IMPACT OF EU ACCESSION PROCESS ON

TURKEY'S FDI PERFORMANCE:

A COMPARATIVE ANALYSIS OF TURKEY AND CEE COUNTRIES

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AB'ye Katılım Sürecinin Türkiye'nin Doğrudan Yabancı Yatırım Performansı

Üzerine Etkisi: Türkiye ve Orta Doğu Avrupa Ülkeleri Karşılaştırmalı Analizi

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5) Katılım Süreci	5) Accession Process

ABSTRACT

Foreign Direct Investment (FDI) is a particularly important element for accelerated growth, technical innovation and enterprise restructuring of countries, as well as capital account relief. The determinants of FDI are thought to be macroeconomic conditions, political climate, institutional factors, labor costs, location, human capital, infrastructure, host country's trade openness and the prospect of European Union (EU) membership for the countries in the EU accession process. Since the beginning of their transition, Central East European Countries have attracted a considerable amount of FDI.

Turkey, on the other hand, has performed quite poor in attracting FDI, despite her renowned economic potential and geographic advantages. However, in late 2005 and 2006 first half, we have seen that the FDI inflow into the country has increased significantly. There is no doubt that, opening of negotiations on October 3rd 2005 has a crucial role in this increase. It is very likely that this latest surge in FDI will proceed hand in hand with the progress of EU accession process.

ÖZET

Doğrudan yabancı yatırımlar, ülkelerin büyümelerini hızlandırmaları, teknolojik yenilikleri ve girişimleri şekillendirmeleri ve sermaye girişi sağlamaları açısından önemlidir. Doğrudan yabancı yatırımı davet eden unsurların (determinantlar); makroekonomik koşullar, politik ortam, kurumsal faktörler, iş gücü maliyeti, yatırım yeri, beşeri sermaye, altyapı, ticaret açıklığı ve AB'ye giriş sürecinde olan ülkeler için beklenen AB üyeliği olduğu düşünülmektedir. Orta ve Doğu Avrupa ülkeleri AB'ye giriş sürecinde kayda değer oranlarda doğrudan yabancı yatırım çekmişlerdir.

Öte yandan Türkiye; ekonomik potansiyeli ve coğrafi avantajlarına rağmen doğrudan yabancı yatırım çekme konusunda zayıf bir performans sergilemiştir. Ancak 2005 yılının sonu ve 2006 yılının ilk yarısında, ülkeye doğrudan yabancı yatırım girişi artmıştır. Hiç şüphesiz ki, bu artışta 3 Ekim 2005 tarihinde AB ile başlayan müzakerelerin etkisi önemli olmuştur. Bu son dalga, çok muhtemeldir ki, AB'ye giriş sürecinde artarak devam edecektir.

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LIST OF ABBREVIATIONS

CEE   Central Eastern Europe
CEEC Central Eastern European Countries
CU   Customs Union
EU   European Union
FDI   Foreign Direct Investment
GDFI   General Directorate of Foreign Investment
GDP   Gross Domestic Product
IMF   International Monetary Fund
M&A   Merger and Acquisition
MNC   Multinational Corporations
MNE   Multinational Entreprises
OECD   Organization for Economic Cooperation and Development
UN   United Nations
WB   World Bank

INTRODUCTION

Globalization, the growing integration of economies and societies around the world (World Bank, 2005), is not a new phenomenon. The economic activity between people on different geographic locations has existed for centuries. The unique side of today's globalization is the rapid pace at which it is accelerating. This is also why globalization today not only includes the exchange of goods and services, but also can be specified as the integration of trade, capital flows, labor or technological transfers between nations (Dutt, 2001). Siphambe (2003) states the dimensions of globalization as economic, political and cultural; all of which have a social impact. In this study, the economic side is analyzed in better detail and it is mentioned that on the economic side, there are five key features of globalization:

(i) Rapidly expanding international trade, facilitated by newer technologies among others. A growth in foreign trade as a share of Gross Domestic Product (GDP) is commonly used as an indicator of globalization.

(ii) Increase in foreign direct investment (FDI) and capital flows.

(iii) Increasing internationalization of production, distribution and marketing of goods and services as a result of the adoption of new organizational forms of production by multinational enterprises and growth in capital markets and FDIs.

(iv) Growing global competition among producers and suppliers of goods and services.

(v) Adoption of economic reforms and liberalization of trade and investment policies undertaken by developing countries

As an economic outcome of globalization; FDI plays an extraordinary and growing role in global business. One of the most obvious consequences of globalization is the fact that it accelerates and intensifies competition. This leads to adopt and develop new strategic approaches not only for multinational enterprises (MNEs), which are doing business abroad, but also local enterprises in order to survive. In European Union Foreign Direct Investment Year Book (2005), it is mentioned that FDI plays a key role in the globalization process as an important element of international relations and their development. While supplementing trade, FDI creates more direct and deeper links between economies. It is a source of extra capital, encourages efficient production, stimulates technology transfer and fosters the exchange of managerial know-how. It is thus believed to improve the productivity of business and make economies more competitive. In this study, FDI data was used as a tool for measuring the evolution of the globalization phenomenon. With the trends of globalization, liberalization in foreign currency and trade regimes, the volume of FDI increased throughout the world. Since the early 1980s, world FDI flows have grown rapidly -faster than both world trade and world output. (OECD, 2001).

FDI has also been a widely discussed topic in the context of European Union (EU). In various researches, the correlation between the FDI attractiveness and EU membership process has been analyzed and most of the studies have come to a consensus that one of the key benefits of the EU enlargement process is the boost it gives to foreign direct investment.

Although the EU-15 is still far from a consensus on the need for ongoing enlargement, the accession countries themselves have been enthusiastic with the

EU integration process. Of the many discussion bases, economic improvement and growth prospects have been the main motives to make the EU membership attractive for these countries. Membership criteria require that an accession country improve and maintain economic soundness, harmonize the legal infrastructure with the Union's Acquis and remove trade barriers. These criteria are also taken as positive economic targets by these countries and appear as benefits to stem from integration with the EU.

Of course, these prospects are also closely watched by the interests of global investors, since the establishment or relocation of facilities to these promising economies are getting more and more feasible and profitable during the course of integration. Therefore, it is generally acknowledged that the FDI stocks in these countries have increased towards and upon accession to the EU. Inflows of investment to CEE countries have increased sharply since 1994, when the EU committed itself to enlarging.

Turkey's being an emerging market and an EU candidate state as well as a growing export partner for foreign companies have been the key motives for developing the purpose of this study. Current EU negotiations added on to the interest and importance to study the background to and the impact of EU accession of Turkey on MNEs' choices to engage themselves in FDI in Turkey.

Turkey is situated on the crossroads between Europe and Asia with a population of 70 millions. Its strategic geographical location is significant as it adds value to the country's economic potential and creates market opportunities for foreign investors. Along with China, India, Russia and Brazil, Turkey has been named to be one of the ten emerging markets in the world by the World Bank as

well as the US Department of Commerce (The World Bank, Erdal & Tatoğlu, 2002). During 2004, Turkey's economic growth rate was 8.9%, which was mainly triggered by exports. Moreover, Turkey is a quarter of the size of the EU in terms of geographical area and has a population that is one-fifth of that of the EU-25. This fact puts the country among the top 25 economies in the world in terms of GDP. (FDI Magazine, 2004). On January 1st 1996, a Customs Union (CU) between Turkey and the EU came into effect. Turkey is the only country to have a CU agreement with the EU without being a member state. The CU allows the free circulation of industrial goods and processed agricultural products and has resulted in a closer economic and political relationship between the EU and Turkey. Customs duties and charges have been abolished and quantitative restrictions such as quotas are prohibited. The CU transferred most of the EU's trade and competition rules to Turkey and made the Turkish economy even more open to FDI.

Although Turkey should be an interesting market for foreign investors both because of the increasing growth rate and its geographical location, she lagged behind other emerging economies as well as 10 new EU member states. FDI inflows into CEE countries increased sharply since 1994, after the public commitment made by EU about Eastern enlargement in Essen European Council. The fact that the total FDI stock has risen by 7-fold between 1994 and 2005 in CEE-Countries recurs to the mind that there could even be a correlation between Turkey's performance, which is far below its potential, and CEE countries' successful FDI attracting performance.

In this context, this study is analyzing the case of FDI inflows into the new member states of the EU, in comparison to and with a special emphasis on Turkey's FDI experience. The study initially examines the definition and determinants of FDI and its effects on the host economy; then discusses the impact of EU accession process on FDI performance of both Turkey and CEE countries. Finally by presenting econometric models, the study investigates if Turkey's FDI attraction performance was affected by the performance of CEE countries between the years 1994 and 2005 and also the impact of major economic determinants on Turkey's FDI performance.

Discussion of the problem

Despite the presence of economic prerequisites and a diminishing number of barriers to entry, FDI in Turkey has remained quite low (FDI Magazine, 2004), especially when compared to other emerging markets such as the CEE countries, Far Eastern and Latin American countries (Erdal &Tatoğlu, 2002). However, it should be emphasized that FDI in Turkey is increasing, even though the progress is relatively slow (Turkish Treasury Department statistics, 2005).

The aim of this study is to identify the impact of EU accession process on the FDI performance of Turkey. Moreover, it also tries to discuss the main reasons and factors that are supposed to be behind the investment decisions of the companies that have engaged in FDI in Turkey and in CEE countries during the EU accession process. Finally, it tries to make an analysis about the effect of CEE accession process on Turkey's FDI performance and the impact of major economic determinants on Turkey's FDI performance.

Statement of the Problem

1. What is the impact of EU accession process on candidate countries' FDI performance?

2. Did CEE Countries' FDI performance in the EU Accession period affect Turkey's FDI Performance in any way?

3. What are the impacts of economic determinants on Turkey's FDI Performance?

1) LITERATURE REVIEW ON FOREIGN DIRECT INVESTMENT

1.1. Definition of FDI

There are several descriptions of FDI in literature. According to IMF and OECD recommendations; "Direct investment is the category of international investment that reflects the objective of a resident entity in one economy (direct investor) of establishing a lasting interest in an enterprise (the direct investment enterprise) resident in another economy." (Falzoni, 2000). In another expression by IMF and OECD, Foreign Direct Investment is defined as "an incorporated or unincorporated enterprise in which a foreign investor owns 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. Direct investment enterprises may be subsidiaries, associates or branches". (Duce, 2003)

1.2. Determinants of FDI

FDI is a particularly important element of economic integration, because it opens possibilities for accelerated growth, technical innovation and enterprise restructuring, as well as capital account relief (Garibaldi *et al* (1999); Holland and Pain (1998)). In literature, there are numerous studies why foreign firms choose to invest abroad. The determinants of FDI are thought to be macroeconomic conditions, political climate, institutional factors, labor costs, location, human capital, infrastructure, trade openness of the host country, and the prospect of EU membership for the countries in the EU accession process.

One of the major determinants of FDI is reasoned by the motives for investing abroad instead of investing at home. Dunning (1977; 1988) represented OLI (Ownership, Location, Internalization) paradigm in order to explain the motivation driving firms to invest overseas and the reason why one location is selected in preference to another. At this point, Dunning has identified four generic types of strategic motives for international investment:

- Market seeking

- Efficiency seeking

- Resource seeking

- Asset seeking

Market seeking or horizontal FDI motives are the correlation between the host economy's market size and FDI flows. In resource-seeking FDI, investors would like to invest in the countries where they can acquire resources such as raw materials, labor and natural resources at a lower real cost. Efficiency-seeking or vertical FDI is undertaken when a firm benefits from setting up different plants at different locations for the sake of economies of scale in order to minimize factor costs. According to Dunning (2002), FDI in developing countries has shifted from market-seeking and resource-seeking to (vertical) efficiency-seeking, as firms are expected to relocate some of their production facilities to low cost developing countries as a consequence of globalization effect on prices.

Loewendahl (2001) reveals that asset-seeking FDI is the most recent motive for FDI to be identified. The major aim in the asset-seeking FDI is to access and exploit technological assets in overseas countries especially in the form of mergers & acquisitions and technology agreements. In this sense,

although the developed countries are considered as the main recipients, there are also developing countries such as Hungary, India and Brazil attracting research & development projects. According to Loewendahl, cost differences are only likely to play a critical role in determining investment location when the investor needs to choose between short-listed countries, which are likely to be part of the same, sub-regional market.

There are many reasons why foreign firms consider macroeconomic stability as necessity to invest. It is widely accepted that macroeconomic conditions play a significant role in attracting FDI. Low inflation rates and stable exchange rates are used as the key factors in verifying the stability and the strength of the economy and provide a degree of certainty to the future of the economy and the projections of the firms in profit considerations. Moreover, a stable macro-economic environment usually implies a stable political environment. (Balasubramanyam, 2001)

According to Michalet (1997): "an indispensable precondition for encouraging foreign investment is to have a stable political and economic climate, and a transparent and nondiscretionary legal and regulatory framework." Institutional factors such as corruption and political instability are key negative determinants of FDI as corruption can discourage FDI by inducing higher costs of doing business. (Wei 1997, Makusen 1998)

Domestic market size and differences in factor costs are highlighted as determinants for the location of FDI by Markusen and Maskus (1999), Lim (2001) and Moosa (2002). Foreign firms seeking a market to invest are more attracted to the country with higher growth rate of GDP as it indicates a larger potential

demand for their product. Market-related factors are more about the traditional determinants of FDI. In an earlier study, Agarwal (1980) argued that the market size of the host country is the most important factor for the attractiveness of FDI. Also in many studies, such as Wheeler and Mody (1992) and Tsai (1994); FDI determinants are revealed as the market- related variables such as GDP, GDP per capita and GDP growth and population.

There are controversial arguments regarding the effect of labor cost on investment incentives. On the one hand, while some authors have claimed that higher wages do not always deter FDI in all industries; on the other hand, it is asserted that a high nominal wage- other things being equal- deters FDI, especially for the firms which engage in labor-intensive production activities.[1] While some studies have shown no significant role of labor costs, some others have shown the positive relationship between labor costs and FDI as higher wages indicate higher productivity.[2] According to Lucas (1998), the importance of human capital tends to be small, when a host country is more appealing to labor-intensive FDI. Contrarily, according to Fung, Iizaka, and Parker, (2002), labor skill is more significant for a host country where more capital and technology intensive investment projects are concentrated.

Fung, Iizaka, and Parker (2002); also found that better developed regions with superior quality of infrastructure are more attractive to foreign firms. Infrastructure facilities including transportation and communication networks are

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[1] See studies that find no significant or a negative relationship of wage and FDI are Kravis and Lipsey, 1982; Wheeler and Mody, 1990; Lucas, 1993; Bajo-Rubio and Sosvilla-Rivero, 1994; Wang and Swain, 1995; and Barrell and Pain, 1996.
[2] For positive relationship between FDI and wage, see Saunder, 1983; Schneider and Frey, 1985; Moore, 1993; and Love and Lave-Hidalgo, 2000.

also found as important determinants of FDI in the studies of Langhammer (1991).

Trade related FDI is analyzed in depth by more recent studies. Export orientation is found to be the strongest variable for attracting FDI according to Sing and Jun (1995). In Gastanaga, Nugent and Pashamova (1998), tariff-jumping hypothesis is addressed in the context of a panel analysis on the effects of host country reforms on FDI. In their study, as the effects of import tariffs on FDI tend to be negative in a time series context, they come to a conclusion that "over time in countries, trade liberalization has become the more important motive for FDI".

Another strong determinant is the prospect of EU membership. It is considered to be the major motive driving firms to invest in the accession countries, which will be analyzed in depth in Section 2.

1.3. The Impact of FDI on the Host Economy

FDI has become an important tool for development of many countries. There is general agreement about the positive impacts of FDI on the welfare of receiving countries. The benefits of FDI concerning the capital market, technology transfer, market access, investment opportunities and export promotion are among the factors attracting FDI inflows from a host country perspective. There is broad consensus that foreign direct investment has a favorable effect on the host economy and especially on economic growth. For over two decades now, several international organizations such as the World Bank, International Monetary Fund, World Trade Organization and divisions of United Nations have been promoting FDI as an essential instrument for boosting

economic growth, technology spillovers and other benefits. In accordance with the reports of these organizations, FDI is believed to raise the level of productivity (which in turn is presumed to enhance economic growth) of a host economy in at least three ways:

- Inviting superior productivity of foreign firms

- Creating spillover effects of FDI which are beneficial for domestic competitors

- Increasing competition in the domestic market, at least in highly concentrated industries

Besides, international investment can either bring access to foreign technologies and new working practices or make available new products and process that embody foreign knowledge, helping to close the 'idea gaps' as Romer puts it in his renowned 1993 article.

Yet, on the other hand, a study in 2002 by Carkoviz and Levine contradictorily suggests that the exogenous component of FDI does not exert a robust independent influence on growth. The authors discuss that the growth effects of FDI remain unclear and that the empirical evidence in this regard is divided. In a parallel view, a different study states that FDI in manufacturing sector has a significant and positive effect on economic growth in the host economies whereas FDI inflows in non-manufacturing sectors do not play a significant role in enhancing economic growth. (Wang, 2003)

According to Zacharov and Kusic (2003), for the recipient countries it is not the amount of FDI that plays a significant role, but contribution to the economic development. FDI does not only increase production in real sector but

also facilitates economic modernization and transfer of know-how. Furthermore, foreign investment creates additional employment in the host country. FDI flow is one of the major ways of technology transfer. By providing new technology and investment goods, the competitiveness of goods and services in the host country will improve, which will lead to higher sales on international markets. FDI supplies not only new technology but also advanced management techniques. These entire positive spillover effects of FDI inflows are believed to accelerate growth in the recipient country. The authors also pointed out the positive correlation between the amount of FDI and the growth of GDP and work productivity. With FDI inflows, the recipient country also benefits from accessing to new markets that contributes to increase export incomes. New market experience for the recipient country leads to better quality production and this helps to raise competitiveness. Moreover, they emphasize that FDI is a source for financing balance deficits and thus host country improves its credit liability, which in turn facilitates access to other financial sources.

There have been many studies in the last decades that analyze the correlation between trade and FDI. Some of them have investigated if trade creates FDI in the end, or vice versa. Another issue is the substitution effect between these two. This was also debated publicly in Turkey; if the Customs Union and increased trade with EU countries could negatively affect the amount of incoming FDI, since the European companies could choose to easily export instead of investing. In Turkey's case, we have seen that this has not happened. Between 1994 and 1996, it was believed that the decrease in tariff rates would increase the exports to Turkey and this would reduce FDI inflows. Contrarily, the

performance of Turkey between these years cannot be explained by substitution effect between trade and FDI. While every step of integration with the EU (trade-related, bureaucratic, legal…etc.) has helped increasing FDI inflows, any economic or political instability deteriorates FDI performance of a country.

Theory suggests that the correlation between trade and FDI is complex and involves many parameters. Sakakibara and Yamakawa (2003) state that this correlation may vary by the product, economic sector and across different countries. The type of FDI (whether it is resource-seeking or export oriented…etc.) may affect the import and export patterns of the host country. The authors defend that usually trade comes first, which in turn creates FDI. In the later stages, this FDI causes increased trade. Another important point mentioned by Sakakibara and Yamakawa (2003) is that the debate of trade vs. FDI is changing into the discussion of international production networks. Since the costs of communication and transportation have improved, it is now a question of where to locate the production and export bases for the multinationals. China, for example, is a popular destination of export-oriented FDI, causing increased raw material imports into the country, as well as exports of semi-finished and finished products. Therefore, the important issue to discuss according to Sakakibara and Yamakawa (2003) is not whether FDI and trade are substitutes, but instead, it is how multinationals decide their production and export locations. Aizenman and Noy (2005), on the other hand, discuss in their literature review that the major argument in this field is that increased FDI results in increased trade. The authors refer to an older study of themselves, and state that causality between commercial

openness (trade) and aggregate financial openness (FDI) is strong in both
directions.

2) IMPACT OF EU ACCESSION PROCESS ON FDI PERFORMANCE

2.1. The Relation Between EU Accession and FDI Flow

According to Eurostat (1997: 39) "European companies have a tendency to respond to globalization pressure by enhancing the division of labor through FDI within the EU rather than to third countries." This means that the EU membership makes a country more attractive for FDI from other EU countries. On the other hand, with the EU membership a country also attains the opportunity to get a share from the FDI inflows to the EU from third countries.

The last European Union enlargement, took place in 2004, introduced eight countries from CEE to the EU. Experience from previous enlargements suggests that joining the EU will increase trade flows between the new member states and other EU countries and will also attract higher levels of FDI to the transition economies (Holland and Pain 2000).

Bevan and Estrin (2000) made an analysis about whether or not EU membership can be viewed as a determining element of the operating business environment, and this may directly influence the rate of FDI flows in transition economies. According to them, the prospect of EU membership might be viewed by potential investors as reducing country risk; for meeting the requirements of EU admission represents an external validation of progress in transition and also because ultimate EU membership implies guarantees in terms of macro economic stability, institutional and legal environment and political stability. They suggest that countries that take part in the EU accession process benefit from increased FDI while the relative position of the delayed entrants could deteriorate and

therefore EU announcements tend to widen divisions in terms of FDI among delayed entrants and candidate countries. They show that key announcements of progress in EU accession have impacted directly upon FDI receipts but have not influenced country credit ratings. The study comes to a conclusion that The Agenda 2000 announcement by the European Commission induced a bifurcation between the 'first wave' transition countries and the remainder of their sample. This process triggers FDI, which also improves country credit ratings with a lag, hence increasing future FDI receipts. Consequently the authors suggested that the accession progress has the potential to induce virtuous cycles for the frontrunners but may have serious consequences for the late comers as the expected amount of FDI may not be received.

Since the start of transition period, accession countries have attracted a considerable amount of FDI. FDI inflows into CEE candidate countries increased sharply since 1994, after the public commitment made by EU about Eastern Enlargement in Essen European Council. In 1990, while the accession countries accounted for 2.1 percent of world GDP, they attracted only negligible amounts of FDI, less than 0.1 per cent of the 1990 total. In 2001, the same eight countries accounted for just over 1.75 percent of world GDP, while attracting over 2.2 per cent of 2001 world FDI flows. In 2002 these accession countries attracted 3.2 per cent of total world FDI inflow.

Table 1: FDI inflows to CEE countries, and its share of total world inflow

mn$	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
World	259.469	341.086	392.922	487.878	701.124	1.092.052	1.396.539	825.925	716.128	632.599	648.146
Czech Republic	869	2.562	1.428	1.300	3.718	6.324	4.986	5.641	8.483	2.101	4.463
Estonia	215	202	151	267	581	305	387	542	284	891	926
Hungary	2.286	5.104	3.300	4.167	3.335	3.312	2.764	3.936	2.994	2.162	4.167
Latvia	214	180	382	521	357	347	413	132	254	300	647
Lithuania	31	73	152	355	926	486	379	446	732	179	773
Poland	1.875	3.659	4.498	4.908	6.365	7.270	9.343	5.714	4.131	4.123	6.159
Slovakia	273	258	370	231	707	428	1.925	1.584	4.094	669	1.122
Slovenia	117	151	174	334	216	107	136	370	1.686	337	516
Total	5.879	12.188	10.454	12.083	16.203	18.579	20.333	18.366	22.657	10.762	18.774
%Share	2,3	3,6	2,7	2,5	2,3	1,7	1,5	2,2	3,2	1,7	2,9

Source: Own calculations on the basis of data from UNCTAD

Regarding CEE countries, inflows of foreign capital were vital as they accelerated growth and development. The importance of FDI is obvious considering its proportion to total fixed capital formation. CEE applicants benefited from the impact of enlargement, since the announcement made by EU at Essen European Council in 1994, as this introduced more foreign capital inflow. Comparing with the world and developed economies, FDI comprises larger proportions of total investment for each year since 1994 for CEE accession countries. (Table 2)

Table 2: FDI inflows as percentage of Gross Fixed Capital

%	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
World	**4.5**	**5.3**	**5.9**	**7.3**	**10.7**	**15.9**	**19.6**	**11.9**	**10.3**	**8.1**	**7.3**
Developed economies	**3.5**	**4.5**	**4.8**	**6.0**	**10.4**	**16.4**	**21.4**	**11.8**	**10.9**	**7.9**	**6.1**
European Union	**5.6**	**7.4**	**7.1**	**8.7**	**16.3**	**27.6**	**40.7**	**22.6**	**23.7**	**16.0**	**8.8**
CEE Applicants	**12.3**	**19.6**	**14.2**	**15.7**	**18.6**	**22.1**	**25.1**	**21.8**	**25.1**	**10.2**	**15.2**
Czech Republic	7.4	14.7	7.4	7.7	21.6	39.7	32.4	33.6	43.2	8.7	15.4
Estonia	33.6	20.7	12.5	19.5	35.0	22.1	27.6	33.7	14.1	34.5	29.6
Hungary	27.4	57.0	34.1	41.0	30.0	28.8	25.2	32.3	19.7	11.7	18.6
Latvia	39.5	26.7	41.0	49.3	21.5	20.7	21.7	6.4	11.4	11.2	16.7
Lithuania	1.9	5.3	8.8	15.7	34.5	20.2	17.7	18.2	25.5	4.6	15.8
Poland	10.5	15.5	15.1	14.5	15.9	18.4	23.8	14.9	11.4	10.8	14.5
Slovakia	6.6	5.3	5.5	3.2	8.8	7.1	36.6	26.3	61.1	8.0	11.1
Slovenia	4.0	3.6	4.0	7.5	4.3	1.9	2.8	7.7	32.7	5.1	6.5

Source: UNCTAD

Barry (2002) emphasized that, much of the FDI flows into CEE have been "market seeking", rather than reflecting an attempt to integrate the production of these transition economies into EU production networks. Holland *et al* (2000) conclude that home-market size and growth potential were driving forces behind CEE-bound FDI in the first decade of transition. According to a study carried out for the European Commission by Boeri and Brücker (2000), previously underdeveloped non-tradable sectors, such as utilities, transport and communications, trade, financial intermediation and other services attracted almost half of FDI flows in the transition economies. The main investment motive here is to supply domestic markets and exploit first-mover advantages in markets with limited or nonexistent competition.

The economic and political system of the CEE countries had been organized according to the system of socialism. From an economic point of view, accession to the EU means a transformation to implement market economy. Studying FDI statistics of CEE countries, it is evident that in the accession period most of the FDI flows were concentrated in Poland, the Czech Republic and Hungary. In Bevan and Estrin (2000), the impact of Essen announcement on FDI inflows to CEE countries is analyzed and they reach the conclusion that a significant increase of FDI was realized by especially Hungary, Czech Republic and Poland. The FDI performance of Hungary, Czech Republic and Poland stand out as they implement a successful privatization strategy and export oriented FDI policies. Holland and Pain (1998) examined in depth why Poland, Hungary and the Czech Republic have been more successful at attracting FDI than other neighboring countries. According to them, they are among the largest regional

economies and were the fastest to recover from the transitional recession. They state that as a result of liberalizing earlier, restructuring and stabilizing their economies and political systems faster, these three countries have afforded investors' access to relatively large, fast growing and stable markets. Moreover, Holland and Pain (1998) pointed out that these countries were also among the first ones to begin membership negotiations with the EU. In this study they implied that the perception of not-so-distant EU membership helped to reduce the level of risk associated with these countries, relative to other countries in the region and this, too, has encouraged investment. As a conclusion they emphasized that the proximity to the EU membership and also privatization path helped them to draw FDI. Moreover, Zacharov and Kusic (2003) denoted that these countries display high FDI performance due to faster compliance with the two economic criteria - which are establishment of a well functioning market economy and capacity to withstand the competitive pressures and market forces within EU- for EU accession and can start the integration process earlier.

Figure 1: Total FDI Inflows to CEECs between 1995-2004
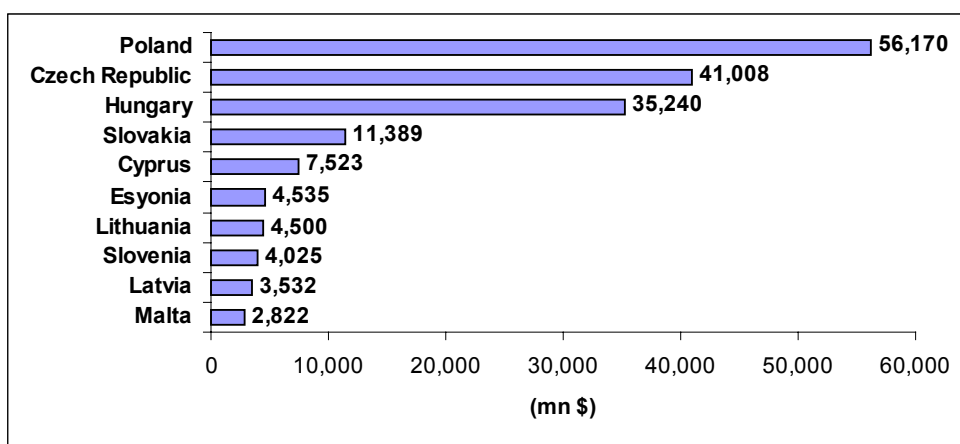
Source: UNCTAD

In order to see the real affect of FDI in these countries' economies, the periods between 1994 and 2004 should be analyzed since the former can be seen as a milestone in the accession process while the latter is the year of accession to the EU. There is a rapid increase in the stock of FDI in Czech Republic, Hungary and Poland in this period of time. As shown in Table 3, in Czech Republic while the stock of FDI accounted for 9% of GDP in 1993, it reached to 52,7% of GDP in 2004. And also in Hungary there is an increase from 14,3% to 25,4%. A similar situation took place for Poland as the ratio raised from 2,9% to 25,4 %. These three countries received about 60 % of annual inflows to the region in 2004.

Table 3: Stock of FDI

	Cumulative FDI as % of GDP			% Change in Real Stock FDI		
	Czech Republic	Hungary	Poland	Czech Republic	Hungary	Poland
1993	9,0	14,3	2,9	-	-	-
1994	10,2	16,9	3,7	32,8	27,1	44,6
1995	13,1	25,3	5,9	61,7	59,5	107,0
1996	13,7	29,4	7,7	16,6	17,5	46,2
1997	16,1	39,3	9,7	7,7	35,3	27,3
1998	23,3	44,1	13,5	55,7	15,4	54,0
1999	29,5	48,4	16,1	22,1	12,2	16,1
2000	38,9	49,0	20,9	23,3	-1,7	31,3
2001	44,4	52,9	22,5	25,2	19,8	20,5
2002	52,6	55,8	25,6	42,7	32,2	17,1
2003	50,1	58,4	26,7	17,1	33,4	14,4
2004	52,7	60,7	25,4	24,6	24,9	11,1

Source: World Investment Report 2005,UNCTAD

In this time period, although there had been a significant amount of inward FDI to these countries, the amount of inflow fluctuated during the accession period. In 2002 while the overall FDI inflows to the candidate countries was $22,6 billion; it declined to $10,7 billion in 2003. In UNCTAD's 2004 report it is implied that this was almost entirely due to the end of privatization in the Czech

Republic and Slovakia. In the rest of the other countries, the decline in FDI inflows was smaller (UNCTAD 2004).

Figure 2: FDI Inflows, to Czech Republic, Hungary and Poland
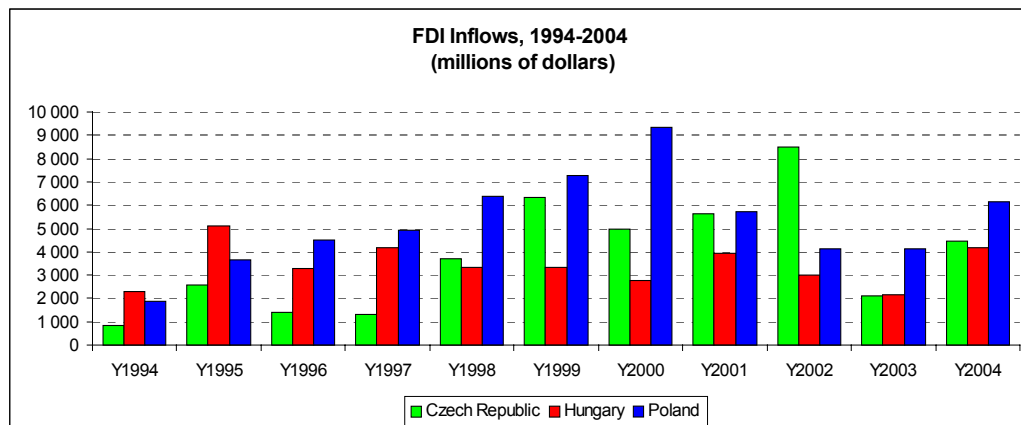
Source: UNCTAD, World Investment Report 2005

It can be claimed that the prospect of EU-25 had also accelerated FDI inflows from member states to candidate countries in the negotiation period. In an article executed by Lovino (2002), FDI transactions to candidate countries from 1996 to 2000 were investigated and it was stated that 87 % of FDI inflows to the candidate countries came from the EU member states in the year 2000. This is an important investigation since it proves that intra-EU FDI transactions had increased within this period. According to the level of concentration, the author implied that Poland, the Czech Republic and Hungary were the destinations for the majority of the total FDI.

2.2. European Union Accession Process, FDI and Turkey

Turkey's formal relations with the EU date back to the 1963 Association Agreement and the country was the first of the current group of applicants to apply for EU membership back in 1987. For a variety of political and economic reasons, the request made little progress over the years, until the Helsinki Summit in December 1999. At that meeting, EU Governments formally recognized Turkey as a candidate country. On October 3rd 2005, membership negotiations were opened with Turkey. Right after the EU Accession Negotiations have been launched, Screening Process is started, which is expected to finalize within a year.

2.2.1. Turkey's FDI Performance Over Time

The key objective of this section is to analyze Turkey's performance in attracting FDI both over time and relative to CEE countries by making implications for EU accession process.

Despite her renowned economic potential and geographic advantages, Turkey has performed quite poor in attracting FDI. There are various reasons such as the domestic and regional unrest in politics, international embargos to potential trading neighbors, reluctance of the bureaucracy for facilitating FDI regulations, domestic and international economic crises, highly volatile currency and the uncertainty related to the fundamental revisions in the banking system. Although Turkey is a high potential country to attract FDI (as the largest economy in the region), it is a striking fact that the country has failed to attract expected levels of FDI.

In its World Investment Report (WIR) for 2004, UNCTAD provides three indicators that measure the performance of a country in attracting FDI. These are the transnationality index - a measure of relative economic importance of foreign affiliates in total economic activity - the FDI performance index and the FDI potential index. In 2001, Turkey ranked seventh from the bottom in the transnationality index of developing countries with Hong Kong having the first position; while in 2002, Turkey ranked sixth from the bottom among developing countries. UNCTAD provides a matrix based on the FDI performance and potential indices. For 1988–90, 1993–95 and 2000–02 periods, Turkey ranked among the under-performers.

Table 4: FDI Matrix

	High FDI Performance	Low FDI performance
FDI potential	Front-runners	Below potential
Low FDI potential	Above potential	Under-performers

It will not be an incorrect statement to imply that the history of FDI for Turkey starts in 1980, which is the year of liberalization. Up until 1980, the cumulative level of FDI had amounted to $228 million with an average annual inflow of $90 million (Erdal and Tatoğlu, 2002), which is a negligible amount.

In a study carried by Hadjit and Moxon-Browne (2005), an overview of FDI in Turkey took place. They summarize the FDI performance of Turkey with a special analysis of the economic and political environment. In this study it is stated that by January 1980, Turkish governments started to implement reform programs to open up the Turkish economy in the aim of establishing a free market, and an outward-oriented economy to integrate Turkey with world

markets. In 1989, Turkey fully liberalized its capital account, which led to a significant increase on FDI flows. Despite this increase, Turkey was still attracting relatively low levels of FDI compared to countries of comparable size such as Argentina and Mexico (Balasubramanyam, 1996). Hadjit and Moxon-Browne (2005), gave some FDI figures for the years between 1980 and 1990. The authorized investment amounted to $6.4 billion in this period while the average value per year was $456.3 million in the same period according to data from General Directorate of Foreign Investment. According to them, the period of 1990s was thought to be crucial for Turkey as Customs Union (CU) with the EU came into force in January 1996. In this period it was a widespread belief that CU would stimulate flows of European FDI into Turkey because of the increased stability and competitiveness of the Turkish economy. However, the realization was totally different than the forecasts as the CU had a significant impact only on authorized investment between 1995 and 1997 whereas the realized FDI did not meet the expectations. Many investments, especially in the manufacturing sector, were announced but did not materialize. This was apparently an outcome of the difference between the optimism due to the CU membership and what happened in reality. It was clearly understood that CU is not enough to secure macro-economic stability and ensure FDI inflows. Moreover, the underdeveloped investment climate could not convert the investors' positive perceptions into reality. Also, Loewendahl & Ertugal-Loewendahl (2001) analyzed this period in their study and mentioned that, during the 1990s when global FDI flows accelerated, FDI in Turkey remained static. According to them the most interesting finding is the 1995-1997 period that Turkey and EU formed a CU in

which the largest gap between the approved and realized investment occurred. They think that investors' perceptions of the opportunities afforded by investing in Turkey did not meet the reality of the situation and most of the new investment was not realized which indicates that the government was unable to facilitate the large interest shown by inward investors into real investment. (Loewendahl, Ertugal-Loewendahl, 2001)

Figure 3: FDI in Turkey
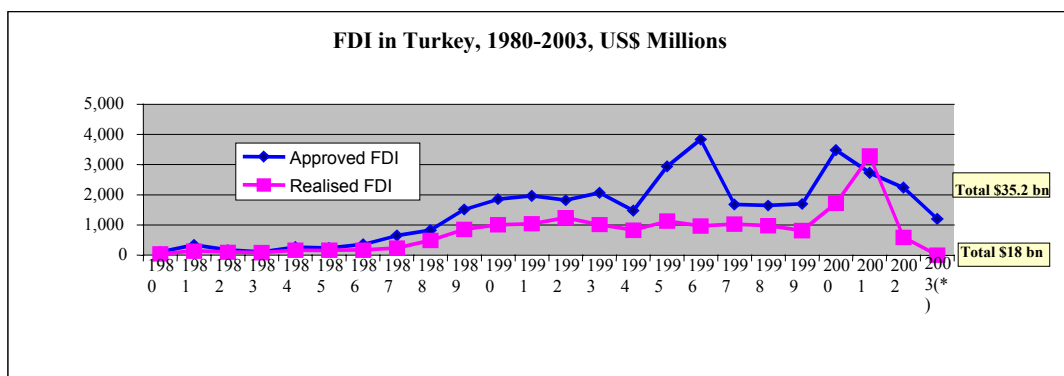
* As of June 2003
Source: Turkish Treasury

December 1999 was another milestone for Turkey since the EU accepted Turkey as candidate member on this date. From then on, the image of Turkey in foreign investors' mind turned out to be a potential location to invest, as Turkey had to meet economic, political and social criteria on her way to EU. However, this positive understanding changed when an economic crisis occurred in 2001, which caused a sharp downturn of Turkish economy. The country faced a severe banking crisis that led to the elaboration of a stabilization program supported by the International Monetary Fund (IMF). This crisis acted as a brake on FDI. The FDI stock between 1995 and June 2002 was $9 billion, but $3 billion of this amount was due to a large license fee paid by Telecom Italia to operate Aria and

HSBC's purchase of Demirbank in 2001 (Hadjit and Browne, 2005). During this period Poland attracted $42 billion; Czech Republic attracted $26 billion and Hungary attracted $26 billion of FDI (UNCTAD, 2005).

Since 1990, Turkey has been able to attract one billion dollars of FDI on average per year while the estimated minimum annual FDI "attraction potential" according to the world investment report of 2002 is $35 billion.

2.2.2 Competitor FDI Locations

In a research executed by Loewendahl and Ertugal-Loewendahl (2001), Turkey's key competitors for FDI were examined. Although they have a different economic background from Turkey, the CEEC constitute fierce competition for Turkey in attracting FDI; the main competitors being Poland, the Czech Republic and Hungary. In this respect, they conducted interviews with 30 senior executives of multinational corporations and directed the question: *"Which countries is Turkey competing with as a location for FDI?"* Below is the summary of results:

Figure 4: Turkey's key competitors for FDI
(% of respondents citing country)
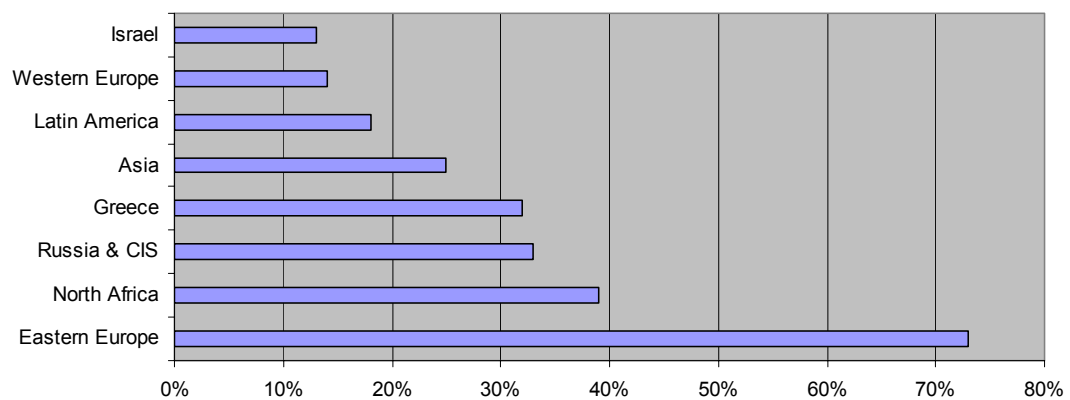
Source: Loewendahl, H., and E. Loewendahl, 2001, "Turkey's Performance In Attracting Foreign Direct Investment: Implications of EU Enlargement"

The figures show that Eastern Europe countries are by far the most cited competitors of Turkey in FDI attracting. The fact that North Africa and Russia & CIS regions follow as second and third; indicates that geographical location of a country is important for defining its competitors. Another common attribute of these countries is the similarity of their economic development levels. The study further states that Hungary, Poland and Czech Republic were the top countries cited as the main East European competitors to Turkey. It is interesting to note that Latin America and Asia were not considered as key competitors of Turkey. According to the results of the research, Lowendahl and Ertugal-Lowendahl suggested that MNCs actually segment the European market into West and East, most likely due to different levels of economic development (and also into North and South for activities such as call centers and shared service centers, due to geographical and cultural differences). These institutions also tend to adopt a regional division of labor within Europe. This is derived from the fact that CEECs and Turkey are competing for manufacturing activities and West European countries are competing for high tech manufacturing and knowledge intensive activities.

In this study henceforth, Hungary, Czech Republic and Poland together will be considered, admitted and called, as the "main competitors" of Turkey and all the comparisons and analyses will be done between these countries and Turkey.

Compared to its main competitors, Turkey attracted considerably low levels of FDI for the 1994–2004 period. Net FDI inflows to Turkey amounted to less than one percent of GDP except 2001; while within this period, the Czech

Republic and Hungary attracted noticeably higher amounts of FDI as percentage of GDP (Table 5). One of the other indicators in explaining FDI and its reflections to the country's economy is the FDI instock data. To measure FDI instock as percentage of GDP is significant since it represents the share of total FDI operating in a country's economy cumulated up to date. In Turkey, inward FDI stock as percentage of GDP did not show significant increases from 1994 to 2004 while it increased from 10,2% to 52,7% in Czech Republic; 16,9% to 60,7% in Hungary and 3,7% to 25,4% in Poland (Table 6). Comparing with its main competitor countries, it can be concluded that Turkey has attracted low amounts of FDI and has not realized a progress during a decade from 1994 (year of the announcement for eastern enlargement), to 2004 (year of entry to EU).

Table 5: FDI Inflows as Percentage of GDP

(%)	Turkey	Chezh Republic	Hungary	Poland
1994	0.5%	2.0%	5.5%	1.8%
1995	0.5%	4.6%	11.4%	2.8%
1996	0.4%	2.3%	7.3%	3.0%
1997	0.4%	2.3%	9.1%	3.3%
1998	0.5%	6.0%	7.1%	3.8%
1999	0.4%	10.6%	6.9%	4.5%
2000	0.5%	9.0%	5.9%	5.7%
2001	2.2%	9.2%	7.6%	3.1%
2002	0.6%	11.5%	4.6%	2.2%
2003	0.7%	2.3%	2.6%	2.0%
2004	0.9%	4.2%	4.2%	2.5%

Source: UNCTAD

Table 6: FDI Instock as Percentage of GDP

(%)	Turkey	Chezh Republic	Hungary	Poland
1994	10.8%	10.2%	16.9%	3.7%
1995	8.8%	13.1%	25.3%	5.9%
1996	8.7%	13.7%	29.4%	7.7%
1997	8.7%	16.1%	39.3%	9.7%
1998	8.7%	23.3%	44.1%	13.5%
1999	9.9%	29.5%	48.4%	16.1%
2000	9.6%	38.9%	49.0%	20.9%
2001	13.5%	44.4%	52.9%	22.5%
2002	10.2%	52.6%	55.8%	25.6%
2003	13.3%	50.1%	58.4%	26.7%
2004	11.7%	52.7%	60.7%	25.4%

Source: UNCTAD

2.2.3. FDI Flows and Trends to Turkey

Upon analyzing the main sources of FDI, it stands out that EU countries stick out in dominating inward FDI to Turkey. For the 2002-2006 period, Netherlands, Germany and France, following USA, were the major investors in Turkey in terms of approved investment.

Table 7: Breakdown of FDI Capital Inflow to Turkey by Countries

Countries (mn $)	2002	2003	2004	2005	2006*	Total
European Union (25)	455	555	1,025	4,991	6,800	**13,826**
Germany	86	142	73	391	196	**888**
France	22	120	34	2,105	328	**2,609**
Netherlands	72	50	568	267	4,842	**5,799**
United Kingdom	8	141	126	284	211	**770**
Italy	241	1	15	692	41	**990**
Other European Countries	26	101	209	1,252	1,182	**2,770**
Other European Countries (Excluding EU)	64	70	109	1,662	51	**1,956**
Africa	0	0	--	3	21	**24**
America	9	58	97	123	535	**822**
North America	9	58	97	115	523	**802**
U.S.A.	2	52	36	89	407	**586**
Canada	7	6	61	26	116	**216**
Central America And Caribbean	0	0	--	8	11	**19**
South America	0	0	--	--	1	**1**
Asian	70	60	60	1,756	48	**1,994**
Gulf Arabian Countries	5	0	--	1,675	20	**1,700**
Near And Middle Eastern Countries	0	1	54	3	12	**70**
Other Asian Countries	65	59	6	78	16	**224**
Australia	0	0	--	1	--	**1**
Unclassified	24	2	--	1	7	**34**
Total	**622**	**745**	**1,291**	**7,381**	**7,462**	**17,501**

Provisional Data (As of June 2006)

Source: Turkish Treasury

Table 8 shows the breakdown of FDI by sectors and sub-sectors. Manufacturing and services dominate FDI in Turkey and there has not been much change in their share of total FDI over time. The distribution of FDI permits by sector indicates that between 1954 and 2005, wholesale and retail sector attracted the biggest share, with 36.7 percent, followed by services (31.9 percent), manufacturing (21.7 percent), mining (1.7 percent) and agriculture (1.3 percent).

Table 8: The Breakdown of FDI by Sectors (1954-2005)

SECTOR	NUMBERS	% OF TOTAL FDI
Agriculture, Hunting and Forestry	**154**	**1,3%**
Fishing	**21**	**0,2%**
Mining and Quarrying	**197**	**1,7%**
Manufacturing	**2.539**	**21,7%**
Food Products and Beverages	255	2,2%
Textiles	355	3,0%
Chemicals and Chemical Products	292	2,5%
Machinery and Apparatus	192	1,6%
Electrical Machinery and Apparatus	169	1,4%
Motor Vehicles, Trailers and Semi-Trailers	190	1,6%
Furniture	123	1,1%
Other	963	8,2%
Electricity, Gas and Water	**113**	**1,0%**
Construction	**658**	**5,6%**
Wholesale and Retail Trade	**4.293**	**36,7%**
Services	**3.732**	**31,9%**
Hotels and Restaurants	926	7,9%
Transport, Storage and Communication	994	8,5%
Financial Intermediation	156	1,3%
Real Estate, Renting and Business Activities	1.156	9,9%
Public Administration and Defence, Compulsory Social Security	31	0,3%
Education	53	0,5%
Health and Social Work	147	1,3%
Other Community, Social and Personel Service Activities	262	2,2%
Activities of Households	3	0,0%
Extra-territorial Organizations and Bodies	4	0,0%
TOTAL	**11.707**	**100%**

* As of October 2005, Provisional Data
Source: General Directorate of Foreign Investment

The total number of companies that have realized FDI in Turkey since 1954 is 13,600. Regarding the forms of FDI, foreign capital companies who chose to undertake greenfield investments in Turkey since 1954 have had the majority with 79%. In terms of the amount they invested, only the period between the years 2000-2003 can be analyzed due to lack of data. Although this analysis does not provide us a perfect benchmark, it is significant as it gives an understanding of the decline in the amount of new establishments during these years.

Figure 5: Mode of Establishment (Number of Companies), 1954-2006*
As of July
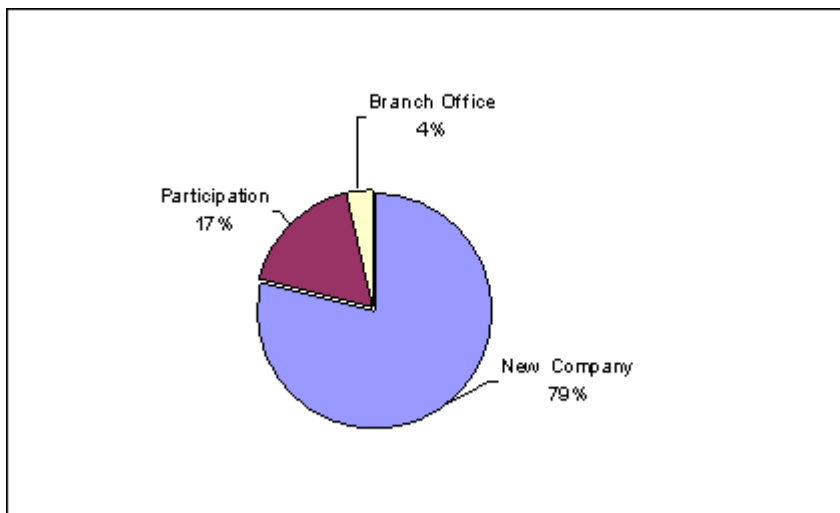
Source: Undersecretariat of Treasury

Figure 6: Mode of Establishment (mn $)

Source: Undersecretariat of Treasury

2.2.3. Reasons Behind Turkey's Underperformance

From a historical perspective, Turkish economy has failed to realize its economic potential and faced several financial crises. For the last twenty years,

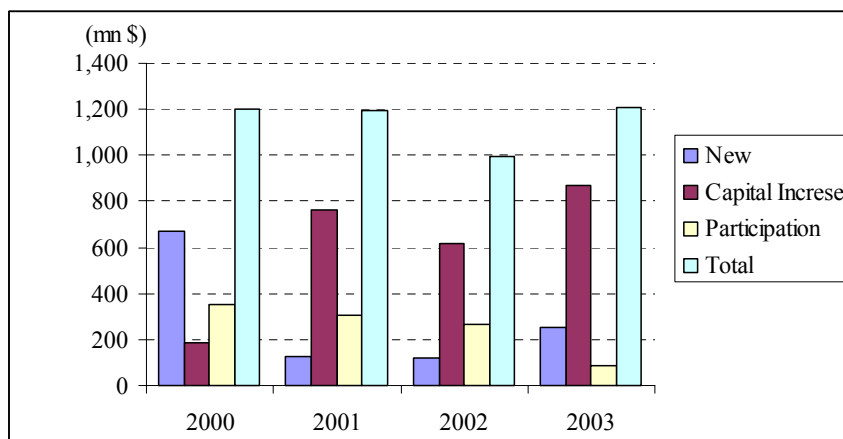the economy has been suffering from a high inflationary environment. (Yilmaz 2003). Even though various governments have tried to apply policies to decrease the rate of inflation, it is still higher than all CEE countries and has been recovering just since 2004. While it was 25% in 2003, it came down to 10% in 2004, when Turkey performed better than Romania (as it was 11,9% in Romania). (Table 9, Table 10) Moreover, Turkey's external debt is mentioned as another crucial problem by Başar and Tosunoğlu (2005). They claim that Turkey's external debts prevent a decrease in the real interest rates to the desired levels and increase the country risk. They suggest that the budgetary deficit, which has a direct effect on country risk, stems from inefficient tax collection, deficits in social security systems, insufficient privatization efforts, the problems of the public sector enterprises and undisciplined expenditures.

Table 9: Key Economic Indicators, 2003

Countries	2003				
	GDP (billion US$)	GDP Growth Annual(%)	GNI Per Capita, Atlas Method* (US$)	External Debt Total (mn US$)	Inflation (%)
Check Republic	90,6	3,2	7.160	34.629	-0,1
Estonia	9,2	6,7	5.480	6.972	1,4
Hungary	83,1	3,4	6.410	45.794	4,7
Latvia	11,1	7,2	4.380	8.802	2,9
Lithunia	18,4	10,5	4.540	8.342	-1,1
Poland	209,8	3,8	5.270	95.219	0,7
Slovakia	32,7	4,5	4.970	18.378	8,4
Slovenia	27,7	2,7	11.870	11.512	5,7
Turkey	240,4	5,8	2.800	145.662	25,3
Bulgaria	19,9	4,5	2.120	13.288	2,3
Crotia	28,8	4,3	5.380	23.451	..
Romania	57,3	5,2	2.260	21.280	15,3

Source: World Development Indicators (2006), Eurostat

Table 10: Key Economic Indicators, 2004

| Countries	2004				
	GDP (billion US$)	GDP Growth Annual(%)	GNI Per Capita, Atlas Method (US$)	External Debt Total (mn US$)	Inflation (%)
Check Republic	107,0	4,7	9.130	45.561	2,6
Estonia	11,2	7,8	7.080	10.008	3
Hungary	100,7	5,2	8.370	63.159	6,8
Latvia	13,6	8,5	5.580	12.661	6,2
Lithunia	22,3	7,0	5.740	9.475	1,2
Poland	242,3	5,3	6.100	99.190	3,6
Slovakia	41,1	5,5	6.480	22.068	7,5
Slovenia	32,2	4,2	14.770		3,7
Turkey	302,8	8,9	3.750	161.595	10,1
Bulgaria	24,1	5,6	2.750	15.661	6,1
Crotia	34,3	3,8	6.820	31.548	..
Romania	73,2	8,4	2.960	30.034	11,9

Source: World Development Indicators (2006), Eurostat

Turkey's failure to attract FDI has both economic and non-economic causes (FIAS, 2001a; FIAS, 2001b).). Erdilek (2003) focuses on these causes and mentions: high transactions costs of entry and operation for foreign investors (due to excessive bureaucracy and red tape, and widespread corruption), lack of protection of intellectual property rights, failure of privatization, inward orientation until 1980, insufficient legal structure and inadequate infrastructure. According to him there are also non-economic factors peculiar to Turkey that lead to attract low FDI such as chronic political instability for years, internal conflicts, historical animosity towards foreign economic presence, fear of foreign political domination within the civilian and the military bureaucracy, lack of FDI promotion, and the structure of Turkish business (mostly family-owned and controlled and closed to foreign takeovers). (Erdilek, 2003)

In 2001, Foreign Investment Agency Service (FIAS) of World Bank carried out a study to present an analysis of the FDI environment in Turkey. They implemented some interviews with potential investors and asked them to grade

major obstacles to FDI in Turkey. In Hadjit and Browne (2005), these results are presented. Those investors declared that, up until early 2000s, they were confronted by economic and political instability, government bureaucracy, a weak judicial system, taxation, corruption, deficient infrastructure and the informal economy while investing. (Figure 7)

Figure 7: Major obstacles of FDI in Turkey
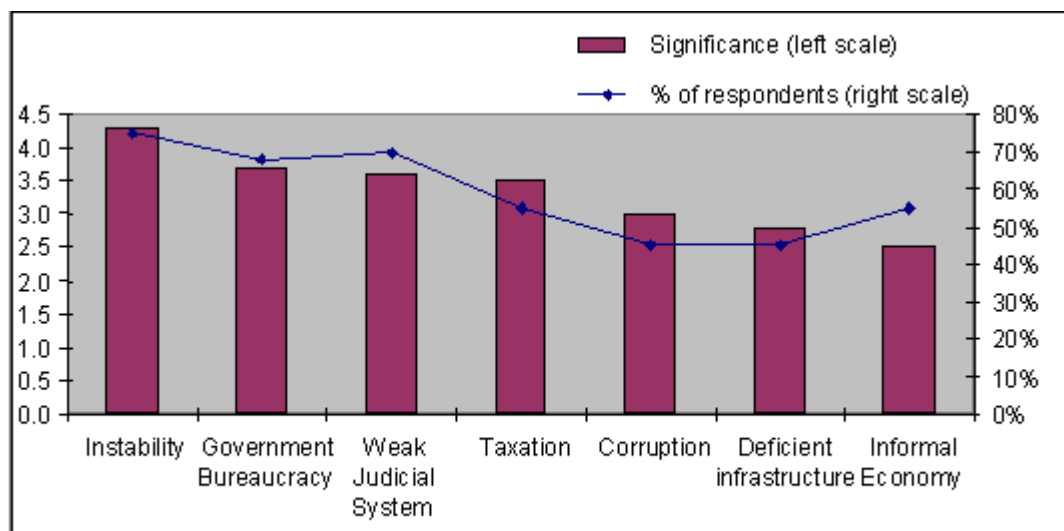
Source: Hadjit, A., E. Mexon-Browne, 2005, "Foreign Direct Investment in Turkey: The Implications of EU Accession" from FIAS study

2.2.4. Opportunities for Foreign Investors in the Turkish Market

There are numerous studies about FDI story of Turkey. Although it is a widely discussed topic from different perspectives, almost all studies compromise on the consensus that despite its advantages, Turkey is performing far below its potential in attracting FDI. This statement is more than a hypothesis hence the

potentiality issue can be supported with the realities of Turkey's economic and social structure.

In a working paper executed by TÜSİAD for the Investors Advisory Council Meeting (2004), Turkey was denoted as a potentially appealing country for foreign investors. As one of the advantages, the study mentions that Turkey has a huge domestic market and is among the biggest emerging markets with a unique location at the crossroads between East and West, overlapping Europe and Asia geographically. Moreover, the importance of the proximity to the new emerging markets in Middle East and Central Asia is emphasized in the sense that it creates unique business opportunities for foreign investors by providing an opportunity to develop business with these countries as well. Another opportunity well worth to mention about Turkey is its location as a gateway of energy sources. Although it depends on the type of business; production and distribution facilities stand out as main concerns while investing in a region. In this regard the study highlights that Turkey, at the gateway of Middle East and Caspian petroleum and Central Asian natural gas to the west, appears to be a good choice for investing. Besides, communication and transportation infrastructures are considered as highly supportive when compared with its competitors. Moreover, "the potential active labor force" of Turkey is concerned as a demographic opportunity with stabilized population growth, increasing households and labor supply; improving welfare and per capita income.

As already mentioned in the "Determinants of FDI" chapter of this study, economic structure of a country is the most underlying factor that affects FDI. In a study published by Başar and Tosunoğlu (2005), it is stated that Turkey has many

advantages compared to other CEE countries in respect of GDP and GDP growth rates. GDP figures are important, since they are accepted as the indicators of market size. Likewise, they affirm that Turkey has many other advantages, being located in a strategic location, having an educated and qualified work force, communication and other infrastructures that are compulsory to meet the needs of investors and lower cost of labor.

Despite all these advantages, for several years, Turkey has experienced lower levels of FDI in comparison not only to its main competitors but also its potentiality. As already mentioned, one of the major aims of this study is to explain the FDI performance of Turkey in comparison to its main competitors, with a specific focus on 1994-2004 period, as it is the negotiation period with EU. Therefore it becomes significant to understand the economic and social structure and the investment environment of Turkey within this period. There were economic and political challenges that Turkey has undergone such as three economic and financial crises linked to political problems in the recent past. But so far, Turkey has recovered relatively well from the most recent 2001 crisis. In 2002, Turkey recovered quite well with a GDP increase of 7.8%, compared to previous year's -9.5%. (Huges, 2004) In 2003, growth was 4.8% and it increased to 8.9% in 2004. (Table 9 and Table 10)

In a Deutsche Bank Research (2005), it is discussed that since the 2001 economic crisis, economic reform programs in force have yielded tangible results: conventionally high inflation rate has come down to historic lows; six zeroes have been dropped from the Turkish Lira; financial sector supervision has been strengthened; more than half of the privatization revenues have been secured in

this period and the FDI stock has increased significantly. All these positive developments contribute to the perception of higher economic stability in the country.

In a working document prepared by Commission of European Communities (2004), it is denoted that the perspective of EU membership triggered substantial FDI from EU companies into the ten new Member States, which joined the EU in May 2004. Therefore, it can be defended that EU prospect for Turkey is set to underwrite substantial increase in terms of FDI. The EU membership will bring Turkey the access to large EU market, increased growth prospects and access to structural funds. Hadjit and Moxon-Brrowne (2005) indicate that the opening up of negotiations might boost investors' confidence by removing uncertainty in political and economic stability. In fact, the EU membership and even the membership process itself produce substantial positive effects for the economies of the member and candidate countries.

Figure 8: FDI Net Inflows to Turkey
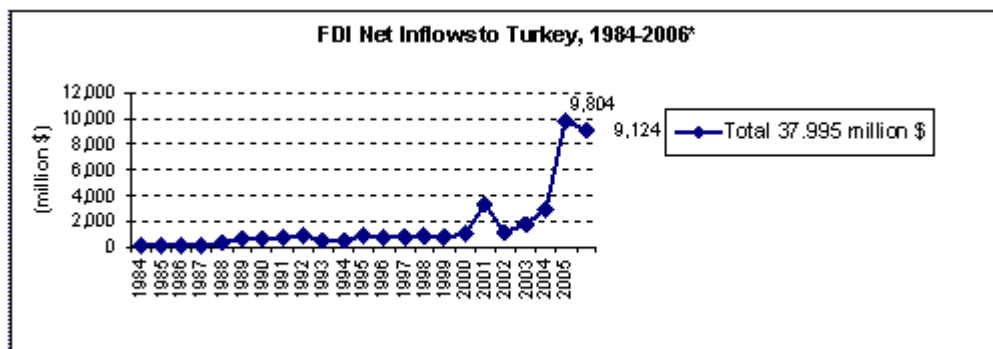
As of July 2006
Source: GDFI

With all these advantages, Turkey has been facing a different progress since 2005. According to a report published by GDFI; 2005 was the year of historical top in Turkey's FDI attractiveness. Total inflow in this year was approximately 9,8 billion US $ which has risen by 3,5-fold of 2004. Regarding its compounds, while 7,9 billion US $ is capital inflow, 1,8 billion $ is the foreigner's purchase of real estate in Turkey. Growth rate, improvement in macroeconomic figures (inflation rates, interest rates…etc.), effect of negotiation process with the EU and also the structural reforms for improving investment environment helped Turkey attract more FDI. It is understood that many investors were on hold with their investment plans before the materialization of EU road map. In this period, the acquisitions in finance sector and the foreign investors' interest on privatization tenders verify Turkey's increasing attractiveness.

At this point, it is argued that whether the major portion of FDI inflow to Turkey in this period is privatization-induced or not. Before analyzing Turkey's experience about privatization, it would be worthwhile to mention the discussions on privatization-induced FDI in literature. In Nunnenkamp (2002), the contribution of privatization on the composition of FDI flows is mentioned and structural shifts are analyzed. According to the study, while one of the structural shifts was the rising share of FDI in services, as privatization involved in service industries in the first place (in Latin America case), the other shift was experienced in the growing importance of mergers and acquisitions, as opposed to greenfield investment. The study dealt with the controversial discussions on privatization-induced FDI. For instance, this type of FDI is frequently assumed to leave the overall volume of investment unaffected. This argument is confirmed in

the sense that M&As, in contrast to greenfield investment, are no more than a change in ownership. As a second argument, from a competition-policy point of view, privatization-induced FDI might be problematic when public assets are sold to domestic private investors. In this type of privatization, a state monopoly would be replaced by a private monopoly. As a third argument, privatization-related FDI is often believed to be a nonrecurring event. However Nunnenkamp argues that this is not necessarily true as any change can occur in ownership, which has been associated with significant additional investment in the rationalisation and modernization of privatized firms. Finally, privatization programs help improve the climate for FDI in indirect ways by indicating the government's commitment to economic reform. Hence, the author concludes that privatizations-related FDI may prove to be the gateway to higher FDI inflows on a regular basis.

Coming back to Turkey's case; privatization, as one of the most essential forms of FDI, has been on Turkey's agenda since 1984. Between 1984 and 2006, $25.7 billion worth of state shares has been privatized in the country. The cash proceeds from these sales have been recorded as $14.3 billion.

From a historical view, in 1980's, Turkey was one of the early countries to initiate privatization programs. Although a fast head start was given in these years, it was not possible to maintain this speed due to political and economic turbulences, as well as opposition from public opinion and bureaucracy. As a result, the privatization performance lagged behind that of the Eastern European countries, which had undertaken similar programs as late as the early 1990's.

Figure 9: Privatization in Turkey
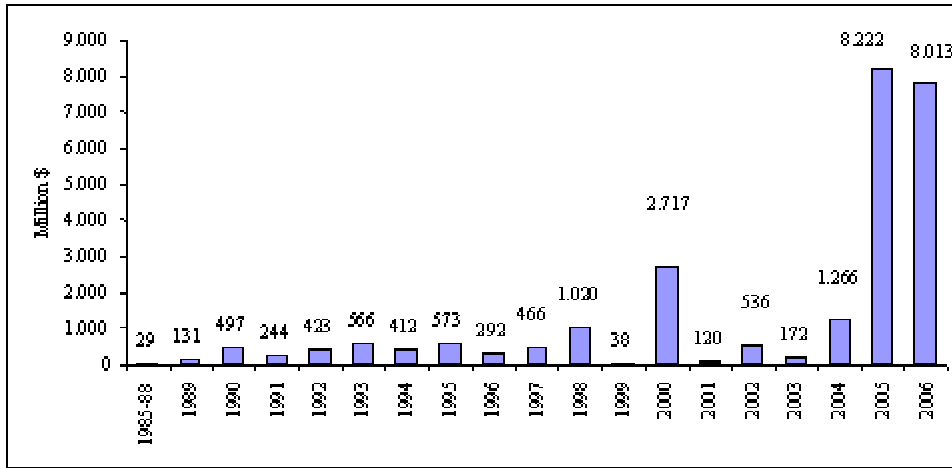
Source: Privatization Agency of Turkey

As seen in the above chart, more than half of the total privatization value was realized before 2005 in Turkey. Of these years, only 2000 was a year that witnessed considerable sales, when POAŞ and TUPRAS privatizations took place. Turkey´s privatization agency wrote a record in the year 2005, when the privatization revenue turned out to be $8,2 billion. Of this, $6,5 was realized by the sale of controlling interest in Turkish Telekom to Saudi telecoms operator Oger. In 2006 up-to-date, $8 billion worth of privatization has been realized; of which $4,1 billion arrived through the Tüpraş and $2,8 billion through Erdemir offerings. Of these, Tupras's 51% controlling shares were overtaken by a consortium of Koc Group (98%) and Shell Group (2%), whereas Erdemir's 46% shares were transferred to Oyak Group for $2,8 billion. (Hadjit, Maxon-Browne, 2005)

In 2005 and 2006, the sharp increase in FDI was gained through privatization. In 2005, privatization-induced FDI was recorded as 1,5 billion US$, which constitutes 18% of total privatization and 15% of total FDI inflow.

Table 11: Privatization and FDI in Turkey

mn $	Privatization	Privatization-induced FDI
1995	515	1
1996	292	0
1997	466	0
1998	1,020	0
1999	38	0
2000	3,302	585
2001	2,579	2,369
2002	537	0
2003	177	0
2004	1,267	49
2005	8,216	1,500
Total	**18,409**	**4,504**

Source: GDFI, 2005

3) ECONOMETRIC STUDY

3.1. CEE Effect on Turkey's FDI Attractiveness

Using regression analysis, this study explores whether or not the FDI inflow to Turkey is affected by the FDI inflows to main competitors; Hungary, Poland, and Czech Republic. As mentioned previously, there are many factors affecting FDI flow into a country such as the EU membership prospect. In this study, FDI inflows to the candidate countries are discussed to have boosted in their negotiation period. As competitor locations, Hungary, Poland and Czech Republic have attracted more FDI than Turkey between 1994-2004. The model aims to find whether or not Turkey attracted low levels of FDI just because of these countries' performance in attracting FDI from 1994 to 2004. In other words, while Turkey's underperformance in attracting FDI in this period can be explained by many reasons, can the FDI inflow to each competitor location and to all 3 together be a reason for Turkey's underperformance? In order to measure this effect, FDI inflow data is placed in the model as percentage of GDP. Since these countries have different characteristics in terms of their economic size, the nominal amount of FDI inflow does not always explain the country's real performance in attracting FDI.

Data for FDI inflow and GDP (in millions of $ terms) are compiled from UNCTAD, World Investment Report 2005. The FDI inflow as percentage of GDP is derived by own calculations for each country. In order to see if there is a change of FDI behavior in the negotiation period, the model includes dummy variable beginning from 1995 as the reflections of Essen European Council, which took place on 9th of December 1994, would be realized since that date. To make a more

accurate analysis, it would be better to put a wider range of data set. However, the FDI inflow as percentage of GDP can only be derived for the years between 1990–2004, due to lack of data for the competitor countries.

As a result, the Model (1) is formulated as follow:

(a) TRGDPFDI = C(1) + C(2)*CRGDPFDI + C(3)*TRGDPFDI(-1) + C(4)*DUMMY

(b) TRGDPFDI = C(1) + C(2)*HGDPFDI + C(3)*TRGDPFDI(-1) + C(4)*DUMMY

(c) TRGDPFDI = C(1) + C(2)*PGDPFDI + C(3)*TRGDPFDI(-1) + C(4)*DUMMY

(d) TRGDPFDI = C(1) + C(2)*COMPOSITE + C(3)*TRGDPFDI(-1) + C(4)*DUMMY

The variables used to explain Turkey's FDI performance as percentage of GDP are as follows:

- FDI Inflows to Turkey as percentage of GDP (TRGDPFDI)
- FDI Inflows to Czech Republic as percentage of GDP (CRGDPFDI),
- FDI Inflows to Hungary as percentage of GDP (HGDPFDI),
- FDI Inflows to Poland as percentage of GDP (PGDPFDI),
- FDI Inflows to all 3 countries as percentage of their total GDP (COMPOSITE)
- TRGDPFDI (-1) deducts FDI inflow to Turkey as percentage of GDP with the previous year. In order to reach a valid model, the diagnostic tests on the residuals implied that an AR(1) term should be included in the model.

As seen from the above formulations, the initial aim is to measure the effect of each country. With another estimation, In (d), the effect of the FDI inflows to all these 3 countries is measured by calculating the ratio of their total FDI inflows to their total GDPs.

OLS estimate is used to estimate the model. The estimation in E-Views gave us the results in the tables in Appendix-A, Model (1). The tables represent the results of the executed regression. Impact of each country's FDI performance and their aggregate FDI performance on Turkey are investigated.

R-squared value is quite low for all estimations. Therefore the proportion (or percentage) of the total variation in TRGDPFDI explained by the independent variables in the regression is not satisfying. R-squared value is relatively higher in the estimation for Czech Republic.

Probability values for all coefficients of the associated t-values, in each estimation, are insignificant. In other words, there is no evidence to prove that the independent variables affected Turkey's FDI inflows in the past.

Another point well worth mentioning is the effect of dummy variable on the estimations. According to the findings, there is no significant difference of the effects of countries performance on Turkey before and after 1995.

The findings of this study reveal different results than expected, since it was a widespread view that main competitors had diverted FDI from Turkey in this time period. However, it can be concluded that the coefficients are not significant, which means there is no correlation between Turkey's underperformance and these countries' FDI performance during the negotiation

process. According to the results of model, it is proved that Turkey drew less FDI than expected not because of its competitors' performance but due to other reasons.

3.2. Impact of Economic Determinants on Turkey's FDI Performance

In the light of previous analysis, it is understood that Turkey did not attract low levels of FDI because of its main competitors who were thought to divert FDI from Turkey between 1995 and 2004. Hence the study deserves further investigations to measure the impact of major economic determinants on Turkey's FDI performance between 1996 and 2006.

EU sets some economic and political considerations to candidate countries for convergence. On June 1993, in Copenhagen Summit, rules for defining a country's sufficiency to enter the EU were declared under the name of Copenhagen Criteria. According to these rules, a new member state must meet 3 criteria such as political, economic and acceptance of the Community acquis:

"Membership requires that candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and, protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union." (Copenhagen Presidency Conclusions, 1993)

Subsequently, The Maastricht criteria, which are assumed to sustain the European Union into the future, specify the economic conditions of the country for admission to the Union:

- An inflation rate no more than 1.5 percent above the average of the three countries with the lowest inflation rates

- Nominal long-term interest rates not exceeding the average of three countries with the lowest inflation rates by more than 2 percent

- No exchange rate realignment for at least two years

- Government budget deficit not in excess of 3 percent of GDP

- Gross debt to GDP ratio does not exceed 60 percent

Taking all these into account, the next model to be tested for Turkey states that FDI is influenced by the prospect of EU membership especially after the fourth quarter of 2005 since membership negotiations were opened on October 3rd of 2005. In literature, it is considered that prospect of EU membership is the major motive driving firms to invest in the accession period. The model aims to find whether or not Turkey's FDI performance is affected by the starting of negotiations. In order to measure this effect, FDI inflow is inserted in the model as percentage of GDP. Data for FDI inflow and GDP were compiled from Central Bank of Turkey. The estimation period includes years between 1996 and 2006. In order to find a more accurate result, quarterly based data were used. In order to see if there is a change of FDI behavior starting with the negotiation period, the model includes dummy variable beginning from the 4th quarter of 2005. As a result Model (2)a is formulated as follows:

FDI = C(1) + C(2)*DUMMY + C(3)*FDI(-1)

In the above equation, FDI illustrates the FDI Inflows to Turkey as percentage of GDP. Dummy illustrates the effect of EU membership negotiations on Turkey's FDI performance. In order to reach a valid model, the diagnostic tests on the residuals implied that an AR(1) term should be included in the model. OLS estimate is used to estimate the model. The estimation in E-Views for Model (2)a gave us the results in the table in Appendix-A, indicating the following relationship between FDI and prospect of EU membership:

FDI = 0.003804106096 + 0.08754459173*DUMMY - 1.009424265*FDI(-1)

It is obvious that there is a significant positive relationship between FDI inflows and prospect of EU membership. R-squared value is approximately %88, which sustains a satisfying explanation for the correlation of Turkey's FDI performance and prospect of EU membership between 1996 and 2006. Probability value for dummy coefficient of the associated t-value is significant. In other words, there is strong evidence to prove that the prospect of EU membership affected Turkey's FDI inflows beginning from the 4th quarter of 2005. Foreign investors understand that a country should meet economic and political criteria to start negotiations. Membership criteria require that an accession country improve and maintain economic soundness, harmonize the legal infrastructure with the Union's Acquis and remove trade barriers. That's why Turkey has started attracting considerable amounts of FDI since 2005.

Moreover, this model deserves further analysis to figure out the effect of major economic determinants of FDI inflow to Turkey especially to explain the FDI increase starting from 2005. Another model is estimated by taking into

account the major economic determinants such as growth rate of the market, openness of the economy to foreign trade, budget deficit, and inflation in addition to the prospect of EU membership. Although these variables are not all the determinants to explain EU accession and FDI inflows, the model is formed with these determinants due to lack of quarterly based data.

FDI = C(1) + C(2)*BUDGET + C(3)*GROWTH + C(4)*INF + (5)*OPENNESS + C(6)*DUMMY + C(7)*FDI(-1)

Similar to the previous models FDI inflow to Turkey is presented in the model as percentage of GDP (FDI). The economic performance of Turkey is measured as the real growth rate of GDP (GROWTH). Trade Openness shows the extent to which a country is open to international trade. It is calculated as the ratio of the sum of imports and exports to GDP. (World Bank (2004), World Development Indicators) Although there are other methods to measure trade openness of a country, in this model World Bank method will be used (OPENNESS). Two variables are used to measure macroeconomic stability: Inflation (INF) and budget deficit (BUDGET). BUDGET is the ratio of budget deficit over nominal GDP. Similar to previous models, FDI (-1) is used to enable a valid model as the diagnostic tests on the residuals implied that an AR (1) term should be included. Data for the variables are compiled from the sources of Central Bank of Turkey, Turkish Statistical Institute and Turkish Treasury. OLS estimate is used to estimate the model. The results are given in Appendix-A, Model 2(b), indicating the following relationship between FDI and its determinants:

FDI = -0.000187 - 0.001523*BUDGET - 0.000145*GROWTH - 4.361994*INF + 49869.54902*OPENNESS + 0.072284*DUMMY - 1.210342*FDI(-1)

According to the findings of this model, the results are surprising in the sense that only trade openness and dummy variables (which refers to prospect of EU membership) are significant as having an impact on Turkey's FDI performance. In the model R-squared is the best fit with %96. Probability values for dummy and openness coefficients are significant at 0,05 level. Although Turkey has experienced successes in reducing inflation rate, fiscal adjustment process and considerable economic growth after the contraction in 2001, the model did not prove the correlation between these determinants and FDI inflow between 1996 and 2006. Despite many explanations for this finding, the prospect of EU membership (explained by dummy variable), which in fact includes all these determinants, is once more explained as the strongest determinant on Turkey's FDI performance. In fact growth rate of an economy is a very important determinant in foreign investors' decisions as well as inflation rate and budget deficit. However, according to model, the prospect of EU membership together with trade openness appears to have the most influential effect on Turkey's FDI. The reason of this finding could be the change in the perceptions of investors with the start of negotiations. The prospect of EU membership might be viewed by potential investors as reducing country risk and meeting the requirements of EU admission, which represents an external validation of progress in transition. And this is also because ultimate EU membership implies guarantees in terms of macro economic stability, institutional and legal environment and political stability.

4) CONCLUSION

FDI has become an important tool for national development for many developing countries. There is general agreement about the positive impacts of FDI on the welfare of receiving countries. On the other hand, it is possible to claim that there exist controversial views regarding the positive impact of FDI on the host country's economic growth patterns. It seems rational to preliminarily accept that FDI can result in positive spillovers to the host economy. However it can also result in negative spillovers if it discourages domestic investment, as local firms cannot compete with foreign firms, and forces domestic enterprises to close down since they cannot obtain the necessary financing for upgrading their technology to compete (UNECE; Economic Survey of Europe, 2001). The opponents of FDI argue that MNCs transfer inappropriate technology to developing countries. Even worse, in a study executed by Woodward (2001), FDI's negative effect on the host country's balance of payments was discussed and claimed that FDI can contribute to the underlying fragility of an economy and make it more sensitive to balance of payments crises in different ways. First, he mentioned that the profits generated from the growing stocks of inward FDI would result as part of foreign exchange outflow. Secondly, FDI will lead to an increase in imports of capital goods. Thirdly he pointed out that current foreign exchange costs of MNCs outpace the foreign exchange they tend to earn through exports of import substitution. Finally, he emphasized the change in consumption patterns through foreign affiliates' advertising strategies. According to Woodward, all of these ways lead to large current deficits, which tend to precede financial crisis. In a more recent study, Buckley, Clegg and Wang (2006) argued

that at greater levels of foreign presence in the economies, negative effects start to become apparent, and may begin to counteract the positive effects on local firms' productivity. Foreign affiliates can draw demand away from their local counterparts through the introduction of new differentiated products and through price reductions, which in the end can deteriorate the productivity of local firms.

Despite the controversial arguments about the impact of FDI on host economies, it is widely agreed that many countries in the transition period are enthusiastic in attracting more FDI since MNCs play significant role in transferring technology, creating employment, contributing the long-run productivity of local firms. According to the common view, FDI inflow also brings in capital and efficiency, produces spillover effects and contributes to the economic development of the country, providing most of the stimuli that fails to come from domestic sources. Expanding markets, low unit wage costs, skilled employees and stable economic and political environments lead foreign investors to transfer their capital to the accession countries (Deutsche Bank Research, 2005). Although there are various determinants affecting FDI inflow to a country, it can be claimed that macroeconomic conditions and the political environment of the country are the most important determinants. Moreover, EU membership also has considerable influence on FDI in the sense that potential investors see it as a guarantee for economic and political stability. In this paper, EU accession process on candidate countries' FDI performance was analyzed for both CEE countries and Turkey. Since the start of their transition, the CEE countries have attracted a considerable amount of FDI. FDI inflows into CEE candidate countries increased sharply since 1994, after the EU announcement about eastern enlargement. The

focus will now probably shift from the previous group of candidate countries to the current EU accession candidates and other emerging markets. Taking into account this experience, this paper initially aimed to find out whether Turkey's performance in attracting FDI was affected by its main competitors' performance. Secondly, the study aimed to investigate the impact of EU accession process and major economic determinants on Turkey's FDI. According to the findings, prospect of EU membership has the strongest impact on Turkey's FDI performance.

It was clearly seen that even the possibility of starting negotiations for Turkey was enough to draw in $9,8 billion of FDI in 2005 and $9,1 billion of FDI as of June 2006. It is very likely that others will follow these early settlers as the progress of EU accession further materializes. Although Turkey has achieved 9.8 billion $ FDI in 2005, it is still performing under its potential. Turkey has not yet a large FDI stock, which means there is still further growth potential. On the way to the EU, Turkey will definitely adopt and implement the EU legislation and standards. Besides; securing political stability, targeting transparency and efficiency in bureaucracy and bringing the economic parameters in line with EU criteria will help Turkey develop its investment climate. Further progress on each of these requirements and definitive prospect of EU membership should make Turkey very attractive for FDI with also other given strengths, which are highly skilled and adaptable labor force, large domestic market, and geographical proximity both to Europe and to the Middle East, Northern Africa and Central Asia markets.

The progress that Turkey has made over the past three years in meeting the convergence criteria to EU, has demonstrated the commitment and determination of the country towards EU membership. It is generally acknowledged that together with EU membership prospect, the Turkish economy has recently taken revolutionary steps towards a favorable investment climate, which in turn has yielded higher inflows of FDI in recent years. The next challenge lies in the sustainability of this picture, as it is required to maintain this positive outlook in the medium to long term.

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APPENDIX-A: Econometric Estimations

Model (1)

(1) a

```
Dependent Variable: TRGDPFDI
Method: Least Squares
Date: 10/01/06   Time: 16:39
Sample(adjusted): 1991 2004
Included observations: 14 after adjusting endpoints
```

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.004521	0.002887	1.566128	0.1484
CRGDPFDI	0.051173	0.051762	0.988615	0.3462
TRGDPFDI(-1)	-0.188884	0.342428	-0.551602	0.5933
DUMMY	0.000671	0.003467	0.193650	0.8503

R-squared	0.140143	Mean dependent var		0.006429
Adjusted R-squared	-0.117814	S.D. dependent var		0.004686
S.E. of regression	0.004954	Akaike info criterion		-7.542260
Sum squared resid	0.000245	Schwarz criterion		-7.359672
Log likelihood	56.79582	F-statistic		0.543280
Durbin-Watson stat	2.091640	Prob(F-statistic)		0.663604

(1)b

```
Dependent Variable: TRGDPFDI
Method: Least Squares
Date: 10/01/06   Time: 17:07
Sample(adjusted): 1991 2004
Included observations: 14 after adjusting endpoints
```

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.006466	0.006340	1.019912	0.3318
HGDPFDI	-0.016656	0.059105	-0.281804	0.7838
TRGDPFDI(-1)	-0.056266	0.329233	-0.170899	0.8677
DUMMY	0.002122	0.003281	0.646671	0.5324

R-squared	0.063541	Mean dependent var		0.006429
Adjusted R-squared	-0.217397	S.D. dependent var		0.004686
S.E. of regression	0.005170	Akaike info criterion		-7.456920
Sum squared resid	0.000267	Schwarz criterion		-7.274332
Log likelihood	56.19844	F-statistic		0.226173
Durbin-Watson stat	2.072220	Prob(F-statistic)		0.876061

(1)c

```
Dependent Variable: TRGDPFDI
Method: Least Squares
Date: 10/01/06   Time: 17:07
Sample(adjusted): 1991 2004
Included observations: 14 after adjusting endpoints
```

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.006819	0.003888	1.753583	0.1100
PGDPFDI	-0.115799	0.154324	-0.750366	0.4703
TRGDPFDI(-1)	-0.136842	0.339567	-0.402989	0.6954
DUMMY	0.005008	0.004615	1.085192	0.3033

R-squared	0.106417	Mean dependent var		0.006429
Adjusted R-squared	-0.161658	S.D. dependent var		0.004686
S.E. of regression	0.005050	Akaike info criterion		-7.503787
Sum squared resid	0.000255	Schwarz criterion		-7.321199
Log likelihood	56.52651	F-statistic		0.396968
Durbin-Watson stat	1.757823	Prob(F-statistic)		0.758126

(1)d

Dependent Variable: TRGDPFDI
Method: Least Squares
Date: 10/01/06   Time: 17:06
Sample(adjusted): 1991 2004
Included observations: 14 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.005566	0.005220	1.066287	0.3114
COMPOSITE	-0.020988	0.132800	-0.158041	0.8776
TRGDPFDI(-1)	-0.028204	0.316283	-0.089174	0.9307
DUMMY	0.002667	0.003534	0.754861	0.4677

R-squared	0.058456	Mean dependent var		0.006429
Adjusted R-squared	-0.224008	S.D. dependent var		0.004686
S.E. of regression	0.005184	Akaike info criterion		-7.451504
Sum squared resid	0.000269	Schwarz criterion		-7.268916
Log likelihood	56.16053	F-statistic		0.206949
Durbin-Watson stat	2.006902	Prob(F-statistic)		0.889275

Model (2)

(2)a

Dependent Variable: FDI
Method: Least Squares
Date: 10/14/06   Time: 20:32
Sample(adjusted): 1996:2 2006:2
Included observations: 41 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.003804	0.000973	3.910015	0.0004
DUMMY	0.087545	0.005854	14.95456	0.0000
FDI(-1)	-1.009424	0.132043	-7.644646	0.0000

R-squared	0.878668	Mean dependent var		0.006024
Adjusted R-squared	0.872282	S.D. dependent var		0.016405
S.E. of regression	0.005863	Akaike info criterion		-7.370032
Sum squared resid	0.001306	Schwarz criterion		-7.244649
Log likelihood	154.0857	F-statistic		137.5946
Durbin-Watson stat	0.965749	Prob(F-statistic)		0.000000

(2)b

Dependent Variable: FDI
Method: Least Squares
Date: 10/11/06   Time: 12:57
Sample(adjusted): 1996:2 2006:2
Included observations: 41 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.000187	0.002694	-0.069501	0.9450
BUDGET	-0.001523	0.010132	-0.150280	0.8814
GROWTH	-0.000145	9.53E-05	-1.526243	0.1362
INF	-4.36E-06	2.97E-05	-0.146732	0.8842
OPENNESS	49869.55	8386.813	5.946186	0.0000
DUMMY	0.072285	0.003999	18.07448	0.0000
FDI(-1)	-1.210342	0.078533	-15.41191	0.0000

R-squared	0.965379	Mean dependent var		0.006024
Adjusted R-squared	0.959269	S.D. dependent var		0.016405
S.E. of regression	0.003311	Akaike info criterion		-8.428973
Sum squared resid	0.000373	Schwarz criterion		-8.136411
Log likelihood	179.7939	F-statistic		158.0086
Durbin-Watson stat	1.889550	Prob(F-statistic)		0.000000