

Policy analysis of direct foreign investment in turkey



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Modern Turkey was founded in 1923 after the defeat Ottoman Empire. Later during the one party rule led by the national hero Mustafa Kemal called 'father of Turks' till 1950, the country went through wide ranging social, legal, and political reforms. In 1950 elections, opposition Democratic Party came to power and political parties have multiplied ever since. The democratic rule was fractured by frequent military coups in 1960, 1971, 1980 and 1997. The last of the coups helped ouster of an Islamic oriented Government.

Besides, Turkey itself engaged itself in military interventions in neighboring Cyprus since 1974 repercussions of which continue even now. Incidentally EU has on 30 Nov 2006 suspended talks with Turkey on EU membership, a key factor and catalyst for its FDI growth potential, over the issue of Turkey's refusal to open up port traffic to Cyprus, an EU member. (see europe. net) Turkey is about 770, 790 sq km in land and 9, 820 in water and the area is slightly larger than Texas.

Population is about 70, 413, 958 as per July 2006 estimates. Life expectancy is 75. 18 years for females and 70. 18 years for males. (2006 estimates)

Ethnic groups are Turkish 80% and Kurdish 20% and religion is 99. 8%

Muslim and 0. 2% Christians and Jews. Turkey's economy is characterized by a combination of commerce and industry with traditional agricultural sector. The agriculture itself gives more than 35 % of employment. Major industry consists of textiles and clothing accounting for one third of industrial employment.

Other industrial items are food processing, autos, electronics, mining of coal, iron, copper and boron, steel, petroleum, construction, lumber and paper.

While its oil production is 50, 000 bbl/day, consumption is 715, 100 bbl/day. Proved oil reserves are 288. 4 million bbl/day as on 1 January 2002. Its current account deficit is \$23. 08 billion as on 2005. 18. 978 million telephones lines are in use along with 43. 609 million mobile connections. It has 16 million internet users as on 2005. (The world Fact Book 2006) Against the above backdrop, this paper analyses FDI scenario in Turkey.

In doing so, the country's policy for FDI, its ability to attract FDI, hurdles it faces in bringing FDIs in to the country are examined. Turkey's poor performance in attracting FDI Being the largest economy in Eastern Europe, the Balkans, the Black Sea basin and the middle east and the EU's sixth biggest trading partner and the world's 7th largest emerging economy, Turkey has attracted only \$ 1billion as FDI in any one year. Countries like Argentina, Poland and Mexico of Turkey's size have attracted FDI 3 times as much.

A 1997 survey of the world bank found no easy explanation for the slow growth of FDI there. (Michalet, 1997: 4-5) FDI Law 2003 Turkey passed an enactment on Foreign Direct Investment on 5 June, 2003 which became official from 17 June, 2003 as there can be no better evidence to show its determination to attract foreign investments, Most of the nations had been skeptical of FDIs as a back door entry for foreign power and invasion and developing countries' lukewarm response to FDIs have been mostly due to this fear.

With the object of encouraging foreign investments, the law sought to “ establish a notification-based system for foreign direct investments rather

than screening and approval”(Article 1) (Turkish Embassy, London) Among other things the law guarantees equal treatment to foreign investors on par with domestic investors , permits expropriation and nationalization only for public purposes with due compensation by due process of law, transfers of funds by foreign investors to their home countries or elsewhere, access to real estate in Turkey, employment of expatriates, and disputes settlement under International arbitration or as per respective investment agreements.

Development and growth FDI of Turkey (1990-2002) Turkey’s annual growth rate was 4% during the period of 1980-2002 in terms Gross National Product. Highest was in 1987 as +9. 8 % and Lowest in 2001 as -9. 5%. There was actually increase in growth rate in 1980s which slowed down in 1990s. And average GDP in the same periods of 1980-2002 was about 4. 2%. This had been increasing during 1980s @ 5. 2% average and decreased in 1990s @ 3. 1% average.

The table in see figure 1 would show the sluggish growth of economy prior to 1990. Turkey ranked lowest with \$ 706 per capita investment (see figure 2) which explains the slow economic growth rate prevailing in 1999. An empirical study found that Turkey’s economic progress depended on its capacity to bring in more foreign capital as FDI in addition exports. (Alici, Ucal 2003) Another empirical study has found that although Turkey has location advantages to attract foreign direct investments, “ the lack of exchange rate and economic stability has hindered its efforts to harbor much higher volumes of FDI” (Erdal, Tatoglu 2002) Turkey is lagging behind in FDI inflows in spite of its potential.

Though worldwide FDI inflows have increased eight fold from \$ 160 billion in 1991 to \$ 1271 billion in 2000 as per UNCTAD figures, Turkey received \$ 750 million net per year amounting to 0. 4% of GDP, ranking the country in 81st position out 91 developing and transition countries having an annual FDI ration to GDP at 2%. Turkey's annual net FDI flows have remained the same trough 1980s and 1990s, while worldwide FDI increased by a factor of 12 in 1990s. by virtue of globalization. " A number of studies were carried out on Turkish - foreign investors to find out why Turkey under performs in terms of attracting FDI and Administrative Barriers to Investments in the form of cumbersome, unclear, time-consuming procedures were found to be major causes. " (Us Melek 2001)

Turkey's major strengths are its strategic geographical location for creating market opportunities, population of more than 70 million and their changing consumption patterns, educated and efficient labour force, globally integrated economy, telecommunications and transportation infrastructure, and presence of major international companies. But the following factors pull down its performance on FDI inflows. They are unstable political and economic conditions, high inflation and high interest rates, sluggishness in privatization, presence of parallel economy, and oft-changing legislation. The OECD forum on international investment held in Mexico city on 26-27 November 2001 highlighted Turkey's ambitious programmes in attracting FDIs as follows.

They are, containing of inflation under floating exchange rates, restructuring of banking sector, structural reforms, strong public finance balances, implementation of income policy on social consensus, and creating more

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competition and efficiency in the economy. Structural reforms will be achieved through creation of better market functioning by laws on sugar, tobacco, natural gas, civil aviation, electricity and telecom sectors. Turkey believes that FDI is only a means to an end and mere pleasing of foreign investors will not bring about a better investment climate. To achieve this, administrative barriers project was carried out in the year 2001. Turkey is notorious for its red-tape as per global competitiveness report.

Price Waterhouse Coopers estimated that Turkey's parallel economy amounted to what would have contributed to an increase of 36% in the corporate tax revenues. Besides, due to this opaque nature of the economy, Turkey is reported to have lost FDI of 1.8 billion U. S. Dollars per year. FDI Diagnostic report of FIAS cited administrative barriers for new FDIs. The OECD report summarises the foreign investment policy of Turkey as follows. " The main features of the foreign investment policy of Turkey are; ? The same rights and obligations for foreign investors with the nationals ? No limitation in equity participation ratios (only 50.000 US Dollars capital share for each investor) Free access to specific sector markets which are also free for Turkish investors ? Free transfer of profits, fees, royalties and the repatriation of capital ? Only a registration procedure required for license, know-how, technical assistance and management agreements ? No compulsory conversion of foreign currency brought by foreign investors into national currency" (Us Melek 2001) Turkey also has taken steps to achieve a secure investment climate by becoming member of organizations such as OECD, WTO, IMF/World bank/MIGA and entering into double taxation

avoidance agreements with 46 countries. It has also entered into agreements with 65 countries for Protection and Promotion of Investments.

Most important of all, Turkey has been aspiring for membership in the European Union and the OECD report has cited events in this chronologically until 2001 as follows. " 1996 - Turkey entered a customs union with the EU and is playing a pivotal role in developing economic cooperation with economies of Eastern Europe and Central Asia. These policies have helped to create an entrepreneurial and resilient private sector. 1999 - Announcement of Turkey as a candidate country 2001 - " National Program" for the adoption of the " Acquis" of European Union has been published and the necessary legislative modifications are on progress" (Us Melek 2001) From the perspective of the U. S. though Turkey is a liberal investment policy regime with Bilateral Investment Treaty since 1990, there are hindrances to private investments in Turkey which are " excessive bureaucracy, political and macro-economic uncertainty; weakness in judicial system, high tax rates; a weak frame work for corporate governance; and frequent changes in the legal and regulatory environment. " (Foreign trade barriers) Besides corruption has been a major impediment especially in Government procurements.

Although a Turkish court has ruled in 2002 that the Turkey Government must either honour the cancelled 46 power project contracts or compensate the companies affected, till date no action has been taken by the Government for settlement of disputes with the affected companies. By raising tax on cola drinks to 47.5 %, the major U. S. cola producers are discouraged to invest in Turkey for cola production. Automakers and Pharmaceuticals have peculiar

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problems in Turkey. Automakers are assessed a special consumption tax of 27 to 50 percent on motor vehicles depending upon engine size which has adversely affected U. S. automobiles. Pharmaceuticals have problems in protecting their intellectual property rights and also face price controls in Turkey. Nevertheless, the U. S. Government has recognised Turkey as one of the ten big emerging markets of the 21st century along with China, India, Russia and Brazil because of high economic growth and growing population. (Tatoglu, Glaister 2000)

The following figure taken from FDI Magazine pages dedicated to Turkey would show the business environment prevailing in Turkey as of 2005. See figure 3 for the country's Annual GDP growth and FDI inflow. (FDI Magazine 2005) Future outlook Turkey's dream of becoming a EU member aimed at garnering sustained FDI inflows from EU member countries has been once again stalled by suspension of talks on the issue linked to Turkey's non-cooperation with EU member country of Cyprus as per the news reports of 30 November 2006. In Turkey's interest, it can not be simply abandoned as it is linked to the country's economic emancipation. The Central and East European countries after becoming EU members in 2004 have started achieving significant increase in GDP growth.

In fact once it became apparent in 1995 itself, that these countries would be taken in, GDP per capita ratio increased from 45 % to 54 % in Hungary, from 38% to 45 % in Poland, from 41 % to 47 % in Slovakia and 60% to 61% in the Czech Republic. Based on this and assuming that Turkey would soon become a EU member, its FDI inflow would show an increasing trend to touch USD 7 billion in the next 10 years. GDP per capita for Turkey is estimated to be 38%
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in 2015 as against the present rate 28 % in 2005. see Table as figure 4.

Short term measure to increase FDI inflow is to achieve through M & A and medium term measure is to attract FDI investors in infrastructure and service sectors. The long-term measure would be to bring in high technology industries.

To achieve the above said targets in conjunction with EU membership, Turkey must set up Investment Promotion Agency (IPAs) by 2006 or 2007 as suggested in the report of June 2006 by Yilmaz (2006) In the alternative, a semi- autonomous promotion Agency under the patronage of Prime Minister must be set up to attract FDI inflows. As per the World Investment Report 2001 the per capita cumulative FDI was \$ 2245 in developed countries and \$ 194 for developing countries. Yet a developing country Turkey has cumulative per capita FDI of \$ 92 only as against a world average of \$ 528. It is only comparable to the levels of Central Asian and African countries who have \$71 and \$ 86 respectively.

Hence Turkey has to go long way in attracting FDIs to at least the levels of the rest of the developing countries. Since Imports do not develop infrastructure in the home countries, countries look to the FDIs to develop their manufacturing sectors and service sectors which provide for long term benefits to the recipient countries. Conclusion From the various studies examined, it seems Turkey's salvation lies in its acquiring E. U. membership at the earliest shedding its Cyprus hangover because of this sole issue stalling Turkey's progress in spite of its strong fundamentals for attracting FDIs. FDIs hold key to Turkey's achieving its economic targets.