THE INTERNATIONAL POSITION OF TURKEY REGARDING FOREIGN DIRECT INVESTMENT POLICIES AND PERSPECTIVES AFTER 17/12/04

Foreign direct investments (FDI) are a crucial variable in economic development. Presently they are the most important source of external finance for developing countries and the type of external resource that offers the highest probability of promoting sound growth. Turkey has not yet been able to attract a significant amount of FDI flows for a country with an economy of its size. In an international comparison the country demonstrates low performance and potential. This fact is partially due to the macroeconomic instability of the country in past years. From a microeconomic point of view the unattractiveness of the Turkish economy for FDI is related to the inadequacy of both its legal infrastructure and its privatization and liberalization policies. This climate is already changing and will change further in the coming years, when accession negotiations begin. Accession negotiations will produce positive changes in the macro and micro economic framework, thus stimulating the inflow of FDI.

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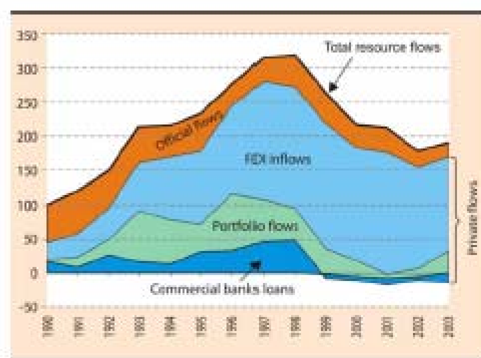
Worldwide FDI Trend

In today's globalized economy the role of FDI in enhancing economic development continues to increase. Developing countries are often characterized by an insufficient level of domestic savings to sustain the investment effort needed to generate an adequate rate of growth in their per capita GNP, that is, a rate of growth high enough to counterbalance the increase in population or the labor force in order to ensure an increase in per capita income. Besides, the higher the rate of growth, the more domestic savings are required to sustain the investment process. Developing countries are generally, characterized by the so-called saving-investment gap, that is, they do not generate the domestic savings they need. For this very reason their investment process has to be augmented with a financial flow from countries with a saving surplus. FDI flows have to be viewed within the context of these financial flows to developing countries. FDI is the main component of such flows, as indicated in Figure 1.

Figure 1
Total financial flows to developing countries, by type of flow, 1990-2003
(Billions of dollars)

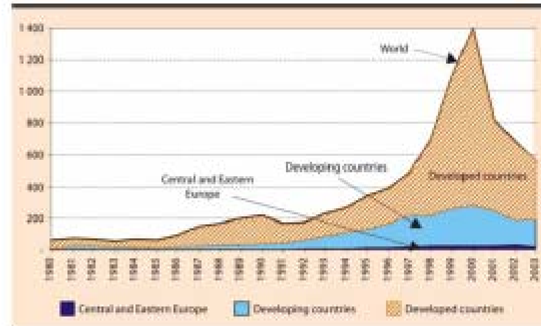


Source: UNCTAD, World Investment Report, 2004

In 2003, FDI inflows accounted for the huge majority of all financial resources flowing into developing countries. China was the leading host country, followed by India and Brazil. Among developed countries, the United States was the leading source for FDI projects, followed by Japan, Germany, the United Kingdom and France.

As we can see in Figure 2, FDI inflows started to rise steadily in 1992, growing from $200 billion to $1,400 in 2000, after which they declined to $ 560 billion in 2003. FDI flows to developing countries grew from about $100 billion at the beginning of the nineties to $250 billion in 2000, and then dropped to $170 in 2003. FDI is the main external financial resource for developing countries; it is therefore an important source of development. However it should be made clear that FDI is not a substitute for domestic investment, actually it complements domestic investment. In the last ten years, FDI flows have accounted for no more than 8% of world investments.

Figure 2
FDI inflows, globally and by type of country, 1980-2003
(Billion of dollars)



Source: UNCTAD, WIR, 2004

However, the difference between advanced and developing countries is relevant. While in the former this ratio is about 6%, in the latter it is about 10%. Trans-national corporations (TNCs) create the bulk of FDI, through green field and expansion FDI projects and through cross-border mergers and acquisitions. In 2003, over 9,300 green field projects were announced at an estimated value of $440 billion, while the number of cross-border M&A was 4,500 deals, about half the number of green field projects.

The International Position of Turkey with regard to FDI

The data in Table 1 provides a general summary of Turkey's standing within international inflows of FDI.

Table 1
FDI inflows and inward stocks by host region and economy, 2003.
(Millions of dollars)

	Inflows	Stock
World	559,576	8,245,074
Developed countries	366,573	5,701,633
Israel	3,745	31,827
European Union	295,154	3,335,454
Greece	47	17,000
Developing countries	172,033	2,280,171
China	53,505	501,471
India	4,269	30,827
Brazil	10,144	128,425
Kazakhstan	2,068	17,567
Turkey	575	18,196

Source: UNCTAD

Inflow and stock of FDI to Turkey in 2003 appear relatively low, especially when compared to the size of its economy. The percentage of FDI inflow to gross fixed capital formation has been approximately 1.6. This data compares unfavorably with the world ratio of 7.5% and a ratio of 10% in developing countries. As far as stock is

concerned, the percentage of gross domestic product is about 7.6% while the world average is 22.9% and 31.4% in developing countries.

We have seen that the role of FDI in the global economy is growing; we have also seen that the bulk of FDI is created by TNC activities. The degree of trans-nationalization of host countries continues to increase. This is represented by an index, calculated by UNCTAD for 2001: the trans-nationality index of host economies. This index is the average of four ratios: FDI inflows to gross fixed capital formation for 1999-2000, FDI inward stocks to GDP in 2001, value added by foreign affiliates to GDP in 2001, and employment by foreign affiliates to total employment in 2001. The most trans-nationalized host economy in 2001 was Hong Kong with an index of 101.9, followed by Ireland, Belgium and Luxemburg with indices of 77 and 76. Singapore was next, with 60. All these are small countries and, consequently small economies. Generally we can say that small economies tend to have higher trans-nationality indexes than larger economies. In the case of developing countries the average index is 20. In this group we find China, whose index is 15. Almost at the same level we find Brazil, Indonesia and Venezuela. Turkey's index is about 8. Turkey is followed by India and South Korea.

In order to complete the assessment of Turkey as a host country for FDI, the indices of inward FDI performance and potential are relevant. The UNCTAD inward FDI Performance Index is a measure of the extent to which host countries receive inward FDI. This index ranks countries by the amount of FDI they receive relative to their economic size, calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. A value greater than one indicated that a country attracts more FDI in proportion to its economic size, so the higher the ratio the more success the country has enjoyed in global competition for FDI.

Among developing countries, but excluding the city states of Hong Kong and Singapore, as indicated in Table 2 the highest value of the FDI performance index for 2000-2002 is that of Bolivia with 3,6 while its rank is 9. Turkey's index is particularly low, even when compared with other countries of Central Asia. This region was the best performer in the Index, reflecting resource-based (oil and gas) FDI in a few countries. In contrast, Western Asia (where Turkey is included) and South Asia had indices below one. The low ranking of Western Asia is clearly a consequence of political instability. The second indicator is the Inward FDI Potential Index. This index includes several factors expected to affect an economy's attractiveness to foreign investors. It is an average of the values of 12 variables.

Table 2
Inward FDI Performance Index 2000-2002
(Rank and Score)

Country	Rank	Score
Bolivia	9	3.661
Kazakhstan	12	3.456
Azerbaijan	13	3.371
Cyprus	20	2.445
Tajikistan	83	0.718
Turkey	109	0.325
India	121	0.215
Iran	135	0.037

Source: UNCTAD

Here is a brief explanation of these variables as they give a useful indication of the main economic components of a country's competitiveness in attracting FDI. The reader will thus have a view of the basic factors attracting FDI. A weak level or performance with regard to these variables will imply a reduced capacity to attract FDI. At the same time, taken as a whole these variables provide a guideline for the definition of economic policy oriented to improve the capacity of a country to attract FDI. They are:

- GDP per capita; the rate of GDP growth over the previous 10 years;
- The share of exports in GDP, indicating openness and competitiveness;
- As an indicator of modern information and communication infrastructure, the average number of telephone lines per 1,000 inhabitants and mobile telephones per 1,000 inhabitants;
- Commercial energy use per capita, for the availability of traditional infrastructure;
- The share of R&D spending in GDP, to capture local technological capabilities;
- The share of tertiary students in the population, indicating the availability of high-level skills;
- Country risk, a composite indicator capturing some macroeconomic and other factors that affect the risk perception of investors;
- The world market share in exports of natural resources, to proxy for the availability of resources for extractive FDI;
- The world market share of imports of parts and components for automobiles and electronic products, to capture participation in the leading TNC integrated production systems;
- The world market share of exports of services, to capture the importance of FDI in the services sector, which accounts for some two thirds of world FDI;
- The share of world FDI inward stock, a broad indicator of the attractiveness and absorptive capacity for FDI, and the investment climate.

Table 3 demonstrates the values of the Inward FDI Potential Index for 2000-2002.

Table 3
Inward FDI Potential Index 2000-2002
(Rank and Score)

Country	Rank	Score
South Korea	18	0.387
Taiwan	21	0.377
Israel	23	0.354
Malaysia	32	0.292
Russian Federation	33	0.291
Turkey	72	0.181
Indonesia	82	0.163
India	89	0.159

Source: UNCTAD

Again we find Turkey low in the rankings. In terms of group of economies, this indicator shows, not surprisingly, the highest values for developed countries. Indeed their score is about 0.396 compared to 0.177 for developing countries. Central and Eastern European countries are ranked in the middle with a score of 0.221.

At this point we can combine into a matrix the two indicators we have examined. This comparison yields insights in terms of the factors that may cause a discrepancy between actual FDI inflows and the structural variables that affect FDI. A comparison using national performance according to the FDI Potential and Performance indices yields insights into the factors that may cause a discrepancy between actual FDI inflows and the structural variables that affect FDI. Countries can be divided into four groups: high FDI potential and performance; low FDI potential but strong FDI performance; high FDI potential but low FDI performance; low FDI potential and performance.[1]

Turkey falls into this last category, demonstrating a strong under-performance. There are 45 countries included in this group.[2] Most of them are poor (or unstable) economies, including economies that have recently been affected by economic shocks, as is the case of Turkey, as well as Argentina and Indonesia.

Turkey's Policy towards FDI

In the last 15 years, Turkey has experienced a deep transformation, changing from an economy mainly based on agriculture to one in which industry, and to an even greater extent, services have gained in relative weight and importance. The choice to open the economy of the country was made in the middle of the 1980's by President Özal and has made construction of certain vital infrastructure for the process of modernization possible. The improvement of the road system, new airports and the

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[1] See: UNCTAD: www.unctad.org/fdistatistics

[2] Algeria, Argentina, Bangladesh, Benin, Burkina Faso, Cameroon, Côte d'Ivoire, Democratic Republic of the Congo, El Salvador, Ethiopia, Gabon, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Suriname, Syrian Arab Republic, Tajikistan, Turkey, Ukraine, Uruguay, Uzbekistan, Venezuela, Yemen, Zambia, Zimbabwe.

communication infrastructure has helped increase the flow of foreign capital, which, in turn, has helped the development of a private sector mainly based on small and medium sized enterprises. This growth trend in the private sector continued until 1994, when the first big financial crisis hit the country.

In the same decade, 1985-1995, Turkey integrated more and more with Western countries and particularly with the European Union after the Custom Union, which came into effect on January 1, 1996.

The economic crisis strongly undermined Turkey's development process, making it necessary to find a new model of sustainable growth that could take advantage of the productive potentialities of the country, hence attracting foreign capital. The reasons for this crisis were: excessive public expenditure, high inflation rates, inefficient state industry and a financial and banking system which did not adhere to international standards.

When AKP (Justice and Development Party) came to power in November 2002, it declared willingness to continue the devolution program concerning the privatization process which the IMF had outlined with a target to create revenues of 4 billion dollars for the state budget. The current government has maintained the agreements made with the IMF to pay back the loan. As a result of this program, inflation has reduced dramatically, exports have grown, currency reserves have reached previously impossible figures, GDP has risen and industrial production has increased - due to foreign demand which led to an increase in domestic demand. A remaining negative parameter is public deficit. As a response to these positive developments, at the end of December 2003, the IMF released an additional 500 billion dollar loan. Simultaneously, the new budget law of 2004 introduced several cuts in public expenditures and new taxation aimed at reaching IMF targets.

Nowadays, a negative note is increasing unemployment, officially around 11%, but practically estimated at around 20%. The government still has to face the problem of an informal economy that accounts for around 45% of the total economy, negatively affecting fiscal entries, which are at negative levels.

Parallel to these macro-economic policies, the government has worked on finding ways to attract more FDI. Recently, market liberalization has improved access of foreign investors to Turkish enterprises as some sheltered sectors have been opened. Although limitations in other sectors remain, the list of enterprises to be privatized has been extended and bureaucratic procedures improved.

Some special projects have been appealing to foreign investors. This is the case for the GAP project (South Eastern Anatolian Project). The project envisages the construction of 22 dams and 19 hydroelectric power plants on the Euphrates and Tigris rivers and their tributaries. It covers in addition to irrigation and hydropower schemes, all related social and economic sectors including industry, transportation, mining, telecommunications, health, education, tourism, and infrastructure. One of the objectives of GAP is to contribute to the national objective of sustained economic growth as well as export and FDI promotion.

Particular attention has been paid to changes in the economic and social structures that could accelerate development in foreign investment:

- Deregulation of interest rates,
- Establishment of organized financial markets for money,
- Foreign exchange stocks and securities,
- Liberalization of capital movement,
- Reforms in the banking sector,
- Stable exchange rates,
- Tight money supply,
- Liberal and flexible foreign investment practices.

Legal obstacles have always been considered by the foreign investor as one of the toughest obstacles. For this reason, Turkey's General Directorate of Foreign Investment (GDFI), within the Undersecretary Ministry of the Treasury, was created as the main governmental body responsible for FDI, together with the Co-ordination Board for Improving the Investment Climate (YOIKK).

The new Foreign Direct Investment Law, adopted in June 2003, could help attract new investors. It provides a secure environment for foreign capital via support from several bilateral and multilateral agreements, granting this capital the same rights and obligations as local capital, while guaranteeing the transfer of profits, fees and royalties, and the repatriation of capital. There are presently various possibilities for doing business in Turkey: establish totally new business ventures, joint-ventures with Turkish businesses, enter into major government contracts, establish licensing and franchising agreements or enter the market through distributors or agents.

One important means that Turkey has adopted in order to attract FDI is privatization. Among MENA countries, Turkey has the highest amount of proceeds from privatization. Regarding FDI, privatization is viewed by the foreign investor as an indication of a government's commitment to economic reform. Turkey sold more than $6 billion state assets in 2000, more than it did during the entire previous ten years. On 14 December 2000, the coalition government announced a new tender to sell Turk Telecom and passed a new telecommunications law in May to speed up the sale. It now aims to sell Turkish Airlines. Among other assets slated for sale are sugar refineries, cigarette factories, mining operations and parts of the petrochemical company Petkim, of which 96 percent is owned by the government.

It is clear that much still needs to be done to attract more investors into the region. Furthermore it will still be a long time before the real benefits of this change can be measured and fully taken advantage of. Furthermore, the system must find a way to remove the sense of uncertainty, both political and economical, which causes high risk rates and hinders investors.

In the longer term, governments must try to improve the basic factors that affect the attractiveness of FDI. A major task is to increase the level of understanding regarding the positive impact of FDI on economies in the global world, among elites, the domestic media and the general population This will make the task of introducing simpler procedures and clearer regulations easier, and help resolve conflicts more constructively.

Perspectives after 17 December 2004

The Brussels European Council of 16-17 December 2004 has finally given a green light to opening accession negotiations with Turkey, a historical decision that will render the expectations of the international business community significantly more positive. If these expectations are combined with sound economic policies by the Turkish government, including policies regarding investment and industry, Turkey's position in a few years with respect to the international flow of FDI will dramatically improve.

Several factors will increase Turkey's favorability as host country for FDI. First of all, the country will have to enforce a stable macroeconomic framework. Government will have to adopt sound fiscal policy, oriented to reducing both the fiscal deficit of about 8.8% of GDP and the public debt of about 87% of GDP (both figures are as of again 2003). Sound fiscal conditions, once achieved, will allow for further reduction in inflation and interest rates. These two factors will contribute to the stabilization of the exchange rate. Low inflation and interest rates, together with stable exchange rates are all indispensable ingredients for creating an attractive environment for FDI.
Microeconomic policies in several sectors will have an influence on FDI. In the field of financial services, progress has been made and will have to continue. This will be another important factor in the creation of a FDI friendly environment. Other relevant policies for enhancing the attractiveness of Turkey as a host country are those related to industry, small and medium-sized enterprises, competition, science and research, education and training, telecommunications and information technologies. As indicated in the European Commission's "2004 Regular Report on Turkey's progress towards accession," significant progress has been made in all these areas.

The course has been set, now the race must be completed!