**Burak Tarhan 5375**

## WHY FOREIGN DIRECT INVESTMENT DOES NOT ENTER TO TURKEY?

### An Overview on the world and Turkey:

FDI can be described as international capital flows in which a firm in one country creates or expands a subsidiary in another. Its basic function is to provide capital to developing countries that face capital inadequacy due to and consequent of structural problems in the finance of economic development.

Today, an increasing number of countries are using FDI and showing tremendous effort to attract FDI to their country. In 1982, FDI inflows and outflows were 57 and 37 billion USD at present value, which remain very small compared to 2000 inflows and outflows of 1271 and 1150 billion USD, respectively. Asia and the Pacific region, in which Turkey is included, have a share of 11.3 %, corresponding to 143.8 billion USD.

As seen, there is a general attitude to use more and more FDI. Turkey, in this context, is by no means an exception. This can be proven by the fact that FDI to Turkey amounted 1.707 billion USD in 2000, compared to 167 million USD in 1982. However, Turkey faces a serious problem in FDI issue: it can attract much less FDI than desired. In the 2001 Annual Report of Directorate General of Foreign Investment, FDI for 1999 amount to 813 million USD. This amount is 1,707 million USD and 3,044 million USD for the years 2000 and 2001, respectively. The sharp increase is undeniable, but so is the huge difference between realizations and expectations.

I am going to defend in this paper this thesis: Turkey can attract much less FDI than it desires because of two kinds of problems, economic and administrative.

I am going to devote the rest of this paper to the proof of this thesis. After a brief overview on FDI, I am going to talk about the economic and administrative problems, respectively. In the conclusion part, I am going to express my views on how these problems can be overcome.

**Economic Problems**

The first and the most important of the problems forming the economic group of problems is “high inflation”. Inflation can be described as “decline in purchasing power of money”. When inflation occurs, you can buy less and less goods when you sell the *same* amount of goods. A reasonable strategy to overcome this situation is to charge more than the amount that will preserve the purchasing power and wait as the it is eroded by inflation.

*This situation automatically reduces the facility of the investor to compete globally. The investor, in order to make profits, will have to buy some inputs. However, when inflation occurs, s/he will have to buy these inputs at a higher price. When these inputs are provided at a higher price, then the costs will increase and sale prices will be higher, too. However, there are other places where inflation is low, compared to Turkey. Here, because of the reason mentioned above, goods can be produced at lower costs. Thus, the investor, if s/he decides to invest in Turkey will have to sell her/his goods at higher prices in the world markets and will be at a permanent disadvantage.*

The second problem in this group is “not implementing the taken economic decisions”. Two valid rules for FDI have been detected by three Swiss economists a couple of years ago. The first of these rules is that economic laws and decisions in countries expecting FDI must not be changed frequently and unexpectedly. The second rule, on the other hand, states that governments and other official institutions assigned to implement these rules and decisions must not look for ways round them. Unfortunately, it is hard to say that Turkey has abided by both of the rules, because of the recent cases. The clearest example for the violation of the first rule is probably the unimplemented regulation changes regarding income tax in 1998. The most important of these changes was the fact that the main principle of income taxing had been changed. All incomes, regardless of their origin were taxable unless otherwise stated in the Turkish income tax law, as of January 1, 1999. These changes had later been postponed, as known.

The clearest example for the violation of the second rule is, on the other hand, the circular of official vehicles. According to this circular, significant constraints had been put to allocation of official vehicles and consequently, it was expected that 20,000 official vehicles were going to be returned. However, as of April 2002, the number of official vehicles returned was 2,441 and most of these vehicles were the ones that had completed their economic life. Under these circumstances, it is very clear that public officials looked for ways round the circular.

Another economic problem that prevents foreigners from investing in Turkey is "corruption". Economists argue that the amount of FDI a country can attract falls as the level of corruption increases. On the contrary, such a country can only attract loans instead of FDI. If this is the case, then is Turkey a country where corruption is widespread? Unfortunately, the answer to this question is "Yes". In the West Europe and North America section of "Global Corruption Report 2001" published by Transparency International, the following statement can be found:

*"Turkey, where democracy is fragile, has set about the task of tackling corruption but, as was evident in its 2001 economic crisis, it has a long way to go.*"

From here, one can clearly understand that corruption is existent and is a factor in preventing foreign investors from investing in Turkey.

To summarize, one can show high inflation, absence of inflation accounting, not implementing the taken economic decisions and corruption. These problems are deterring foreigners from investing in Turkey. However, it is hard to say that these are the only factors that lead Turkey to attract much less FDI than expected. On the other hand, a number of administrative problems, which I am going to mention now, accompany these economic problems.

**Administrative Problems**

The presence of administrative problems can probably best be documented by the principle decision to adopt "The Program to Improve the Investment Environment in Turkey" by the Turkish government. This detailed program entails various administrative problems for foreign investors and suggestions for their solutions.

One of these administrative problems, according to this report, is long and repetitive bureaucratic operations. For example, if a foreign investor wants to establish a standard company in Turkey, he has to go through 19 stages, which last at least 2.5 months. According to the same report, the solution is nothing but the abolishment of *unnecessary and repetitive* bureaucratic operations. Another section in the same report points out that if the same foreign investor wants to acquire land belonging to Treasury and to turn it into land where investment is possible, he has to take receive lots of approvals and investment permissions from the state officials, which last at least 2 years. If a foreign investor can set up a company in 2.5 months and has to wait for 2 years for matters about investment place, then he will refrain from investing in Turkey, since there are countries presenting the same facilities with fewer requirements.

The report mentioned in the last two paragraphs also states that rights for intellectual property (RIP) are not being protected sufficiently. The reasons for this insufficient protection are loopholes in the legal system concerning RIP and long bureaucratic operations. What is even more terrifying is that the same report suggests that laws and implementations violating the article no. 39/3 of “Agreement on Trade-Related Aspects of Intellectual Property Rights” (TRIPS). The terrifying aspect is not the article itself but the fact that the Turkish government is violating an agreement to which it is a party.

A third administrative problem is not-well functioning legal system concerning FDI in Turkey. The first reason of this situation is the not updated Turkish Law of Encouragement of Foreign Capital, which was passed in 1954. Because of being not updated, it doesn’t talk about instruments that are today considered as “encouragement”, such as investment discounts or loans. Economists argue that the makers of this law probably thought that passing a law specifically about foreign capital would mean an encouragement for foreign capital. As a second reason, one can show the general malfunctioning in Turkish judiciary, which affects the legal system concerning FDI as well.

Corruption, in addition to being regarded as an economic problem, can as well be regarded as an administrative problem, too. The reason is that state officials or officials of organizations with close relations to states can also be involved in corruption. Because it has been seen that this probability has come true in various parts of the world, Transparency International has developed “Corruption Perceptions Index” (CPI), which tries to measure the misuse of public power for private benefits. The scores are on a 10 point scale and it’s considered that in the government and public administration of any country receiving a score of less than 5, there is a high level of corruption. Turkey’s score in CPI is unfortunately 3.6. In a country with a high level of corruption, there will be less FDI. Thus, corruption becomes a reason for Turkey’s failure to attract the desired level of FDI.

To summarize, one can say that a number of problems, such as long and repetitive bureaucratic operations, corruption, insufficient property rights and not well functioning legal framework are the main administrative problems that prevent Turkey to attract more FDI. They are by no doubt serious problems, because the importance of FDI in the development of a developing country can not be denied. (Indeed, most developing countries, unlike in the past, prefer to realize the investments they wish with foreign capital now.) Thus, it is a must for Turkey to continue the efforts to persuade more foreigners to invest in Turkey. In the final section of this paper, I would like to express my thoughts about which actions could make Turkish authorities' efforts easier.

**Conclusion: How can Turkey attract more FDI?**

If Turkey wants to persuade more foreign economic agents to invest in Turkey, it has to reduce the current high inflation. The reason is that the entrepreneurs will have to provide inputs at higher prices than the prices necessary to protect purchasing power, if they want to go on with production. Thus, they will have to sell their goods at higher prices, compared to prices of other countries. When this occurs, the foreign entrepreneur will be able to sell his goods only in Turkey and his business will not expand beyond a certain extent. Seeing these, the investor will probably prefer initially to invest in countries other than Turkey, provided that high inflation exists in the future.

Another action Turkey must take is to get rid of corruption. A number of steps have been taken in order to reach this goal, such as relatively quick legal action against people who are accused or convicted of corruption. However, a lot of things also need to be done, such as the reorganization of the salaries of public personnel and the establishment of a new evaluation system of this personnel's performance. This will not only prevent corruption, but also will make it impossible to repeat the mistakes in the past.

Turkey must, in addition, must urgently reconsider the bureaucratic operations it requires from foreign investors eliminate the repetitive and unnecessary operations. This will be mutually beneficial. The state will have relieved itself from checking whether unnecessary procedures have been completed, whereas the entrepreneur will be able to concentrate on his future investment and possible success more.