

# EU Integration Process: Will Turkey Overcome the FDI Obstacles?

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This paper analyses Turkey's performance in attracting foreign direct investment (FDI) and highlights the key obstacles for FDI in Turkey. When compared with its main competitor countries, which includes the group of new EU member states and other candidate countries, it can be concluded that Turkey has a very low rate of FDI inflow. It can be argued that one of the major problems behind the low performance in FDI inflows is macroeconomic instability. In this paper we will also perform an empirical analysis to examine the relationship between FDI and macroeconomic instability in the EU new member states and the candidate countries. According to the regression results, it was found that the GDP and openness have positive effects on the FDI, whereas current account balance and inflation have been found to be negative. On the other hand, the results related to external debt run opposite to our expectations.

*Key Words:* foreign direct investment, EU integration, determinants of FDI, panel data analysis, EU candidate countries

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## Introduction

Membership of the European Union (EU) is vital not only for accessing to the single market of the EU, but also having access to the structural funds of Europe, not forgetting economic growth and political stability. To start with, EU integration processes are likely to have primarily been of political nature. Also, membership criteria require that the candidate country must have achieved a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union (European Council 1993).

Empirical studies illustrate that many of the individual institutional reforms required for EU accession have influenced FDI receipts positively.

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Therefore, membership in the EU makes a country more attractive for FDI than other countries (Bevan-Estrin and Grabbe 2001).

In May 2004, the EU expanded from fifteen to twenty-five member states. Eight countries from Central and Eastern Europe – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia – together with the Mediterranean islands of Malta and Cyprus joined the EU. Bulgaria, Romania, Croatia and Turkey are the candidate countries.

This paper analyses Turkey's performance in attracting FDI and highlights the key obstacles for FDI in Turkey. It can be argued that one of the major problems behind the low performance in FDI inflows is macroeconomic instability. In this paper we will also perform an empirical analysis to examine the relationship between FDI and macroeconomic instability in the EU new member states (from Central and Eastern Europe) and the candidate countries. Malta and Cyprus are excluded from the analysis due to the lack of data availability.

The paper will focus on three main sections. The first section clarifies determinants of FDI and effects of EU integration process on FDI inflows. The second section compares FDI in Turkey with the new member states of the EU and other candidate countries. In the third section the relations between FDI and macroeconomic instabilities in the new member states and candidates are empirically analyzed by using panel data regression.

### **Determinants of FDI and the EU Integration Process**

There are a number of policies and perspectives developed to illustrate the level and structure of FDI. These policies will be grouped under three headings in this study: overall economic policies, national FDI policies and international FDI policies. Even though there are various factors affecting the FDI, it can be claimed that among other factors, the most underlying feature is the economic structure of a country. The policies aiming to strengthen the macroeconomic structure will highly influence the FDI. These policies could be related to market size, to the cost of investments, to the policies of openness, to the economic and political stability and to the financial health. Primarily, in developing countries, the market size is an important factor to attract FDI. The economic variables such as population, GDP, GDP per capita and GDP growth rate can be used in identifying the market size. Also, another factor which may affect FDI, is the cost of investment. Some of the other important determinants for FDI are the economic, political and financial stabilities. At

this point, the most important variables for the stability should be clarified, namely, the exchange rates, inflation rate, current account deficit, budget deficit and external debts. Another important determinant that can be evaluated within the overall economic policies is the openness of a country. It can be claimed that a country can attract more FDI if the ratio of foreign trade to the GDP increases (Basar and Tosunoglu 2005).

National FDI policies related with FDI are important to attract foreign capital to the country. Consequently, governments have gradually started to eliminate the barriers which prevent investments and have designed general investment climates. The FDI incentives used to attract FDI in developing countries can be analyzed in three groups (Sass 2003). The first group is fiscal incentives, which consequently reduces the tax burden of investors. The main components of fiscal incentives are: tax credit, tax relief, tax rebate, exemption from custom duty, reduction of tax base, VAT exemption, accelerated depreciation, reinvestment allowance, tax holiday and loss accrual. The second group is financial incentives given directly to investors. These are soft loans, grants, sovereign guarantee on investment credits, exports guarantee, insurance and credit, subsidized funding for various purposes. The other incentives include preferential government contracts, real estate supplied below market price, promotion of institutional investment, small and medium size enterprises (SME) development programs, customs free areas, special economic zones and industrial parks. Beside traditional economic determinants, the literature suggests that other factors, namely international FDI policies may be equally important. In the 1990s, the globalization trends throughout the world witnessed great changes in the strategies and policies applied in the countries in which FDI were carried out (Banga 2003).

In the globalization process, in addition to all macroeconomic determinants, regional integrations have provided great contributions to the FDI inflows. In this context, there have been unexpected and remarkable developments in FDI in recent years. Increasing competition among developing countries to draw foreign investors and reducing bureaucratic procedures preventing significant foreign investments have had important effects upon these developments. Moreover, the developments mentioned above have increased the numbers of both bilateral and regional agreements (Banga 2003). Regional economic integration has been one of the most significant changes in the international business environments during the past two decades. International economic integration

accelerates the free movement of created production factors across national boundaries and makes a theory of international trade based on immobile factors irrelevant. The static and dynamic effects of economic integration modify world production by providing new opportunities to multinational enterprises (Kim 2003).

In succession with these improvements, membership of the EU has remarkable effects for the FDIS. EU enlargement offers some major openings into new export and financial markets. The accession into the EU could be seen as a process during which the barriers to exchange of goods, services and factors of production between the EU and the candidate countries are removed and common policy principles and norms of behaviour are adopted (Vilpišauskas 2002). The removal of barriers to trade results in an increased access to the new markets. Consequently it creates new opportunities for companies to expand their activities beyond the national borders and provides consumers with a wider range and a better quality of products and services. It also creates conditions for the growth of competition. The present trading arrangements between the EU and the candidates already guarantee tariff-free trade for most industrial products. Tariff reduction can produce economic benefits through increased trade, the reduction of distortions in the economy, and less bureaucracy and form-filing.

The analysis of economic impacts of the EU single market has shown that this integration process has led to a medium and long-term increase of growth rates in the participating economies. This above average growth makes the total region more attractive, not only for domestic investors but also for foreign ones (Zakharov and Kušić 2003).

Notably, after the foundation of the EU, a considerable increase of intra and inter-regional FDI flows was observed among the member countries. Ireland experienced a real FDI boom after its EU accession in the year 1973. Another success story is the accession of Spain and Portugal to the EU in 1986. Indeed, after their accession to the EU, Spain and Portugal experienced large inflows of FDI. The respective shares of FDI in GDP rose from 1.1 percent and 0.8 percent in 1981–1985 to 2.1 and 2.9 percent over 1988–1992 (Kaminski 2000).

Also, commitments to EU access can increase the level of FDI, thereby improving national economic performance. In contrast, countries excluded from the EU, typically because of poor progress in the adoption period will receive lower levels of FDI because their country credit ratings tend to be poor (Bevan and Estrin 2000). In the accession process,

EU pre-accession funds offer real commercial opportunities for candidate countries. Since membership in the Single Market is likely to generate additional economic benefits for the candidate countries, from the candidate countries point of view it would be rational to extend transition periods to the adoption of EU *acquis*, which requires significant investments. In other words, the enlargement is somewhat based on a consistently applied rule which states that the candidate countries have to transpose and enforce the norms and principles which are applied in the EU.

Accession of candidate countries also includes the alignment of external trade regime (including the adoption of the EU common external tariff), the adoption of product and process standards (ranging from quality standards of toys, pharmaceuticals, electronic equipment, etc. to safety at work and environmental norms), and application of other EU common policies (common agricultural policy, transport policy, regional policy, etc.). The effects of adopting these measures on the economies of candidate countries depend on the nature and degree of adjustments to the *acquis* as well as the level of integration already achieved (Vilpišauskas 2002).

The candidate countries have also already started to adopt harmonised European standards and recognised accreditation systems for certification and testing bodies. This should help eliminate the difficulties sometimes faced by those trying to sell their products to these states. In addition to these, liberalisation of services, such as energy and telecoms, should provide new opportunities in previously inaccessible market sectors.

### **The FDI Performance of Turkey and a Comparison with EU New Member States and the Candidate Countries**

Turkey is the largest economy in Eastern Europe, the Balkans, the Black Sea basin and the Middle East and also one of the sixth biggest trading partners of the EU (Loewndahl and Loewndahl 2001). However, when compared with its main competitor countries, which includes the group of EU new member states and other candidate countries, it can be concluded that Turkey has a very low rate of FDI inflow. Table 1 indicates that Turkey's FDI inflows of \$636 million in 1993 increased to \$940 million in 1998 and amounted to \$3,265 million in 2001. It can be stated that the FDI inflows between 1993 and 2000 were stable. However, the economic crisis experienced in 2001 caused a significant FDI decline in 2002. After

TABLE 1 Net FDI Inflows (current million US dollars), 1993–2003

Country	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Czech Republic	654	878	2,567	1,435	1,286	3,700	6,312	4,987	5,640	8,496	2,514
Estonia	162	214	201	150	266	580	305	387	542	284	890
Hungary	2,349	1,144	4,878	2,362	2,223	2,084	2,019	1,694	2,594	2,862	2,506
Latvia	45	214	179	381	521	356	347	410	163	253	299
Lithuania	30	31	72	152	354	925	486	378	445	712	179
Poland	1,715	1,875	3,659	4,497	4,908	6,365	7,270	9,340	5,712	4,131	4,123
Slovak Republic	198	269	236	350	173	562	354	1,925	1,584	4,123	571
Slovenia	112	116	150	173	334	215	106	135	503	1,686	337
Turkey	636	608	885	722	805	940	783	982	3,265	1,038	1,562
Bulgaria	40	105	90	109	504	537	818	1,001	812	904	1,419
Croatia	120	116	114	510	532	932	1,467	1,089	1,558	1,123	1,998
Romania	94	341	419	263	1,215	2,031	1,041	1,037	1,156	1,144	1,844

Source: World Development Indicators ([www.worldbank.org](http://www.worldbank.org)).

the 2001 crisis, the amount of FDI decreased to \$1,038 million in 2002. It is worth noting that at the same period, Poland, the Czech Republic and Hungary proved to be the top three beneficiaries for inward FDI.

FDI inflows to EU new member states declined from a record \$26 billion in 2002, to a low of \$18 billion in 2003. 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 small (UNCTAD 2004). If we compare the amount of FDI inflows to Turkey with these countries, the FDI inflows to Poland are 4.3 higher, Hungary 2.1 and Czech Republic 3.1 higher than those to Turkey. On the other hand, when compared with the other candidates, the picture is different. The amount of FDI inflows to Turkey is the same as for Croatia and Romania and two times higher than for Bulgaria. To clarify this state of affairs, it will be helpful to bring out the economic structures of the new member states, Turkey and other candidates.

When taken into consideration the overall economic policies, Turkey has many advantages in its evaluation. Firstly, compared with other countries, Turkey has advantages from the characteristics of GDP and the growth rate of GDP that are reflected as indicators of the market size. During the period of 1990–2003, the growth rate has shown a trend of

TABLE 2 Key Economic Indicators, 2003

Country	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Czech Republic	89,715	3	8,855	0	34,629	-11.7	-5,660	1.2828
Estonia	9,082	5	6,693	1	6,972	3.1	-1,199	1.59
Hungary	82,731	3	8,398	5	45,784	-6.2	-7,210	1.2809
Latvia	11,072	7	4,716	3	8,802	-1.5	-916	0.9751
Lithuania	18,215	9	5,308	-1	8,342	-1.9	-1,278	1.11
Poland	209,562	4	5,400	1	95,219	-4.5	-4,599	0.7137
Slovak Republic	32,518	4	6,048	9	18,378	-3.7	-281	1.56
Slovenia	27,748	3	13,937	6	11,512	-2	-98	1.13
Turkey	240,375	6	3,452	25	145,662	-9.7	-7,905	0.5994
Bulgaria	19,860	4	2,550	2	13,288	-0.4	-1,675	1.1629
Croatia	28,797	4	6,403	0	23,451	-4.6	-2,066	1.12
Romania	56,951	5	2,570	15	21,280	-2	-3,311	0.8035

Column headings as follows: (1) GDP (current million US dollars); (2) GDP annual growth; (3) GDP per capita (US dollars); (4) inflation (%); (5) external debt total (current million US dollars); (6) budget balance (as percentage of GDP); (7) current account (current US million dollars); (8) openness (imp. + exp./GDP).

Source: World Development Indicators ([www.worldbank.org](http://www.worldbank.org)) and IMF International Financial Statistics ([ifs.apdi.net](http://ifs.apdi.net)).

increase with the exception of some years. Therefore, it can be claimed that, ideally, Turkey should draw more FDI. Although it is not emphasized in the table, Turkey has many other advantages. These can be listed as follows: being located in a strategic location, having an educated, qualified and young work force, having communication and other infrastructures that are needed to meet the needs of investors, and having a lower labor cost. It has to be emphasised that population and work-force are the main advantages of Turkey from the respect of attracting the FDI. By 2015, Turkey's population is projected to stabilize at the level of approximately 80 million and the size of the adult population – in other words, the potential active labor force is – projected to increase at a constant rate over the next two decades in contrast to the EU countries and the candidates. Furthermore, Turkey has a liberal legal framework tied to the FDI since 1954. However, there are some disadvantages in the Turkish economy. Firstly, for the last twenty years, the Turkish economy has been suffering from a high inflationary environment (Yilmaz 2003). Even though various governments in office have tried to apply policies

to decrease the rate of inflation, the rate of inflation is still higher than in other countries. Secondly, the amount of Turkey's external debts is another crucial problem. Indeed, the rate of the external debts to the GDP is about 60%. According to the optimistic forecast of the Undersecretariat of the Turkish Treasury, it will decrease to 50% in 2008 (Undersecretariat of Turkish Treasury 2004). The amount of the external debts is about \$145 billion and this prevents a decrease in the real interest rates to the desired levels. Henceforth it increases the country risk. In addition, high amounts of interest payments, inefficient tax collection, deficits in social security systems, insufficient privatization efforts, the problems of the public sector enterprises and uncontrolled expenditures are all causing budgetary deficits.

Besides all these macroeconomic instabilities, the political instability can also be a key obstacle. There have been several elections in the last 15 years which have caused jitters on the economy. It has to be noted that the frequently changing governments have given their priorities to short-run political benefits and in the long-run have not been sensitive to the economic problems. Table 3 demonstrates Turkey's locational advantages and disadvantages for FDI.

As indicated in table 3, the macroeconomic and political instabilities are the major obstacles of low volume of FDI in Turkey. If Turkey can manage to eliminate macroeconomic and politic instabilities, it stands to reason that it should attract more FDI. In this context, first of all, in Turkey it is necessary to control public debts; to decrease the rate of inflation and to provide macroeconomic stability. To achieve all these positive conditions financial discipline should be ensured.

Turkey is a candidate country. It is clear that being a candidate makes Turkey attractive for FDIs because when compared with its European competitors, Turkey has many advantages. Its full membership depends on its adaptation to all the norm and standards of the EU. Being part of the EU will make Turkey attractive to the FDI.

It has to be reminded that the FDI inflows are closely related to the business environment, tax policies of the state, property rights, sectoral license, customs and standards. In this context, the legal adjustments improving the investment environment related to all these factors mentioned should be harmonised. Also, these adjustments will help not only in compliance with EU *acquis*, but also to develop a more competitive investment environment for Turkey (Dutz-Us and Yilmaz 2003).

Since 2001, Turkey has realized important structural reforms to sustain

TABLE 3 Turkey's advantages and disadvantages for FDI

Key Location Factors	Competitive Position
Economic size	Strong
Economic growth	Strong
Population size	Strong
Per capita incomes	Medium
Labor costs	Strong
Regional integration zone	Strong
Labor skills and supply	Strong
r&d and innovation based	Weak
Telecommunications & internet infrastructure	Medium
FDI legislation	Strong
Facilitation process	Medium
Political commitment	Weak
Incentives	Strong
Investment promotion	Weak
Economic instability	Weak
Policy certainty	Weak
Political interference, bureaucracy, and corruption	Weak

Source: Loewndahl and Loewndahl 2001.

the economic growth, to improve the investment environment and to attract more FDI inflows. Undoubtedly, the most significant is the Law on Foreign Direct Investment (no. 4875), which was enacted in 2003. This new Law on FDI was designed to reflect the Turkish liberal approach (see <http://www.treasury.gov.tr>). It constitutes the legal infrastructure of FDI. However, it is too early to evaluate the influences of the law on FDI level. It is expected that the law will positively contribute to the FDI inflows. These adaptations aiming to improve the investment environment should be strictly sustained. These continuing efforts are also vital for full membership of Turkey in the EU.

### Methodology

Using panel data regression analysis, this paper explores whether or not the macroeconomic determinants of FDI affect FDI inflows in the EU new member states and candidate countries. The study will also help to determine the policies that can be employed for increasing the amount

of FDI inflows for the candidate states. As mentioned previously, there are many factors affecting FDI. In this study, FDI inflows are analyzed by using five important variables. The independent variables used to explain FDI read as follows: the rate of inflation (INF), external debt/GDP (EXTD), the current account balance/GDP (CAB), import+export/GDP (openness) and GDP. It is expected that the GDP and openness are positively correlated with FDI inflows; however, INF, EXTD and CAB that are the components of the country risk, are expected to be negatively correlated with FDI.

#### SOURCES AND DESCRIPTION OF DATA

The data source for the dependent variable is the World Development Indicators (WDI) published by the World Bank. The independent variables were obtained from WDI, EUROSTAT and IMF, International Financial Statistics. The models are estimated by using STATA statistical software. The panel data set used in this study consists of twelve countries. The data collected were limited to the year of 1993–2003, due to the data availability problem.

#### MODEL AND ESTIMATIONS

In the panel data regression analysis, two panel analytical models, Fixed Effects Model (FEM) and Random Effects Model, can be used. In some cases, FEM can produce significantly different results than REM. The Hausman test is applied to assess whether FEM or REM is more appropriate in the panel data regression model (Chan and Gemayel 2003). In this study, the Hausman test was applied and, according to it, the FEM was preferred to the REM.

In this study, we estimate fixed effects regressions with a data set from eight new member states and four candidate countries. In our model, FDI and GDP are measured in logarithmic form. In addition to this, EXTD and CAB included in the model by using one period lagged values in order to avoid endogeneity problems. Table 4 shows the estimated results obtained by using panel data between 1993 and 2003.

According to the panel data regression results, it is worth noting that GDP and openness are significant and positive correlated with FDI in all models. The results of model A illustrate that the coefficient of GDP and openness are positive and significant at 1% level, confirming the market size positively correlated with FDI. The results did not differ from what was expected. Also, in the results of our analysis, the coefficient of the in-

TABLE 4 Determinants of FDI inflows, 1993–2003 (LSDV model, dependent variable is  $\ln$  FDI)

	Model A	Model B	Model C	Model D
GDP	1.4813 <sup><math>\alpha</math></sup> [0.3405]	1.0861 <sup><math>\alpha</math></sup> [0.3598]	0.8952 <sup><math>\beta</math></sup> [0.3860]	1.1024 <sup><math>\alpha</math></sup> [0.3445]
Inflation	-0.0006 [0.0004]	-0.0001 [0.0007]	-0.0003 [0.0007]	0.0000 [0.0007]
Openness	1.1274 <sup><math>\alpha</math></sup> [0.4264]		1.1261 <sup><math>\beta</math></sup> [0.4980]	1.0238 <sup><math>\beta</math></sup> [0.4858]
Ext. debt /GDP <sub>t-1</sub>		0.9726 <sup><math>\gamma</math></sup> [0.5364]	1.1465 <sup><math>\beta</math></sup> [0.5171]	
CAB/GDP <sub>t-1</sub>		-3.2336 <sup><math>\gamma</math></sup> [1.8569]		-3.993 <sup><math>\beta</math></sup> [1.7340]
Bulgaria	0.0158 [0.3624]	0.2465 [0.3755]	0.6123 [0.4443]	-0.008 [0.3543]
Croatia	0.0109 [0.3462]	0.3645 [0.4745]	0.7123 [0.4773]	-0.005 [0.3453]
Czech Republic	-0.3954 [0.5952]	0.7462 [0.7974]	1.0157 [0.8156]	0.0732 [0.5906]
Estonia	0.7255 [0.4987]	1.0816 <sup><math>\beta</math></sup> [0.4612]	0.6531 [0.5577]	0.1244 [0.5263]
Hungary	-0.2621 [0.5341]	0.309 [0.6486]	0.6481 [0.6635]	-0.105 [0.5241]
Latvia	0.7328 <sup><math>\beta</math></sup> [0.3679]	0.7431 <sup><math>\gamma</math></sup> [0.4069]	0.9017 <sup><math>\beta</math></sup> [0.3978]	0.4196 [0.3688]
Lithuania	-0.1307 [0.3110]	0.1529 [0.4532]	0.418 [0.4213]	-0.3955 [0.3194]
Poland	-0.64 [1.0010]	0.1509 [1.0968]	1.303 [1.2325]	0.1212 [1.0238]
Romania	-0.4367 [0.5701]	0.0618 [0.7070]	0.9347 [0.7688]	-0.1601 [0.5750]
Slovak Republic	-0.585 <sup><math>\gamma</math></sup> [0.3421]	-0.0684 [0.4739]	0.0903 [0.4759]	-0.736 <sup><math>\beta</math></sup> [0.3367]
Slovenia	-1.1547 <sup><math>\alpha</math></sup> [0.3244]	-0.3042 [0.5222]	-0.2681 [0.5309]	-0.966 <sup><math>\alpha</math></sup> [0.3366]
Turkey	-2.3234 <sup><math>\beta</math></sup> [1.0733]	-1.5915 [1.0920]	-0.4842 [1.2473]	-1.4244 [1.0829]
Constant	-15.918 <sup><math>\beta</math></sup> [7.7331]	-6.3551 [8.1744]	-3.1775 [8.6413]	-6.9973 [7.8315]
Observations	128	117	118	117
R <sup>2</sup>	0.733	0.745	0.736	0.748
Adj. R <sup>2</sup>	0.7	0.707	0.698	0.71
F-stat.	22.164	19.666	18.99	19.958

Notes:  $\alpha$  significant at 1%,  $\beta$  significant at 5%,  $\gamma$  significant at 10%; standard errors in brackets.

flation was calculated negatively but it is too small and insignificant. This result can be explained by the multiplicity of the extreme data related to the inflation rates in the countries included in the survey.

In the second stage, we include EXT<sub>TD</sub> and CAB variables which indicate the country risk to the model. The results of model B illustrate that the coefficient of GDP is positive and it is significant at 1% level. On the

other hand, the result of *EXTD* runs opposite to our expectations. The positive relation between *EXTD* and *FDI* was an unexpected result. This could be explained by the accounting relation current account balance and external debt in the balance of payments. Another reason for this is that the integration efforts of countries to join the *EU* have a positive impact on *FDI*. Despite the fact that the amount of *EXTD* is increasing, the integration process reduces the country risk and this fact can affect the *FDI* positively. Moreover it was found that there is a negative relation between *CAB* and *FDI*. This result is parallel to what was expected. In the third stage, *EXTD* and *CAB* were included separately to the model because of the accounting relation (model *C* and model *D*) and we found the coefficients of these variables are significant at 5% level.

Finally, we examined the effects on countries by using *EU* membership dummies; it was concluded that the coefficients are not significant in general, except in the Slovak Republic, Slovenia and Latvia. We found the coefficients of Latvia to be positive and significant in three models (model *A*, model *B*, model *C*), illustrating that Latvia *FDI* inflows are greater than would be expected. On the other hand, when we looked at the results related to Slovenia and Slovak Republic in two of four models (model *A* and model *D*), the coefficients are significant and negative. We can say that these countries draw less *FDI* than expected. Similarly, Turkey draws less *FDI* than expected according to the results of model *A*.

### **Conclusion**

*FDI* can have strong and positive effects for national economies. There are a number of policies and perspectives developed to enhance the level and structure of *FDIs*. Even though there are various factors affecting the *FDIs*, it can be claimed that the economic structure of the countries is the most important and foreseen factor. However, in the globalization process, in addition to all macroeconomic determinants, regional integrations have provided great contributions to the *FDI* inflows. Under these circumstances, membership of the *EU* has a remarkable influence on the *FDIs*. Therefore, membership of the *EU* is vital for access to European single markets, access to European structural funds, and improvement of economic growth and political stability.

The panel data regression analysis presented in this study has shown the key determinants of *FDI* inflows to the *EU* new member states and the candidate countries. In this paper, we have found that the *GDP* and openness have a positive effect on *FDI*, whereas current account balance

and inflation have been found to be negative. On the other hand, the results related with external debt run opposite to our expectations.

Of our EU membership dummies, we found that only the Latvia coefficient is positive and significant in three models, illustrating that Latvia FDI inflows are greater than would have been expected. On the other hand, we found Slovenia, Slovak Republic and Turkey's coefficients are significant and negative. We can easily say that these countries draw less FDI than expected.

Indeed, Turkey as a candidate country has better conditions from the respects of GDP and the GDP growth rate when compared with its European competitors. However, in Turkey, there are serious obstacles preventing the FDI inflows to Turkey, significantly high rates of inflation, external debts and current account deficits. This study shows clearly how crucial the macroeconomic instability is in attracting or deterring the FDI. For this reason, candidate countries, and Turkey in particular, need to implement some policy measures in order to attract FDI. To do so, firstly, the economic obstacles that seem to prevent full membership of the EU should be developed. Moreover the political determination on this issue should be sustained. Finally, Turkey must eliminate macroeconomic and political instabilities.

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