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PRELIMINARY REPORT

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PREVIEW OF BPM6 METHODOLOGY AND ANALYSIS OF FOREIGN DIRECT INVESTMENT IN 2015 IN CROATIA

ABSTRACT: Foreign direct investments include equity capital, reinvested earnings and debt relations between ownership-related residents and non-residents. Since 31 October 2014, the Croatian National Bank has started to publish information in the field of statistics Relations (balance of payments, foreign debt and the IIP) in accordance with the methodology prescribed by the sixth edition of the Manual on Balance of Payments (Eng. Balance of Payments and International Investment Position Manual, BPM6), thus changing the presentational form of direct investment. Direct investments are not classified according to the so-called direction of investments (Eng. directional principle) on direct investment in Croatia and direct investment abroad anymore, but according to BPM6 apply the so-called principle of assets and liabilities (Eng. Assets / Liabilities principle). The aim is to point out the differences between the standards BPM5 and BPM6 and determine which activities and which countries are the most represented in the structure of direct investments in Croatia. By identifying relevant activities and countries in the structure of foreign direct investment, relevant information is obtained about the macroeconomic state of the Republic of Croatia and about the opportunities and potential dangers that certain activities and countries provide.

KEY WORDS: neoliberalism, mentality, tourists

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INTRODUCTION

Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor, regardless of whether a resident invests abroad or a non-resident invests in Croatian residents. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while, on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10% threshold and its strict application is recommended to ensure statistical consistency across countries[1]. A direct investment relationship arises when an investor resident in one economy makes an investment that gives control or a significant degree of influence on the management of an enterprise that is resident in another economy, where control and significant degree of influence are defined as follows[2]:

- Control is determined to exist if the direct investor owns more than 50 percent of the voting power in the direct investment enterprise.
- A significant degree of influence is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise.

From 31 October 2014, the Croatian National Bank started publishing data on external statistics (balance of payments, external debt and international investment position) in accordance with the methodology prescribed by the Balance of Payments and International Investment Position Manual, 6th edition (BPM6). Also, with the beginning of the implementation of BPM6, the balance of payments historical data for 2000-2013 have been revised in line with the new methodology[3]. In line with the application of the new statistical standard, the presentation form of direct investments has also been changed. Direct investments are no longer classified in accordance with the directional principle to direct investments into the Republic of Croatia and direct investments abroad. Instead, under BPM6, the assets/liabilities principle is applied. In addition, direct investments within each of the segments are further divided into:

- Direct investments in direct investment enterprises ("regular" direct investment).
- Investments in direct investor (reverse investment) – This type of investment involves investments where the original recipient of a direct investment invests less than 10% in the capital of its direct investor or grants its direct investor some form of a loan (credit, note).
- Investments between horizontally related enterprises (fellows) – This type of direct investments implies investments where the investor holds less than 10% share in the capital, if the investor belongs to the same group of enterprises as the reporting entity.

Motives and types of FDI

The basic rule of the market economy is the rule of equal supply and demand in order to reach the equilibrium of quantity and price. If this rule is applied on FDI, it would imply that the buyer and seller, or the recipient and provider of FDI, should have interest in FDI. There are four objectives that influence decisions of foreign investors on foreign investment (Pavlović, 2008):

TABLE 1. FDI PRESENTATION FORMAT FOR ASSETS AND LIABILITIES

Equity	In direct investment enterprises
	In direct investor (reverse investment)
	Between fellow enterprises
Reinvested Earnings	
Debt Instruments	In direct investment enterprises
	In direct investor (reverse investment)
	Between fellow enterprises
Net Acquisition of Financial Assets	

Available on https://www.hnb.hr/en/web/guest/statistics/statistical-data/rest-of-the-world/foreign-direct-investments, date of access 15.9.2016.

1. Market-seeking
2. Efficiency-seeking
3. Resource-seeking
4. Asset-seeking (both tangible and intangible assets)

In addition to the aforementioned objectives, there is a strategic goal of investing, usually defined by the governments of individual countries, which encourages foreign investment of multinational companies in vital inputs, e.g. oil and gas (Pavlović, 2008.). In particular, in the Republic of Croatia investment incentives are regulated by the Investment Incentives Act (hr. Zakon o poticanju ulaganja) under which the incentives are awarded to domestic and foreign, legal or natural persons. These incentives are mainly fiscal (tax and customs privileges), and to a lesser extent financial (covering the costs of employment) (Bilas, 2006.).

The most common types of FDI are:

- Horizontal and vertical investments
- Greenfield and brownfield investments

Investments abroad in order to establish or buy an existing company that will replicate all of the existing production of investors are called horizontal investments. Basic economic motives for this type of investment are direct presence in foreign markets, bypassing customs and other duties which may burden imported products, as well as transport costs. Investments abroad in order to establish or buy an existing company that will manufacture part(s) of more complex products are called vertical investments. Most common motives for that type of investment are cheaper or accessible inputs (Pavlović, 2008).

The growth enhancing ability of FDI is affected by the chosen mode of FDI. Andreas Johnson (2006) argued that the effects of FDI inflows on variables such as technology spillovers and physical capital are expected to differ between greenfield and brownfield FDI. Greenfield FDI implies that the Multinational Enterprise constructs new facilities of production, distribution or research in the host country. The result is an increase in the host country stock of physical capital that can be substantial, especially for capital-scarce developing economies. In the case of brownfield investment, the Multinational Enterprise acquires already existing facilities in the host country. Brownfield FDI should therefore only result in a limited increase in the stock of physical capital since there is a change in ownership rather than an inflow of new capital. Greenfield and brownfield FDI should affect the host country growth differently since greenfield

FDI results in a larger inflow of physical capital. This finding supports the fact that most FDI has flown into the Central and Eastern Europe in the form of brownfield investments. If those FDI inflows had come in the form of greenfield investments, the results on the economy would have automatically been visible in a higher growth rate (Bačić et al., 2004). Regarding the Republic of Croatia, Boris Sisek (2005) found that there are few FDI in Croatia which represent greenfield investment, which create jobs, are export-oriented and represent a major impetus for economic restructuring. Without a consistent strategy of economic development and with the failed economic policies (which insists on stable prices and exchange rates) the Republic of Croatia failed to create an adequate macroeconomic and business environment and does not stimulate the investment climate for FDI. The problem of attracting foreign investors lies in the entire system from the administration, the judiciary, the tax system and political will to attract investments. There has to exist a political stability, transparency in privatization and strict conduction of contracts. This means that private property has to be protected, legislation and judicial protection improved, and corruption repressed.

Differences between directional principle and asset/liability principle

The latest international standards for compiling FDI statistics lead to more meaningful measures of direct investment but also lead to significant changes in the FDI statistics that can be hard to interpret. The latest guidelines recommend that these statistics be published according to the asset/liability presentation rather than the directional presentation as had been recommended in previous guidelines so that the FDI statistics would be more comparable to the other statistics included in the BOP and IIP accounts. The two presentations cover the same flows and positions but differ in how they are classified and aggregated. As a result, the two presentations can differ significantly for specific countries and in specific time periods. However, they are related to one another.

The first main difference between the two presentations is how the pieces are organised. Under the asset/liability presentation, the asset side includes all assets of both resident parent companies and of resident affiliates, and the liability side includes all liabilities of both resident parents and resident affiliates. In contrast, the outward investment position consists only of positions of resident parents, and the inward investment side consists only of positions of resident affiliates. The second main difference is in the treatment of reverse investment. Reverse investment is when an affiliate invests in its parent. Under the directional presentation, reverse investment is subtracted to derive the amount of total outward or inward investment of the reporting country.

While the presentation on an asset/liability basis is appropriate for macroeconomic analyses, it is not as useful for studying the nature and motivations of foreign direct investment. For example, it is not useful for identifying the source countries of direct investment in a particular country or for assessing the access to specific foreign markets by direct investors in that country. The directional principle is most appropriate for these types of analyses and, thus, both BPM6 and BMD4 recommend that statistics by industry or by partner country or region be shown on a directional basis rather than an asset/liability basis. Contrary to given recommendation, it seems there is no public data available on FDI statistics following directional principle in the Republic of Croatia since 2014.

An examination of statistics for a sample of countries that published both measures revealed that the two measures tended to move together and tended to be of similar magnitude. These tendencies can be of use when analysing FDI statistics published according to the different presentations across countries or over time (OECD, 2014). A statistical analysis was conducted to confirm whether the previous

TABLE 2. DIFFERENCES BETWEEN DIRECTIONAL PRINCIPLE AND ASSET/LIABILITY PRINCIPLE

ASSETS	LIABILITIES
Of direct investors in direct investment enterprises	**Of direct investment enterprises to direct investor**
A1 Equity	L1 Equity
A2 Debt instruments	L2 Debt instruments
Of direct investment enterprises in direct investor – Reverse investment	**Of direct investor to direct investment enterprises – Reverse investment**
A3 Equity	L3 Equity
A4 Debt instruments	L4 Debt instruments
Of resident fellow enterprises in fellow enterprises abroad	**Of resident fellow enterprises to fellow enterprises abroad**
A5 Equity	L5 Equity
A5.1 Equity (if ultimate controlling parent is resident[1])	L5.1 Equity (if ultimate controlling parent is nonresident[2])
A5.2 Equity (if ultimate controlling parent is nonresident[2])	L5.2 Equity (if ultimate controlling parent is resident[1])
A6 Debt instruments	L6 Debt instruments
A6.1 Debt instruments (if ultimate controlling parent is resident[1])	L6.1 Debt instruments (if ultimate controlling parent is nonresident[2])
A6.2 Debt instruments (if ultimate controlling parent is nonresident[2])	L6.2 Debt instruments (if ultimate controlling parent is resident[1])

[1] That is, resident in the compiling economy.
[2] That is, not resident in the compiling economy.

Asset/Liability presentation

Direst investment assets:
Equity: A1 + A3 + A5;
Debt instruments: A2 + A4 + A6

Direct investment liabilities:
Equity: L1 + L3 + L5;
Debt instruments: L2 + L4 + L6

Directional principle presentations

In principle:

Direct investment abroad (outward direct investment):
Equity: A1 – L3 + A5.1 – L5.2;
Debt instruments: A2 – L4 + A6.1 – L6.2

Direct investment in the reporting economy (inward direct investment):
Equity: L1 – A3 + L5.1 – A5.2;
Debt instruments: L2 – A4 + L6.1 – A6.2

Acceptable practical alternative:

Direct investment abroad:
Equity: A1 – L3 + A5;
Debt instruments: A2 – L4 + A6

Direct investment in the reporting economy:
Equity: L1 – A3 + L5;
Debt instruments: L2 – A4 + L6

International Monetary Fund (2008), Balance of Payments and International Investment Position Manual, Sixth Edition

TABLE 3. DIFFERENCE BETWEEN IN ORGANIZATIONAL SCTRUCTURE BETWEEN DIRECTION AND ASSET/LIABILITY PRINCIPLE

Country's direct investment assets are equal to	Country's direct investment liabilities are equal to
Resident parents' equity in and lending to foreign affiliates	Foreign parents' equity in and lending to resident affiliates
plus	plus
Resident affiliates' equity in and lending to foreign parents	Foreign affiliates' equity in and lending to resident parents
Country's outward investment is equal to	**Country's inward investment is equal to**
Resident parents' equity in and lending to foreign affiliates	Foreign parents' equity in and lending to resident affiliates
minus	minus
Foreign affiliates' equity in and lending to resident parents	Resident affiliates' equity in and lending to foreign parents

OECD (2014), Implementing the latest international standards for compiling foreign direct investment statistic, Asset/Liability versus Directional Presentation

TABLE 4. NET FDI POSITION AND GROWTH RATES FOR BOTH FDI PRESENTATION METHODS

YEAR	NET FDI ASSET/LIABILITY PRESENTATION (MIL. EUR)	ANNUAL GROWTH RATES (%)	NET FDI DIRECTIONAL PRESENTATION (MIL. EUR)	ANNUAL GROWTH RATES (%)
2000	-1,073	–	1,141	–
2001	-967	-9.93	1,329	16.54
2002	-410	-57.58	531	-60.07
2003	-1,473	259.21	1,657	212.15
2004	-742	-49.60	671	-59.51
2005	-1,253	68.73	1,276	90.22
2006	-2,414	92.69	2,557	100.36
2007	-3,156	30.76	3,435	34.37
2008	-2,675	-15.25	3,094	-9.92
2009	-1,294	-51.62	1,492	-51.77
2010	-820	-36.67	484	-67.54
2011	-1,113	35.75	1,053	117.44
2012	-1,205	8.32	1,083	2.83
2013	-822	-31.82	676	-37.63

Adapted from Croatian National Bank (2004-2013) Bulletin

TABLE 5. REGRESSION RESULTS

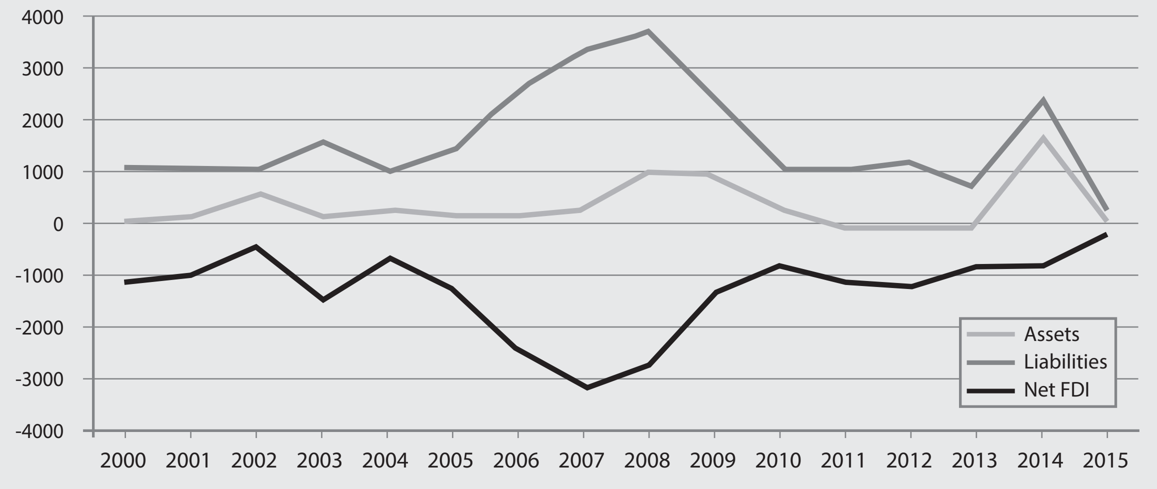
	NET FDI POSITIONS	ANNUAL GROWTH RATES
Correlation	-0.98	0.94
Significance	$p < 0.01$	$p < 0.01$

statement was true for the Republic of Croatia; therefore, the following hypothesis were tested:

- *H1* – There is a significant positive relation between net positions of FDI statistics measured by asset/liability principle and directional principle.
- *H2* – There is a significant positive relation between annual growth rates of FDI statistics measured by asset/liability principle and directional principle.

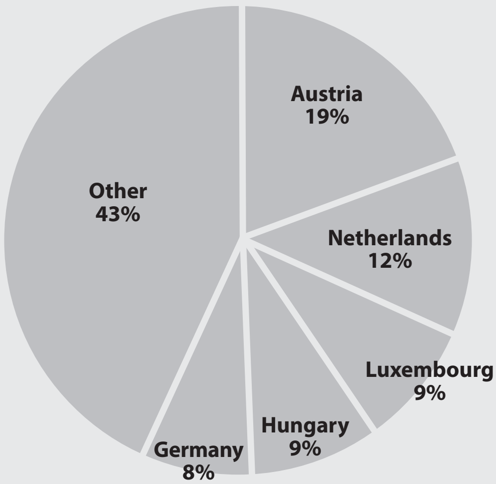
Since both measures are published only for years 2000-2013, only FDI statistics for given years was analysed. Table 4 shows net FDI position for both presentations, along with their growth rates. Following the results given in Table 5, hypotesis *H1* wasn't confirmed, but, quite the opposite, there is a significant negative relation between net positions of FDI statistics measured by asset/liability principle and directional principle. In other words, inward FDI are presented as negative values by asset/liability method while they are presented as positive values by directional method. Hypotesis *H2* was confirmed, there is a significant positive relation between annual growth rates of FDI statistics measured by asset/liability principle and directional principle. Following the given conslusions, to conduct an analysis of FDI statistics by asset/liability method (without directional statistics of FDI) the net values and growth rates should be taken into account.

GRAPH 1. FDI ASSETS, LIABILITIES AND NET POSITION IN REPUBLIC FOR CROATIA, PERIOD 2000-2015

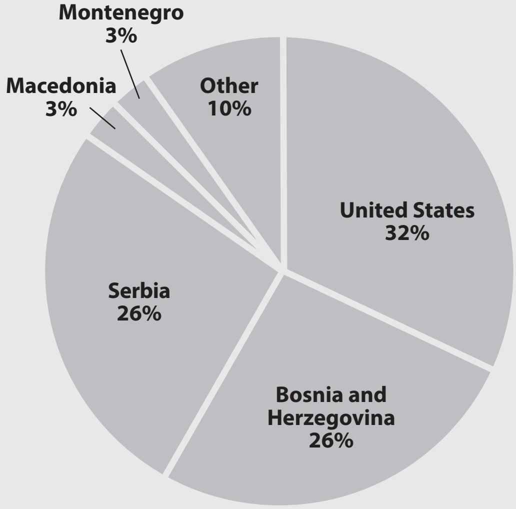


Adapted from https://www.hnb.hr/en/web/guest/statistics/statistical-data/rest-of-the-world/foreign-direct-investments, date of access 15/9/2016

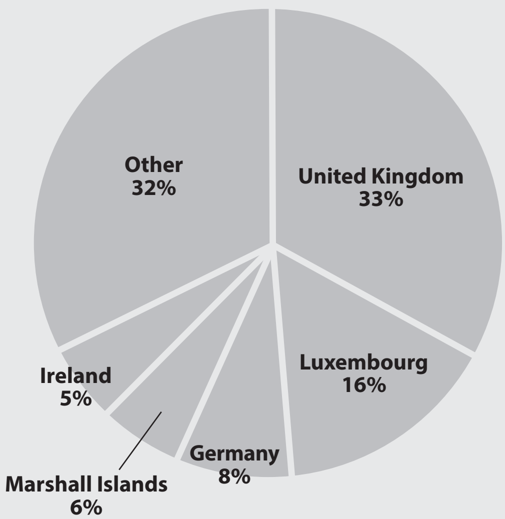
GRAPH 2. TOP FIVE COUNTRIES BY NET INWARD FDI FROM 2000 TO 2015



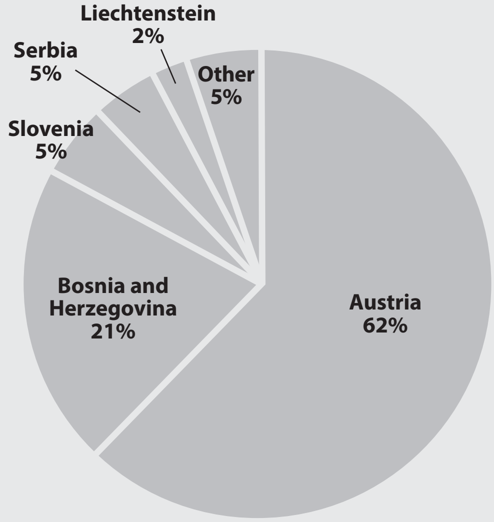
GRAPH 3. TOP FIVE COUNTRIES BY NET OUTWARD FDI FROM 2000 TO 2015



GRAPH 4. TOP FIVE COUNTRIES BY NET INWARD FDI IN 2015

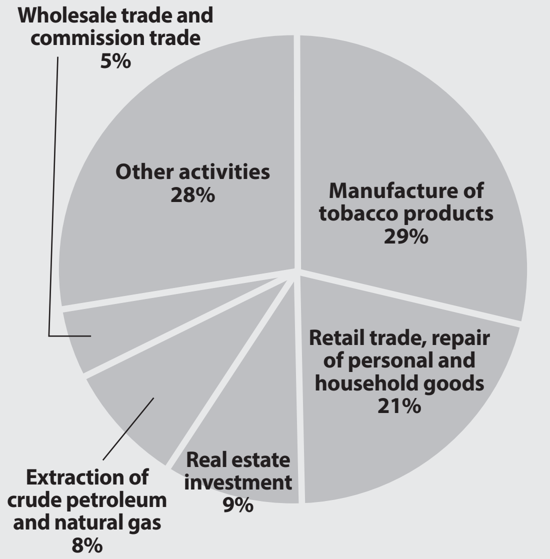


GRAPH 5. TOP FIVE COUNTRIES BY NET OUTWARD FDI IN 2015

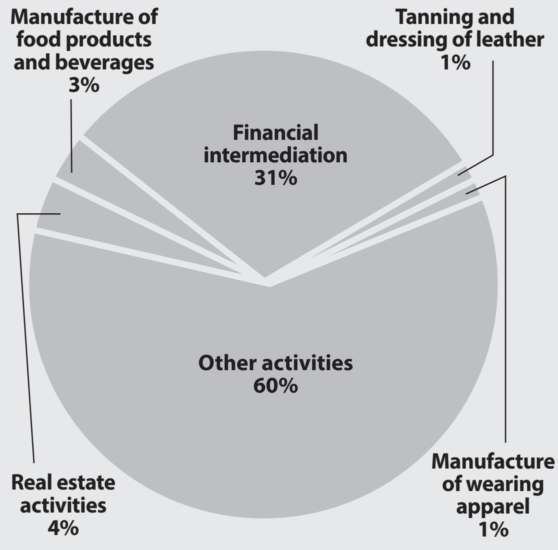


Adapted from https://www.hnb.hr/en/web/guest/statistics/statistical-data/rest-of-the-world/foreign-direct-investments, date of access 15/9/2016

GRAPH 6. TOP FIVE ACTIVITIES BY NET INWARD FDI IN 2015



GRAPH 7. TOP FIVE ACTIVITIES BY NET OUTWARD FDI IN 2015



Adapted from https://www.hnb.hr/en/web/guest/statistics/statistical-data/rest-of-the-world/foreign-direct-investments, date of access 15/9/2016

FDI statistics for the Republic of Croatia in 2015

In accordance with the methodology prescribed by BPM6, data also include the round tripping, which increases net acquisition of financial assets and net incurrence of liabilities by the same amount. This type of direct investment was recorded in December 2008 (EUR 825.7 m), August 2009 (EUR 666.5 mil), December 2010 (EUR – 618,6 mil) and June 2014 (EUR 1.485,8 mil). Mentioned round tripping is one of the reasons why the directional data presentation is recommended for FDI analysis. Throughout the 2000-2015 the Republic of Croatia had more inward FDI than outward FDI, especially during the financial crisis where the amount of net FDI peaked at – 3 billion EUR.

The Republic of Croatia had FDI relations with 66 countries, of which 22 with net outward and 44 net inward FDI in the period 2000-2015. Countries that invested the most in Croatia are Central Europe countries (top five being: Austria 19% of total inward FDI from period 2000-2015, Netherlands 12%, Luxembourg 9%, Hungary 9%, Germany 8%) while FDI from Croatia mostly went towards the United States and countries in the Balkan region (top five being: The United States 32%, Bosnia and Herzegovina 26%, Serbia 26%, Macedonia 3% and Montenegro 3%). Interestingly, the top five outward countries make 90% of total outward FDI which means that the Republic of Croatia mostly invests in the mentioned countries.

In 2015 the top five countries that made investments in Croatia make about 68% of total inward FDI for the 2000-2015 period. Interestingly, one of the top countries are the Marshall Islands. Most probable explanation for those inward FDI is that the Marshall Islands are a very popular tax haven. The top five countries that the Republic of Croatia invested in make 95% of the total, with Austria being the most popular outward FDI country in 2015 (62% of total outward FDI).

Activities shown in graphs 6 and 7 are sorted according to NACE classification (i.e. Statistical classification of economic activities in the European Community). 72% of inward FDI in 2015 is concentrated in 5 activities, where the leading activity (29%) is manufacture of tobacco products. Over 30% of outward FDI are financial intermediation activities and only three activities make over 1% total outward FDI in 2015, which means that outward FDI are almost uniformly dispersed following NACE classification.

Most of the given results can be easily explained by analysing FDI that took place in Croatia. For example, the upsurge of FDI liabilities and assets in 2014 was, as mentioned, due to round tripping which was caused by Agrokor Group acquiring the majority stake of Poslovni sistem Mercator. The surprising finding that the manufacture of tobacco products had the biggest share amongst activities in inward FDI in 2015 was caused by the acquisition of Tvornice Duhana Rovinj (TDR) by the British American Tobacco (BAT), which, on the other hand, complements findings about inward FDI by country in 2015, where the United Kingdom share was 33% of total inward FDI in 2015.

CONCLUSION

Balance of Payments and International Investment Position Manual, Sixth Edition (BMP6) introduced new presentation formats for FDI statistics, which would make FDI statistics more comparable to the other statistics included in the BOP and IIP accounts. On the other hand, the directional principle is more appropriate for most economic analyses and, thus, it is recommended that, in addition to asset/liability principle, statistics by industry or by partner country or region be shown on a directional basis. Since 2014 there have been no public data in the Republic of Croatia available on FDI statistics by directional method but findings confirmed there are some similarities between the two methods. Our empirical study shows there is a very strong, negative and significant link between net FDI positions measured by asset/liability principle and directional principle. Secondly, there is a significant positive relation between annual growth rates of FDI statistics measured by asset/liability principle and directional principle. Those two findings enable to analyse direction of FDI even if FDI statistics is presented by asset/liability method.

Over the period 2000-2015 the Republic of Croatia had the net inward FDI position with 44 countries and net outward FDI position with 22 countries, meaning there are a lot more countries interested in investing in Croatia than vice versa. Most of the net inward FDI positions are from the countries in Central Europe, while most of the net outward FDI positions are with the United States and the Balkan countries. Nevertheless, it is difficult to find a trend in FDI position, because, as shown in this article, a single FDI (e.g. acquisition of Tvornice Duhana Rovinj by British American Tobacco) has a huge impact on FDI statistics.

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