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Removing Administrative Barriers to FDI: Particular Case of Turkey

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With the trends of globalization, liberalization in foreign currency and trade regimes, the volume of FDI increased throughout the world. Since the early 1980s, world Foreign Direct Investment flows have grown rapidly - faster than both world trade and world output. According to UNCTAD figures, foreign direct investment inflows, which amounted to $160 billion in 1991 reached $1,271 billion at the end of 2000, experiencing an eight-fold increase. Especially, the cross-border mergers and acquisitions among developed countries are shaping the FDI figures for the last years.

When Turkey is compared to the neighboring countries, Central Europe can be seen as an emerging location for FDI. Turkey, as a recipient country has been lagging behind, compared to her potential. Despite her strong potential, Turkey has not benefited very much from increased FDI flows brought on by globalization. From 1995 to 2000, FDI inflows to Turkey averaged about 750 million $ net per year equivalent to about 0.4% of GDP. This percentage places Turkey 81st out of 91 developing and transition countries, where on average the annual inward FDI ratio to GDP is about 2 percent. Turkey's annual net FDI flows have stagnated at the levels of the late 1980s, while worldwide FDI increased by a factor of 12 during the 1990s, thanks in large part to globalization.

A recent study by UNCTAD named "Inward FDI Index" captures the ability of countries to attract FDI after taking their size and competitiveness into account. The index is the ratio of three ratios; showing each country's share in world FDI relative to its shares in GDP, employment and exports. According to this index, Turkey receives less FDI than the countries of relative economic size and "under performs" in terms of attracting FDI.

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.

Turkey's major strengths

In these efforts to attract foreign investment, Turkey both have some advantages and disadvantages. The main strengths of Turkey can be summarised as:

- unique geographical location creating diverse market opportunities
- population of 63 million whose consumption patterns are improving
- qualified, efficient, young, educated and cost competitive work force
- A dynamic and globally integrated economy with an improved business environment
- A well-developed telecommunications and transportation infrastructure
- The existance of prominent transnational companies in the world

But, the low levels of FDI in Turkey can be attributed to several disadvantages like;

- Political and economic instability
- High inflation and real interest rates
- Delays in the privatization program
- Existance of an unrecorded economy
- Frequently changing legislation
- lack of competition and efficiency in the economy

Reforms are underway

Turkey is now ambitiously adopting an economic programme for the transition to a stronger economy. The main features of this economic program include stern measures to:

- continue fighting inflation under the floating exchange rate system in a determined manner
- carry out the extensive restructuring of the banking sector
- ambitious structural reform agenda
- strengthening the balance of public finances to prevent deterioration in the future
- implement an incomes policy based on social consensus
- reforms to raise competition and effectiveness in the economy

For strengthening the real economy, a special emphasis is given to the reforms to enhance competition and effectiveness.

These reforms can be analysed under two main headings. Several structural reform laws for the better functioning of markets such as:

- sugar law
- tobacco law
- natural gas law
- civil aviation law
- electricity market law
- privatization of Turk Telecom

And an "**Administrative Barriers to Investment**" Project which aims a general improvement in the investment climate of Turkey. This project is only the first, but an important step in creating a better "investment climate" in Turkey. Making improvements in the business environment is not a matter of pleasing foreign investors; it is a matter of raising the level of competitiveness in Turkey and raising incomes of Turkish workers, citizens over the long term. Attracting FDI is only a means to an end. Turkey as a whole suffers from these barriers and disincentives to invest, which hurts the competitiveness of Turkish producers. In order to raise incomes in Turkey, the economy will have to compete in an ever-more competitive world economy.

It is known that the old order of economic protection in which countries could get away with bad administrative environments does not exist any more. We also realize that, if certain changes will not be made, both Turkish and foreign owned companies will be in trouble producing even for the domestic market - through increased competition from inputs - and will not be able to compete in export markets.

So, the ultimate goal for this study was to increase the competitiveness of the Turkish investment environment for all private businesses, thus create a better "investment climate". The Administrative Barriers project has been carried on within this year with a strong political will from the Government, as well as support from public institutions and private sector. Administrative Barriers are areas where investors come into contact with public sector authorities to:

- enter the country
- work in the country
- establish businesses
- operate businesses

and they can counteract general liberalization reforms, delay or prevent new investments, impede re-investments by existing investors, scare of new investors who tend to rely on information obtain from already existing investors. Turkey has been criticized by having a difficult investment climate by international investors and institutions:

- Global Competitiveness Report (World Economic Forum) ranked bureaucratic ‘red tape’ as a leading competitive disadvantage for Turkey
- Price Waterhouse Coopers (PWC) estimated the effect of Turkey’s opaque business climate to be equivalent to a 36% increase in the corporate tax
- PWC also estimated that the cost of lost, or foregone, FDI in Turkey per year due to opacity is over US$1.8 billion
- The FDI Diagnostic Report conducted by FIAS in 2000 also pointed Administrative Barriers as an impediment to new investments

The Government of Turkey requested FIAS to jointly realize the project. This project is an important step of the program for strengthening the real economy. The aim is to improve the investment climate of the country, where both foreign investors and local investors will benefit. The project had a strong political will from the Government, as well as support from public institutions and private sector. The project is also expected to have positive results on the struggle with the unrecorded economy and re-defining the role of state to its core functions.

The project has evolved as follows;

- Preparation of the report for Administrative Barriers study
- Conference to share the results of the report and other various findings
- Workshops and establishment of study groups such as;
  - Company Registration
  - Employment
  - Sectoral Licensing
  - Land Access and Site Development
  - Taxation and Incentives
  - Customs and Technical Standards
  - Intellectual Property Rights
  - Investment legislation
  - Investment promotion

- An action plan has been prepared based on the results of the workshop and transformed into a Decree
- The study groups are designated as technical committees to carry on the studies and report regularly
- Some immediate measures have already been scheduled by the Decree

In the decree, the framework for problems and possible actions to be taken have been identified for each of these nine areas, and technical committees will continue their studies on these issues. The committees will be supervised by an “Investment Climate Improvement Coordination Council”, who will report quarterly to Council of Ministers and to the private sector at large. The Decree also includes a “short term scheduled actions list” for immediate measures to be taken within the next three months.

The streamlining of various administrative procedures is not a cure-all to stimulate investment. However, it can send valuable signals to foreign and domestic investors that the government is serious about reform and promoting investment. The actions needed to remove administrative barriers are often not costly in financial terms, but involve the much harder task of overturning embedded thinking amongst government officials. As in some cases, problems are due to an absence of dialogue between government departments and with the investor community. The "action plan" to be applied will just do this and bring things into discussion within the government and the private sector.

Having a political will, and showing this will through a decree, participants will be forced to find a mutual solution to the problem.

NGOs, private sector and academicians are also members of the study and leading NGOs of the private sector take part in the high council where decisions will be taken.

This project is the first step in creating a better investment climate in Turkey. As complementary efforts over the next months, it is planned to:

- Set up a well-funded Investment Promotion Office for which we seek technical assistance from OECD, WB, UNCTAD and countries with success cases.
- Hold regular high-level Investor Council Meetings
- Put in place a revised database system
- Set up a backward linkage programme to ensure that smaller local enterprises also are as
- internationally competitive as possible and add value to the activities of the larger companies.

These efforts form a cornerstone of the government's new private sector development strategy to create a more transparent and stable investment climate.

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

In addition to these legislative features, Turkey provides a secure investment environment through;

- Turkey is a member of multilateral organizations like OECD, WTO, IMF/World Bank/MIGA
- International arbitration is possible for the settlement of disputes where foreign investors are involved
- Avoidance of double taxation Agreements with 46 countries have been signed and came into force

Protection and Promotion of Investment Agreements have been signed with 65 countries and 43 of them has entered into force. Turkey is also a candidate country for the membership to European Union;

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

However, these measures form the first steps for attracting FDI. As an effort to keep in line with world experiences and trends in FDI, establishing a promotion agency and developing a "sectors policy" to attract FDI in its own premises is now being evaluated.