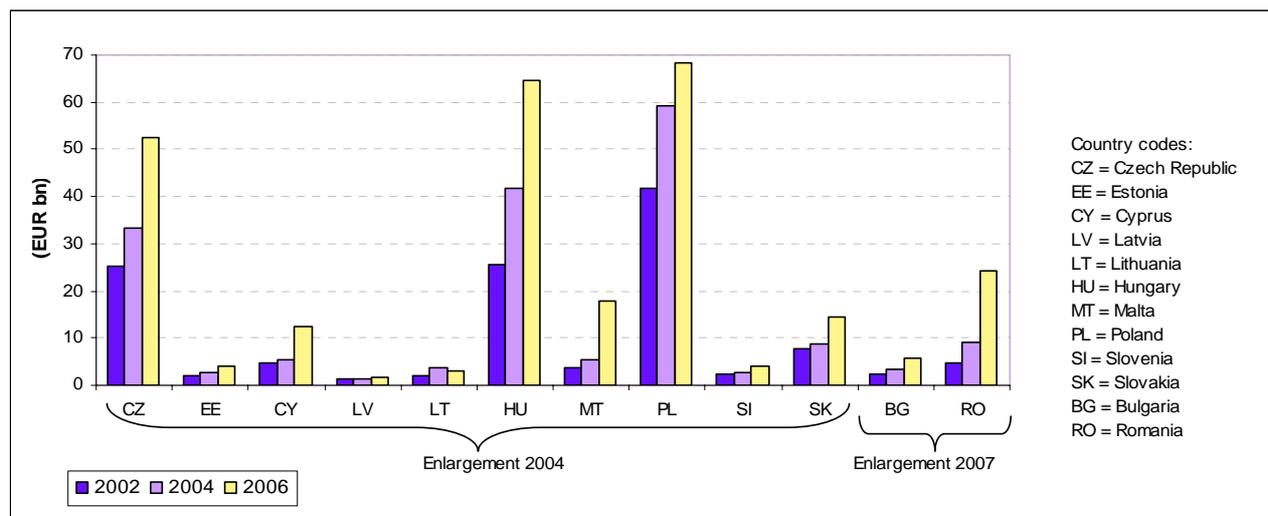
Among these three economies, the strongest growth in absolute terms was recorded in Hungary (increase of EUR 22.7 bn from 2004 to 2006),

followed by the Czech Republic with an increase of EUR 19.1 bn over those two years.

The stock held in Romania was nearly three times larger at the end of 2006 than two years before (from EUR 9.0 bn at the end of 2004 to EUR 24.4 bn at the end of 2006), which made it the fourth largest partner among the new Member States.

At the end of 2006, Germany was the main holder of FDI stocks in the new Member States, with 23 % of the EU-15 total (EUR 63.1 bn).

Figure 3: EU-15 outward stocks in the new Member States



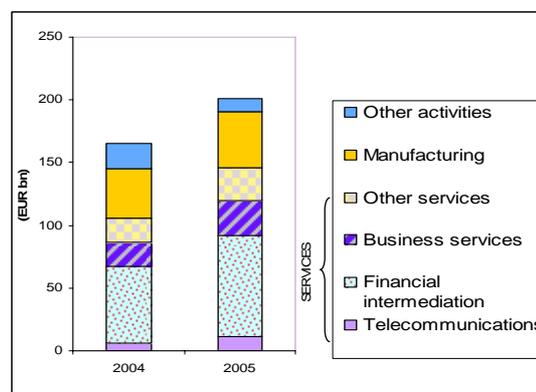
Services gaining most from the surge in FDI

The services sector, particularly financial intermediation, business services and telecommunications, has gained most from the surge in FDI in the new Member States. At the end of 2005, 73 % of EU-15 FDI stocks held in the 10 new Member States¹ were in *services*, against 64 % the year before. In absolute terms, stocks in *services* increased by EUR 40.1 bn, reaching 146.2 bn, a 38 % growth compared with the situation at the end of 2004. *Financial intermediation* remained the predominant activity within the services sector, with EUR 80.4 bn and 55 % of total services. *Business services* ranked second with a 19 % share (EUR 27.2 bn) while *Telecommunications* accounted for 8 % (EUR 11.6 bn).

The share of manufacturing remained very close to the figure recorded the year before, with a value of EUR 44.1 bn (22 % of total EU-15 stocks). Absolute growth since 2004 has been more

moderate than for services: 14 % and EUR 5.5 bn. A quarter of the stocks in *Manufacturing* were in *Vehicles and other transport equipment*, which shows the importance of the automobile industry for the Central European new Member States.

Figure 4: EU-15 FDI stocks held in the 10 new Member States by main activity²



¹ For Bulgaria and Romania no sectoral breakdown at EU-15 aggregate level is available.

² Services activities consist of: Trade, Hotels and Restaurants, Transport, Telecommunication, Financial intermediation, Business services, Real estate services, Other services not elsewhere classified.

Other activities include Agriculture & fishing, Mining & quarrying, Electricity, gas and water, Construction and Not allocated.

Financial intermediation includes Monetary intermediation, Other financial intermediation, insurance and pension funding (except compulsory social security) and Activities auxiliary to financial intermediation.

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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