Investment Environment and Foreign Direct Investments in the Underlying Trends of the Turkish Economy

Prof. Dr. S. Ridvan Karluk
Dean, Faculty of Economics
Anadolu University
Eskisehir, Turkey

Abstract

This paper examines, investment environment and foreign direct investments (FDI) in the underlying trends of the Turkish economy and incentives for foreign direct investment in Turkey. My paper, according to which the beneficial effect of FDI, in terms of enhanced economic growth, is stronger in those countries which pursue an outwardly oriented trade policy, like Turkey since 1980s, than it is in those countries adopting an inwardly oriented policy. The beginning of 1980s constituted a turning point in the economic life of Turkey. At the time, the government decided to shift the economy from an inward oriented and protective system to an outward oriented and liberalized environment, mainly by liberalizing foreign trade. Turkey accomplished the bulk of its rigorous structural reform program. Stabilization and structural reforms draw Turkey nearer to EU. Sustained growth will come together with implementation of strict monetary and fiscal policies. The lifting of repressive controls on financial markets, referred to as financial liberalization, was realized gradually over 1980s as a part of this policy change. The opening up of key markets such as banking, telecommunications, energy, tobacco, and agriculture to competition and projected privatizations are indicative of Turkey’s progress towards becoming an effective free market. Turkey liberalized its capital accounts in 1989, taking an important step towards integrating its economy with the global economic system. Potentially, Turkey is an appealing country for global investors. Despite her numerous advantages, Turkey has not received considerable FDI inflows in the last decade. Foreign direct investments to Turkey surged in the first quarter of 2011 but inflows have slowed considerably in light of continuing economic turmoil in Europe, the source of much of Turkey's FDI.

Economy: Overview

The Turkish economy has shown remarkable performance with its steady growth over the last nine years. A sound macroeconomic strategy in combination with prudent fiscal policies and major structural reforms in effect since 2002, has integrated the Turkish economy into the globalized world, while transforming the country into one of the major recipients of FDI in its region. The privatization efforts, tax reform, abolishing the barriers to enter for network industries and natural monopolies, constructing regulatory authorities, adapting adequate laws etc. are all processes that change the face of Turkish economy. While these reform efforts aim to structure and strengthen the fundamentals of the market economy, there will be more room for entrepreneurs and the corporate sector to take initiative. However, this new environment will be a more competitive and though one to survive for the firms ignoring efficiency and technologic development.

Turkey's economy is increasingly driven by its industry and service sectors, although its traditional agriculture sector still accounts for about 30% of employment. An aggressive privatization program has reduced state involvement in basic industry, banking, transport, and communication. After Turkey experienced a severe financial crisis in 2001, Turkey adopted financial and fiscal reforms as part of an IMF program. The crisis affected adversely almost all sectors of the economy. The industry was particularly hit by a large fall in domestic and mainly in external demand, including for cars and electrical appliances. During the period, portfolio inflows virtually dried up and FDI was almost halved although they remained sizeable at roughly 1% of GDP.

The reforms strengthened the country's economic fundamentals and ushered in an era of strong growth - averaging more than 6% annually until 2008, when global economic conditions and tighter fiscal policy caused GDP to contract in 2009, reduced inflation to 6.3% - a 34-year low - and cut the public sector debt-to-GPD ratio below 50%. Turkey's well regulated financial markets and banking system weathered the global financial crisis and GDP rebounded strongly to 7.3% in 2010.

The economy of Turkey is defined as an emerging market economy by the IMF and is largely developed, making Turkey one of the world's newly industrialized countries. The CIA classifies Turkey as a developed country. Turkey is often classified as a newly industrialized country by economists and political scientists; while Merrill Lynch, the World Bank and The Economist magazine describe Turkey as an emerging market economy. The World Bank classifies Turkey as an upper-middle income country in terms of the country's per capita GDP in 2007. She has one of the fastest growing economies in the world.

Turkey enjoys a very special location at the crossroads between East and West, overlapping Europe and Asia geographically. Turkey is located at the gateway of the Middle East, Caspian petroleum and Central Asian natural gas to the West, which are regarded as the future energy reserves of the world. The proximity to the new emerging markets in the Middle East and Central Asia creates unique business opportunities. Turkey is the leading investor in Caucasian and Central Asian Turkic Republics. Due to her strong cultural and historic ties, Turkey provides privileged access and a perfect base to develop business with these countries. Turkey is one of the G-20 major economies. The EU membership will bring Turkey access to big EU market, increased growth prospects and access to structural funds.

Reasons and Advantages to Invest in Turkey

Foreign direct investments have displayed a noteworthy increase especially after 1980 due to factors varying from liberalized capital flows, privatization, mergers, joint ventures and GSM sales. The improvement in the underlying trends of the Turkish economy should be appreciated on the base for the attractiveness of direct investments in Turkey. With the shifting economic setting in Turkey, not only the public sector but also the corporate sector is facing a need to adapt itself to a more competitive environment. But more importantly Turkey’s EU membership boost confidence by removing uncertainty in political and economic stability. In fact, the EU membership and even the membership process itself produces substantial positive effects for the economies of the member and candidate countries from growth rate to GNP per capita and FDI inflows. Further economic and judicial reforms and prospective EU membership are expected to boost Turkey's attractiveness to foreign investors.

The Law No. 4875 on Direct Foreign Investments, published on April 17, 2003 and come into force consequently, has abrogated the Law No. 6224 for Promoting Foreign Capital and brought in an important renewal in terms of foreign investments and changed the permission and approval system by the notification system in respect of any foreign investments due to come to Turkey. Together with this arrangement, it is not necessary for the investor to get permission from the Undersecretariat of State for Treasury of the Republic of Turkey on the matters that are defined in the second article of the Law No. 4875 and included in the direct foreign investment conception, and to fulfill its obligation to inform the General Directorate of Foreign Capital within the prescribed procedures and principles, determined by the Application Regulation of the Direct Foreign Investment Law, come into force on August 20, 2003.

There are a lot of reasons to inveset in Turkey. The advantages that a foreign investor may have within the scope of Article 3 of Direct Investment Law (DYK) may be listed as follows:

- To set free any foreign investors to make direct foreign investment in Turkey unless it is indicated otherwise by the provisions of private law and international agreements,

-To make the foreign investor be subject to equal treatment with the domestic investors,

-Not to nationalize or expropriate the direct foreign investments unless the public benefit requires so and they are remunerated accordingly pursuant to the applicable legislation,

-Possibility of transferring any net profit, dividend, sales, liquidation and compensation values, any amounts that may arise from the activities and procedures of the foreign investors in Turkey to be payable in return to any licenses, management and similar agreements, and payments of the principals and interests of any foreign loans by means of banks and private financial institutions freely to abroad,

-To set free any foreign companies at the status of a legal entity that the foreign investors may have established in Turkey or participated in to ac-quire any immovable assets or limited rights in-kind in the regions open for the acquirement of Turkish citizens,

-The determination of value of the capital beyond cash shall be made within the framework of the provisions of the Turkish Commercial Code. To take the assessments of any international assessment bodies or experts due to be determined or designated by the courts of country of origin or competent authorities, authorized to make assessment according to the applicable legislation of the country of origin as basis in case of the use of securities of any companies, established in foreign countries, as an investment instrument,

-Issuance of a work permit by the Ministry of Labor and Social Security for any foreign origin personnel to be employed at the companies, branches and corporate bodies, established within the scope of the Law on Direct Foreign Investments,

-Issuance of a license for the companies, established according to the laws of foreign countries, to open a liaison office in Turkey, provided not to involve in any commercial activities there.

The achievement of the market economy with its rules and institutions not only offers a window of opportunity from medium to long term, but also brings Turkey ready for a more convenient investment environment to foreign investors.

Foreign Direct Investments in Turkey

The essence of the structural reforms is the establishment of a market economy with its rules and institutions, while removing the political rant distribution mechanisms to achieve more efficient resource allocation and improve the economy’s resilience to shocks. With the changing economic setting in Turkey, there is now more room for global entrepreneurs and the corporate sector to take initiative. Considering that the Turkish economy proved its capacity next to the global competitiveness, it would be fair to claim that the new environment will bring more pros than cons for the foreign investments. Actually, Turkey has significantly improved the functioning of its market economy, while further decisive steps towards macroeconomic stability and structural reforms are also enhancing the attractiveness of foreign investments.

According to the 2010 World Investment Report, UNCTAD expects global inflows to reach more than $1.2 trillion in 2010, rise further to $1.3–1.5 trillion in 2011. International direct investments diminished both in developed and developing countries by 44% to USD 566 billion and by 27% to USD 548 billion, respectively, while share of the developed regions in international direct investments was decreasing, that of the developing regions was on the rise. The decline in worldwide international direct investment inflows by 37% to USD 1.1 trillion in 2009, over the previous year. In 2008, while the impact of the financial crisis was limited, investment inflows declined by 16%, however much steeper decline was observed in 2009.

Turkey could only attract USD 1 billion foreign investment on the average per year since 1990. According to generally accepted international standards, the minimum annual FDI attraction potential of Turkey is USD 35 billion (UNCTAD 2002), which means that Turkey faces an investment loss of minimum USD 34 billion every year. In order to catch this potential Turkey has to build confidence to its economy by ensuring stability of rules and regulations, transparency and political stability.

While FDI inflows to Turkey decreased by 18% in 2008, it has plummeted in 2009 over the previous year by 58%, contracting at a much higher rate than global FDI inflows. Foreign direct investments to Turkey surged in the first quarter of 2011, reaching a net amount of USD 3.95 billion, a notable 154 percent increase over the previous year. According to the data provided by the Undersecretariat of Treasury, the country attracted USD 3.49 billion of foreign capital in January-March, a 233 percent increase from last year’s USD 1 billion in the same period. Equity investments also surged by 256 percent, reaching USD 3.54 billion from USD 995 million booked in the same period of 2010. The stock value of FDI stood at $174 billion at year-end 2010, but inflows have slowed considerably in light of continuing economic turmoil in Europe, the source of much of Turkey's FDI.

The number firms operating with FDI in 1980 was 78, which has risen to 6,584 as of June 2003. As of the end of 2010, more than 25.800 companies with foreign capital were operating in Turkey. Two thirds of them were established in the last seven years. The majority of the companies with international capital are in the wholesale and retail trade sectors while this is followed by manufacturing, real estate, renting and other business activities. Textile goods production leads the manufacturing sector investments followed by chemicals and chemical products, food products and the beverage sector.

Turkey has attracted the highest amount of FDI from EU member countries, Asian and the Middle Eastern countries. Investments from Europe still dominate Turkey’s FDI, representing approximately a $1.3 billion worth of a $1.6 billion total. Total volume was $2.8 billion in the first half of 2009. Foreign investments from all European countries fell, excluding Bulgaria, England, Holland, Malta, Poland, Spain and Sweden. Investments from Austria, France, Italy and Luxembourg fell sharply. High investment figures of European countries contradict recent suggestions that Turkey’s foreign trade policies were shifting in political axis from the West to the East. Still, the Gulf countries’ comparatively modest investments in Turkey. Kuwait and United Arab Emirates follow Saudi Arabia, whose investments in Turkey reached $39 million following an increase of $6 million.

According to UNCTAD, top five largest recipients of international direct investment inflows are USA, China, France, Hong Kong and UK. Having received USD 7.6 billion in FDI inflows, Turkey holds 32nd place among the largest recipients of FDI inflows. Turkey’s position fell down to 15th place in this year’s ranking for developing countries. Among the developing regions, South and East Asia stand out as it has been in the previous years. In the UNCTAD Report Turkey is included among the West Asian countries, and ranks 3rd in the region, behind Saudi Arabia, which ranks 1st.

Table 1 Foreign Direct Investments Inflow to Turkey by Year

USD million						
	2005	**2006**	**2007**	**2008**	**2009**	**2010**
FDI Total (Net)	10,031	20,185	22,046	18,269	8,409	8,899
Equity Investment (Net)	8,134	16,982	18,393	14,698	6,168	6,225
nFlows	8,535	17,639	19,136	14,733	6,250	6,260
.i Liquidation Outflows	-401	-657	-743	-35	-82	-35
Intra Company Loans*	56	281	727	634	459	180
Real Estate (Net)	1,841	2,922	2,926	2,937	1,782	2,494

*Loans that companies with foreign capital are given by foreign partners
Source: Central Bank of the Republic of Turkey

Table 2 Foreign Direct Investments Inflow to Turkey by Countries

USD million						
Countries	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
European Union	5,006	14,489	12,601	11,076	4,927	4,762
Germany	391	357	954	1,237	497	498
France	2,107	439	367	679	617	589
Netherlands	383	5,069	5,442	1,343	718	501
United Kingdom	166	628	703	1,335	350	233
Italy	692	189	74	249	314	54
Other European Countries	1,267	7,807	5,061	6,233	2,431	2,887
Other European Countries (Excluding EU)	1,646	85	373	291	305	243
Africa	3	21	5	82	2	0

USA	88	848	4,212	868	260	318
Canada	26	121	11	23	52	56
Central-South America and Caribbean	8	33	494	60	19	5
Asian	1,756	1,927	1,405	2,345	673	873
Near and Middle Eastern Countries	1,678	1,910	608	2,184	361	437
Gulf Arabian Countries	1,675	1,783	311	1,963	209	371
Other Near and Middle Eastern Countries	2	3	196	96	78	16
Other Asian Countries	78	17	797	161	312	435
Other Countries	2	115	36	2	12	3
Total	8,535	17,639	19,137	14,747	6,250	6,260

Source: Central Bank of the Republic of Turkey

Table 3 Breakdown of Companies with International Capital by Sector

Sectors	**1954 - 2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Total (1954-2010)**
Agriculture, hunting, fishing and forestry	123	33	39	46	52	55	61	409
Mining and quarrying	132	50	45	77	87	73	73	537
Manufacturing	1,860	377	412	463	454	388	399	4,353
Manufacture of food products and beverages	208	36	42	34	34	50	63	467
MManufacture of textiles	229	61	45	46	21	18	19	439
Manufacture of chemicals and chemical products	218	36	40	54	45	39	51	483

MManufacture of machinery and equipment	138	26	51	44	46	29	24	358
MManufacture of motor vehicles, trailers and semi-trailers	136	21	15	19	23	18	7	239
0tOther manufacturing	931	197	219	266	285	234	235	2,367
Electricity, gas and water supply	89	8	40	69	108	128	116	558
Construction	317	307	386	444	344	299	319	2,416
Wholesale and retail trade	2,899	680	717	757	760	913	1,082	7,808
Hotels and restaurants	689	160	182	196	203	171	152	1,753
Transport, storage and communications	654	213	256	270	282	264	334	2,273
Financial intermediation	120	18	46	42	42	17	14	299
Real estate, renting and business activities	634	470	626	779	635	468	511	4,123
Other community, social and personal service activities	299	141	171	161	204	160	172	1,308
Total	7,816	2,457	2,920	3,304	3,171	2,936	3,233	25,837

Source: Undersecretariat of the Treasury

Main Incentives for Foreign Direct Investment in Turkey

Turkey provides various incentives and grants to the investors for he purpose of facilitating larger investments and capital cotributions by the local and foreign investors and eliminating the regional imbalances. The current incentive regime is in line with Turkey's commitments under the WTO and EU Customs Union. Hence, it is within the scope of international liabilities and commitments of Turkey. There is no discrimination between the local and foreign investors with respect to the application of incentives. The state aids in Turkey are provided by many state institutions and regulated with a number of legislations separately. The new law aims to centralize these system and monitor and supervise all state aids in integrity and to make sure the regulations regarding state aids are in line with the agreements concluded between Turkey and European Union.

A significant range of additional economic reforms has changed the global investment conditions in Turkey. The new FDI Law introduced by the Parliament in 2003 guarantees equal treatment for all investors, with no distinction made between international investors and locals. A new law on the monitoring and supervision of state aids has been published on

23.10. 2010. The law establishes two institutions (The Committee of Monitoring and Superising State Aids and General Directorate of State Aids) for this purpose and includes all state aids except for the aids provided for agriculture, fishing and service industries within the scope of the new law.

The incentives granted to the investors under the current regime can be classified under below headings;

- Investment incentives,
- Export incentives,
- Free Trade Zones,
- Technology Parks,
- Research and Development Incentives,
- Incentives to Less Developed Regions.

Conclusion

Turkey is an attractive country for global investors. Turkey with a relatively high quality labor force and economic location advantages with easy access to regional markets**.** The experience of more than 16,000 (as of end-2010) foreign capital establishments, including 112 of the Fortune Top 5000 companies, confirms Turkey as a predominant investment location. Starting of negotiations with EU will stimulate FDI inflows to Turkey. With a population of 77,804,122 (July 2010 est) and an increasing consumer purchasing power, Turkey offers a huge and dynamic domestic market to investors. Gross domestic product based on purchasing-power-parity (PPP) was $1.038 trillion, (nominal $729.051 billion) per capita GDP was $12,300 (2010 est., nominal $10,206) The average growth rate for the last 5 years, which is well above many OECD countries, implies a dynamic and growing economy. Turkey's real GNP increased by 8,9% in 2010. The Turkish labour force is well-known for its skills and learning capacity, and competitive labour rates offer cutting edge for industries. FDI inflows to Turkey, which had reached to a level of USD 22 billion in 2007, dropped - in line with global decline - to USD 19.5 billion in 2008 with an 13% decrease and to USD 8.4 billion in 2009 with a sharp 56% decrease. By the end of 2010, FDI inflows to Turkey have reached to 9.3 billion USD. In 2010, FDI inflows rose by 8% compared to 2009. As of September 2011, FDI inflows to Turkey totaled 9.1 billion USD, corresponding to 97% increase compared to the same period of the previous year. Parallel to the reflections of the global crisis in 2009, a moderate recovery was realized in 2010 in FDI inflows to Turkey. This recovery trend had affirmative impacts in the first half of 2011 and Turkey is projected to attract more than 10 billion USD FDI in 2011, depending on the developments and risks in the global economic environment.

Sources

1. Asım Erdilek, (1986), "Turkey's new open-door policy of direct foreign investment: a critical analysis of problems and prospects'', METU Studies in Development, Vol. 13, No. 1-2, pp. 171-91.
2. Balance of Payments Statistics released by the Central Bank of Turkey (http://scholar.google.com.tr/scholar?q=Balance+of+Payments+Statistics+released+by+the+Central+Bank+of+Turkey&hl=tr&as_sdt=0&as_vis=1&oi=scholart)
3. CIA World Factbook (https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html#Econ)

4. FDI Reports at the Undersecretariat of Treasury (http://www.treasury.gov.tr/irj/portal/anonymous?guest_user=treasury)
5. IMF, Balance of Payments Manual: Fifth Edition, Washington, D.C., 1993
6. IMF, World Economic Outlook: Rebalancing Growth, April 2010 (http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/text.pdf)
7. International Monetary Fund, 2011 World Economic Outlook
8. International Investors Association of Turkey, Investment Environment In Turkey, August 2011 (http://www.yased.org.tr/webportal/Turkish/Yayinlar/Documents/Investment_Environment_Turkey_2011_track%20changes%20v4%20%20SOn%20accepted.pdf)
9. List of Foreign Capital Companies in Turkey
10. (http://www.hazine.gov.tr/irj/go/km/docs/documents/Hazine%20Web/%C4%B0statistikler/Uluslararas%C4%B1%20Do%C4%9Frudan%20Yat%C4%B1r%C4%B1m%20%C4%B0statistikleri/Di%C4%9Fer/F%C4%B0RMA_L%C4%B0STES%C4%B0_150710.xls/)
11. OECD, Economic Outlook, No: 86, 2011
12. Regulation for Implementation of Foreign Direct Investment Law
13. (http://www.treasury.gov.tr/irj/go/km/docs/documents/Treasury%20Web/Legislation/Foreign%20Direct%20Investment%20Legislation/Regulation%20for%20Implementation%20of%20FDI%20Law.pdf)
14. S. Rıdvan Karluk, Foreign Capital Regulations, The İstanbul Chamber of Commerce, Publication No. 1984-17, İstanbul, 1984.
15. S. Rıdvan Karluk, Türkiye'de Yabancı Sermaye Yatırımlarının Ekonomik Büyümeye Katkısı (Foreign Investments Role to the Development of Turkey), Türkiye Cumhuriyet Merkez Bankası, Ankara, 2001. (http://www.tcmb.gov.tr/yeni/evds/yayin/kitaplar/kitap2/turkyabsermyat.doc)
16. Turkish Economy In The World **(**http://www.treasury.gov.tr/irj/go/km/docs/documents/Treasury%20Web/Statistics/Economic%20Indicators/egosterge/Sunumlar/Ekonomi_Sunumu_ENG.pdf)
17. UNCTAD WIR Series (http://www.unctad.org/wirhttp://www.yased.org.tr/webportal/Turkish/arastirma_raporlar/Documents/2010_06_23_ST_INNOVATION_IN_TURKEY-byTUBITAK.pdf)
18. http://aegeaninvestments.co.uk/turkey/index.html
19. http://www.allaboutturkey.com/info.htm
20. http://www.atimes.com/atimes/Central_Asia/KH25Ag01.html
21. https://www.cia.gov/library/publications/the-world-factbook/fields/2004.html

22. https://www.cia.gov/library/publications/the-world-factbook/appendix/appendix-b.html
23. https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html
24. http://www.doingbusiness.org/reports/global-reports/doing-business-2012
25. http://www.doingbusiness.org/data/exploreeconomies/turkey
26. http://www.economywatch.com/world_economy/?page=full
27. http://econ.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,contentMDK:20394793~menuPK:1192714~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html
28. http://www.hazine.gov.tr/irj/go/km/docs/documents/Hazine%20Web/%C4%B0statistikler/Uluslararas%C4%B1%20Do%C4%9Frudan%20Yat%C4%B1r%C4%B1m%20%C4%B0statistikleri/Di%C4%9Fer/F%C4%B0RMA_L%C4%B0STES%C4%B0_150710.xls/
29. http://www.investinturkey.gen.tr/?SESSID=07Xd6Y0B54TI5GQ3N2PTe53Xc0M4HMJS&bol=6&Kat=&Hbr=17&Gst=0
30. http://www.investinturkey.gen.tr/?SESSID=07Xd6Y0B54TI5GQ3N2PTe53Xc0M4HMJS&bol=5&Kat=2&aKat=13&AltB=45
31. http://www.invest.gov.tr/en-US/investmentguide/investorsguide/Pages/FDIinTurkey.aspx
32. http://www.indexmundi.com/turkey/gdp_per_capita_(ppp).html
33. http://www.indexmundi.com/turkey/#Economy
34. http://www.iie.com/publications/papers/mussa0410.pdf
35. http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/text.pdf
36. http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/text.pdf
37. http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf
38. http://www.tcmb.gov.tr/yeni/evds/yayin/kitaplar/kitap2/turkyabsermyat.doc
39. http://www.state.gov/r/pa/ei/bgn/3432.htm
40. http://www.unctad.org/wirhttp://www.yased.org.tr/webportal/Turkish/arastirma_raporlar/Documents/2010_06_23_ST_INNOVATION_IN_TURKEY-byTUBITAK.pdf)
41. http://www.treasury.gov.tr/irj/portal/anonymous?guest_user=treasury
42. http://www.yased.org.tr/webportal/Turkish/Yayinlar/Documents/Investment_Environment_Turkey_2011_track%20changes%20v4%20%20SOn%20accepted.pdf
43. http://data.worldbank.org/indicator/NY.GDP.PCAP.CD
44. http://www.worldbank.org.tr/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/TURKEYEXTN/0,,contentMDK:20630704~menuPK:361720~pagePK:141137~piPK:141127~theSitePK:361712,00.html

45. http://www.wto.org/english/tratop_e/tpr_e/s192-01_e.doc