THE DYNAMICS OF FOREIGN DIRECT INVESTMENT IN TURKEY FROM A HISTORICAL PERSPECTIVE

A Master's Thesis

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by

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I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Arts in International Relations.

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ABSTRACT

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In this thesis I discussed different components of foreign direct investment inflows from the perspective of hosting countries. Since foreign direct investment has been accepted as an important tool for the development of economies, FDI has taken particular attention by governments and there has been a huge competition to attract FDI. Last years show an improvement in FDI attraction of Turkey which can be explained through commitment to liberalization, privatization and influence of EU. In fact reforms made to fulfill EU criteria were only one among many influences of EU on FDI inflows. European countries have a tendency to channel FDI within the borders of EU which consequently renders EU membership is an important advantage for attracting FDI from EU countries. Signals of this advantage when coupled with the geographical position of Turkey showed itself positively in statistics of FDI in Turkey. To illustrate the effects of the relationship with the EU, I provide a comparative analysis with Romania and Argentina. Three of the cases-Turkey, Romania and Argentina- point out to

the fact that structure of the economy, privatization and liberalization, stability and international networks (as in the case of the EU) matter considerably when we discuss general trends of FDI inflows.

ÖZET

TARİHSEL YAKLAŞIMLA TÜRKİYE'DE DOĞRUDAN YABANCI SERMAYE DİNAMİKLERİ

Sönmez, Asena

Yüksek Lisans, Uluslararası İlişkiler Bölümü

Tez Yöneticisi: Yrd. Doç. Dr. W J Korab-Karpowicz

Temmuz 2008

Bu tezde doğrudan yabancı yatırımın yatırım alan ülkeler açısından farklı bileşenlerini tartıştım. Doğrudan yabancı yatırım gelişmekte olan ülkeler tarafından ekonomiyi geliştirmenin en önemli yollarından biri olarak kabul edildiğinden hükümetler yabancı yatırımı ülkelerine çekmek için yarışa girmiş durumdadır. Son yıllarda Türkiye'de doğrudan yabancı yatırımda görülen gelişmeleri liberalleşmede sebat edilmesi, özelleştirme ve AB'nin etkisiyle açıklamak mümkün olmakla birlikte AB kriterlerini yerine getirmek için yapılan reformlar AB etkilerinden sadece biri olarak değerlendirilebilir. Avrupa Birliği'ne üye ülkeler yatırımlarını AB sınırları içinde yoğunlaştırma eğilimine sahip olduklarından AB üyeliği AB üyesi ülkelerden yatırım almak için çok büyük bir avantaj sağlamaktadır. Bu avantajların sinyalleri ve Türkiye'nin konumu son bir kaç yılda olumlu anlamda yabancı yatırım istatistiklerine yansımaya başladı. Bu etkileri daha geniş bir çerçevede inceleyebilmek için Romanya ve Arjantin gibi ülkeyle

karşılaştırmalı bir analiz de sunmaktayım. Romanya, Arjantin ve Türkiye bir arada incelendiğinde ekonominin yapısı, özelleştirme, istikrar ve uluslararası bağlantılar (AB örneğinde olduğu gibi) yabancı yatırımı çekmekte önemli özellikler olarak öne çıkmaktadır.

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CHAPTER I

INTRODUCTION

In this thesis I will discuss foreign direct investments in Turkey with an emphasis on post-1999 environment. The main reason of this focus is the assumption that 1999 was an important turning point for economic and political restructuring in Turkey since it was given the candidate for European Union membership status at Helsinki Summit at this year. By focusing on this period I will emphasize domestic transformations as well as changing international structure with respect to the impact of European Union.

Turkey till recently has been seen as an underperformer in terms of FDI inflow. Since Turkey is relatively a large market offering low costs in terms of labor and situated close to the Western markets, the country should have definitely become an attractive address for FDI. However, political and economic instability, taxation, lack of infrastructure and some structural barriers proved to be important impediments. These impediments on the other hand seem to be disappearing due to the influence of the EU and structural changes undertaken to fulfill Copenhagen criteria. Therefore, the influence of the EU and relative position of Turkey in the international FDI market deserves more attention.

Consequently, in the first chapter I will set the theoretical framework to discuss the position of Turkey in FDI inflows, and while doing so, I believe the historical background will prove to draw a more comprehensive picture.

Chapter two is reserved for a more detailed discussion of push and pull factors in relation to post-1999 environment. I will combine political and economic factors since they are closely related when it comes to legal framework and stability issues concerning foreign direct investment.

In chapter three, I will try to put the discussions in chapter two into a critical perspective. To be able to see these factors I mentioned in the first and second chapters at work more clearly I will also provide two case studies for comparison: Argentina and Romania. These two cases will be helpful to designate the role of EU and respective internal dynamics as well as to make some predictive statements for the near future.

Finally, in the conclusion section, I will interpret my arguments presented in three of the chapters in light of the data I will be presenting.

CHAPTER II

FOREIGN DIRECT INVESTMENT IN TURKEY: A HISTORICAL FRAMEWORK

Foreign Direct Investment (hereafter FDI) is conventionally defined as "form of international inter-firm cooperation that involves a significant equity stake in, or effective management control of, foreign enterprises."(De Mello 1997:4) There is a huge body of literature concerning FDI. A considerable part of this literature focuses on FDI in third world economies, studies on decision-making processes of Multinational Corporations (MNCs) and more generally the push-and-pull factors of hosting economies. Since developing countries come to think of FDI as an important source for capital and know-how, studies on these factors have been highlighted not only in the scholarly circles but also by policy making circles. These developments are of course influenced by successful examples as well as the advice given by the World Bank and International Monetary Fund to the developing economies. Nevertheless one has to note the fact that the largest percentage of FDI is within the infamous triad- North America, Western Europe and

Japan.(Actually China can be a prospective member of this triad since in 2004 it was the second largest host for FDI after the USA) When developing countries are taken into consideration FDI flow is clearly focused on few countries. As has been noted by Shah Tarzi we have ten countries that take the "lion's share." (Tarzi 2005:500) China taking the lead, Mexico, Brazil, India, South Africa and a group of emerging Asian economies happen to be in this list. As explicitly seen in Figure 1, most of the FDI goes to the developed countries.

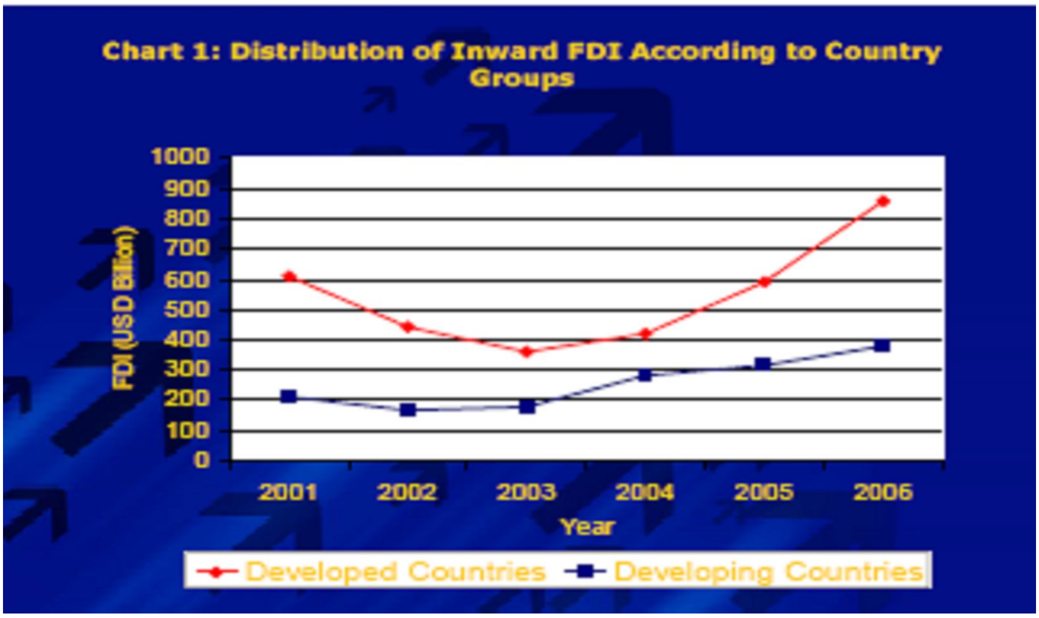

Figure 1: Distribution of FDI According to Country Groups

Source: UNCTAD, *World Investment Report 2007*

Here in this scheme how to attract FDI is tied to the question of what kind of incentives can be created and what kind of policy choices should be made to influence FDI flows, in short what is the added value of a country to prosper in this environment of fierce competition for investment. These choices are very much related to the factors that influence the decisions of the MNC of investment when they choose a certain location. Table 1 can be helpful in our discussions.

We can broadly summarize the main determinants of FDI as differentials in factor endowments, cost structures, characteristics of the market and the recipient economy. (De Mello jr 2007:2) From these three general factors the last one seems to be the most important one for our discussion. Even if one can argue that cost structures are also related to the characteristics of the market and the recipient economy to a certain extent, I will discuss while making a broader analysis of push and pull factors. However, while doing that I will not dwell much on the explanations that emphasize microeconomic explanations that focus on the decision making at the enterprise level to take individual FDI projects.

As can be seen from the table 1, market size and the potential growth of the market seem to play the most important role. Theoretically speaking, when these closely interrelated factors are in evaluation, they can be considered as promising for Turkey that is commonly accepted as a country with a big potential. However, in spite of the expectations, when the current figures of FDI in Turkey are considered, these sentences are generally followed by "Turkey has a great potential but…" Therefore it seems crucial to make a detailed analysis of the other factors in order to perceive the reason of Turkey's failure in fulfilling the expectations. After these two, comes low level of competition as a determining factor; low level of competition in a host country would be contributing positively to the decisions of the investors. Position of Turkey in most sectors does not allow such an advantage by being an open economy connected to the markets in Europe and Middle East compared to possible protective measures favoring a specific firm in a closed economy. This is especially the case after mid 90s when Turkey joined Customs Union as part of EU negotiations. After these three factors mentioned above, we need to take into consideration political stability, labor quality and infrastructure as important dynamics that influence FDI decisions. Here, it seems Turkey has a lot to discuss.

Location Factors	Relevance(a)	Adequacy (b)
Low Labor Costs	3.59	65.0
Low transportation/Logistics costs	3.09	65.0
Labor Quality	4.39	77.7
Availability and Low Cost of Land	2.62	57.3
Large Size of Host Market	7.13	90.3
Potential Growth of Host Market	7.53	88.3
Low Level of Competition in Host Markets	5.57	86.4
Good Infrastructure	4.21	71.8
Availability of Industrial Networks	3.36	70.9
Political Stability	4.93	78.6
Tax Reduction Incentives	2.85	61.2
International Trade Agreements	3.01	61.2

Table 1—Measures of relevance and adequacy for location factors (After Ufuk Canöz&Muharrem Aydın:2004)

Notes: (a) average score given to factor (based on 10)
(b) percentage of firms that scored the factor as a determinant

Canöz and Aydın in their research, list the foremost determinant factors that affect the decisions of the investor firms and measure the relevance and adequacy of these factors. Relevance column refers to the average score given out of 10 by the firms to each factor whereas the adequacy column stands for the percentage of the firms that evaluate the factor as a determinant. Table 1 is indeed in line with Dunning's OLI model which incorporates macro economic analysis of FDI flow. (Dunning:1981) OLI stands for ownership, location and internalization advantages. (Dunning:1981) This model analyses FDI from three different approaches as exemplified with their initials. FDI decisions according to this approach are related to ownership, location and internalization advantages. Here again size of the market and growth rates matter as the most important factors. As I have mentioned before, here Turkey does not have a particular disadvantage even if it cannot compete with the advantageous position of fashionable FDI targets such as India or China. However what comes after is more crucial and more related to political and socio-economic dynamics of the hosting economy. Macroeconomic stability, micro and macro political stability with a well developed infrastructure are accounted for the following factors of importance while the case of Turkey proves the importance of the latter. Since Turkey is relatively a large market offering low costs in terms of labor and situated close to the Western markets, she should have definitely become an important address for FDI if she did not fail in the factors I have just mentioned. This being the case, in the following chapter, I will dwell on internal dynamics of post-1999 period in detail. Yet before going into the details of this discussion I would like to provide a general picture about FDI and Turkey's record of FDI so far.

2.1. Historical Background

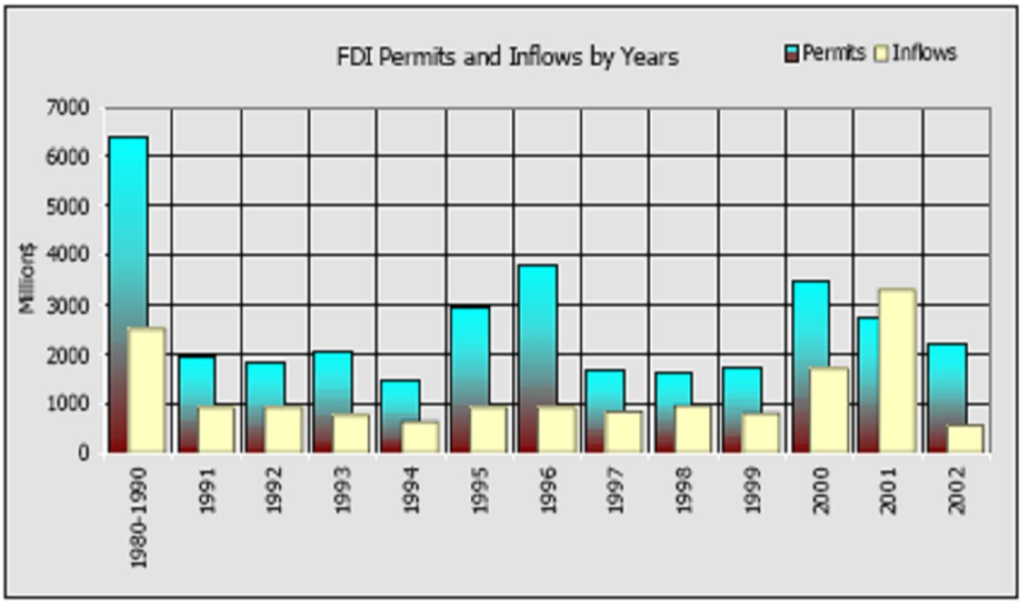

Figure 2: FDI permits and inflows by years until 2002

Source: General Directorate of Foreign Investment (GDFI). February 2003. *Foreign Investment in Turkey 2002*. Republic of Turkey Prime Ministry Undersecretariat of Treasury

Although the legal framework preparations for the Foreign Direct Investment were already started in 1950s, after the end of statist economic policies, the liberalization of the Turkish economy, namely its opening to the world has changed over time. The impact of Import Substitution Industrialization (ISI) policies, political instability, coup d'etats, intervention in Cyprus and most importantly non-liberal characteristic of the Turkish economy limited FDI flow severely up to 1980. In 1979, inflation reached triple-digit levels, unemployment rates rose considerably and the government had problems in payments of loans. This was seen as the ultimate failure of the ISI system which would eventually start to be replaced by neo-liberal measures. This period of political and economic instability and unwelcoming environment of FDI was reflected in numbers. As has been noted by Melek Us, the director of foreign investment department in Turkey, the cumulative FDI until 1980 was only USD 220 million. (GDFI:2003)

24 January 1980 decisions were crucial in changing the ongoing state of Turkish economy. It was a set of economic policy packages which changed the structure of Turkish economy. They were steps taken towards the liberalization of the economy and included decisions such as devaluation of currency and encouragement of foreign investment. After the implementation of these decisions, the economy experienced a relatively high growth rate, a healthy balance of payments and relatively low inflation in early 1980s which unfortunately changed again in the late 1980s due to populist policies of the changing governments. Late 1980s and early 1990s

was marked by a failure of deflationary policies and debt financing which culminated in the crisis of 1994. The share of FDI in GNP remained insignificant, rising only from 0.1 percent during the 1970s to 0.4 percent during the 1990s. (Central Bank of Turkey 2002:22)

1980s was a period of export-led growth and opening of the economy but FDI only started to enter the economy significantly after 1988, remaining at a low level. Between 1985 and 2001 total FDI was 7.7 billion, "roughly equivalent to total long-term borrowing by the private sector (excluding banks) in just one year (1999)" (Ertugal & Selçuk 2001:10) This is clearly an outcome of the instability of the political and economic environment and a signal for structural adjustments. One has to remind the political instability and the inflationary environment of the time not to mention that Turkey experienced three major financial crises within this period. Even if Turkey has experienced such problems, fortunately she succeeded in getting back on the track both in political and economic terms. In this process a prospective EU membership served as the most accelerating issue on the agenda which was set as a target for policy makers.

As I have mentioned above, prospective EU membership has been a big factor for attracting FDI since it can be interpreted as a sign of new opportunities and more importantly as a sign of prospective stability. Yet one of the important landmarks in terms of Turkish integration to the EU, Customs Union does not seem to have a major impact. Table 3 shows that 1995 and 1996 witnessed an upward trend in terms of FDI permissions but they were failed to be realized in the long term. That is why one may conclude that it does not have an impact for FDI inflow to Turkey. However, it also shows that beginning of such a relationship with the EU definitely attracted attention if not created a period of rapid FDI inflow. Just like indirect impact of FDI for the development of a given economy (contributing to the structure of the economy) (Alfaro: 2004), EU seems to have an indirect impact through attracting attention to Turkey. The fact that this attention could not be sustained is of course related to internal and external dynamics that I have mentioned above and will elaborate in the next chapter.

Even if Turkish economy was proceeding in liberalization and there were important steps taken for EU membership in the period between 1980 and 2007 there were three major economic crises that proved to be serious impediments for FDI inflow. The crisis of 1994, 1999 and 2000/2001 can be seen as crises of economic structure, mismanagement and cumulative results of populist policies. (Öniş: 2003) The normalization efforts then after were held in cooperation with IMF. New stand-by agreements were signed which coupled with determinant steps taken to join European Union. There have been positive signs with structural changes in the economy and a relative political stability. By 2004, Turkey was catching up with prospective members of the EU such as Romania which were to be accepted within the Union by 2007. Considering this fact, such a comparison would be very productive for analyzing effects of EU in FDI flows. Therefore I will discuss it in the third chapter while focusing on the external factors.

So far, I have mainly emphasized economic stability, yet politics and economy cannot be separated that easily. Economic instability goes hand in hand with political instability and vice versa. When a country such as Turkey embarks upon liberalization of its economy it would necessitate structural and institutional changes which need a long-term stable policy making. The mere fact of the existence of 13 different governments between 1989 and 2003 is itself very suggestive of the situation. Important issues such as privatization (which was on the agenda since the 1980s but continues to remain unfinished as of today) and revision of the banking system received fluctuating attention from different governments and plans of structural change remained less effective due to the instability of the political environment.

2.2. Contemporary Environment and Obstacles for FDI

Last five years from this perspective can be considered as a significant change. AKP government managed to provide a relatively stable political environment owing to the fact of being a single party government instead of a coalition as we were used to have. Non negligible steps were taken by this government to fulfill Copenhagen criteria, so that membership talks have been opened in 2005. This functions as a guarantee for continued democratization while measures were started to be taken against corruption and the independence of the judiciary system. These developments seem to be very promising when presented as such but they need further discussion as important internal dynamics which have enormous influence on FDI flow to Turkey as can be seen in Table 3. Yet again maybe one of the most important developments concerning FDI was the new law to encourage FDI. In the words of US-Turkish Business Council (TAIK) it was part of a law that aims to "eliminate bureaucratic red tape, introduce equal treatment to both domestic and foreign investors and protect foreign investors' rights in a fashion that match international standards" (TAIK 2004) The law brings about changes that would make it easier to pass necessary bureaucratic steps for investment, that would lead to equal treatment of Turkish citizens and foreigners together with an internationally accepted definition of "foreign investor". As has been announced by TAIK, they were clearly motivated to be more competitive in the international market to attract FDI.

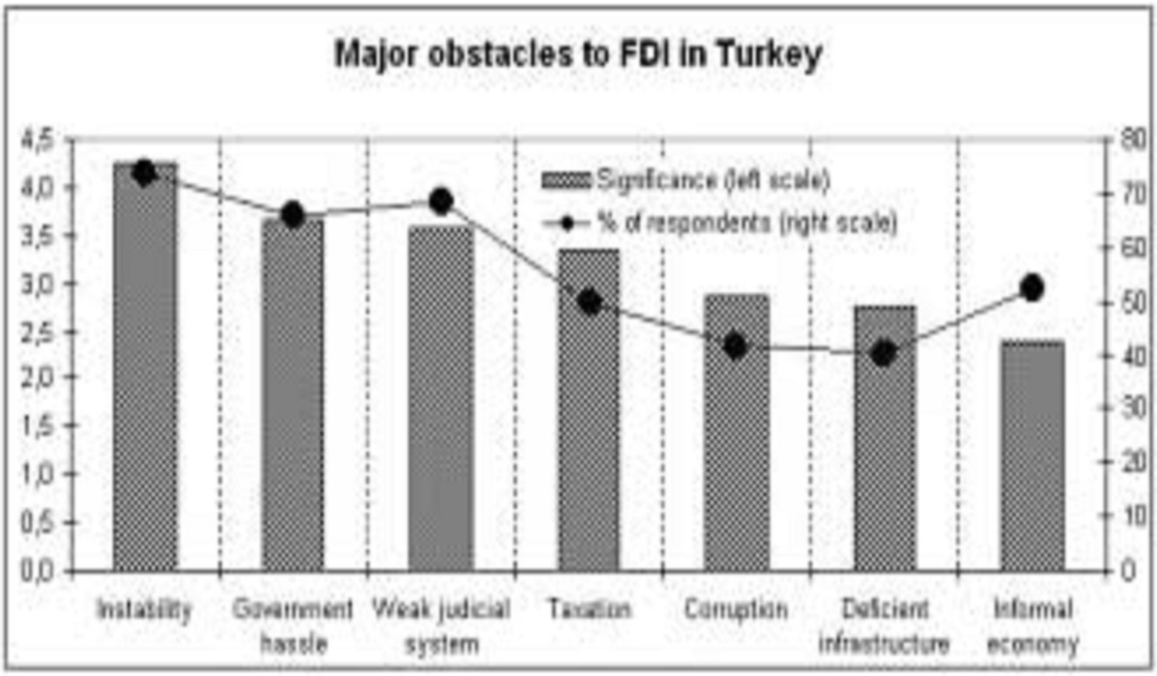

Figure 3: Major obstacles of FDI in Turkey

Source: OECD, *Economic Survey: Turkey* (October 2004), p.143.
(cited in Hadjit and Browne, p.329)

Yet again when we take another look at the table 3 above, the obstacles as of 2004 seems to be less bureaucratic than political since infrastructure and taxation are well down the least while political instability is the biggest obstacle. This being the case, the impact of being an EU candidate becomes more important especially because it is an anchor for political stability and structural reforms. Therefore, I will be taking Argentina and Romania as two cases studies that are comparable with Turkish FDI story. They will help me determine the role and influence of EU in this particular situation and also help us understand the specific combination of external and internal dynamics that were impediments for FDI so far but can be overcome or become a source of potential in the coming decades. I choose Argentina as a success story which can be compared to Turkey both due to its structural/historical background and market size. Here EU would not be playing a role so the emphasis would be in different dynamics. However, Romania being a Central Eastern European (CEE) transition economy proves to be an interesting example for Turkey not only for the analysis of EU influence on candidate countries but also due to its timing of EU membership.

Hadjit and Browne suggest in reference to Bevan and Estrin that "countries that take part in the EU accession process benefit from increased FDI while the relative position of the delayed entrants could weaken and therefore EU announcements tend to widen divisions in terms of FDI among delayed entrants and candidate countries."(Hadjit and Moxon-Browne 2005:326) This idea is essential since it brings an analyze to the situation of post-1999 environment (which will be the focus of this thesis)

Since EU negotiations play the role of the carrot and the stick simultaneously, this not only provides a motivation to fulfill Copenhagen criteria immediately but also ensures relative political and economic stability in fear of causing another economic crisis if the path of reforms is left aside. This aspect seems to be crucial in the development of all candidate countries but since Turkey's situation proves to be more complicated than others it will become the major focus of my comparison between Turkey and Romania.

All in all, the importance of FDI in economic development is recognized world wide not only by individual counties but also by international organizations such as the World Bank or IMF when their emphasis on FDI as a structural tool to increase the strength of an economy is considered. The share of FDI that goes outside the triad of Europe, North America and Japan is relatively small. Yet this share is also not distributed evenly but focuses on ten major developing economies which can be listed as China, Brazil, Mexico, Argentina, Poland, Chile, Malaysia, Korea, Thailand, and Venezuela. Under these conditions states have to be very competitive if they want to attract FDI. When reliance on debts and what can be called as short-term capital flows were realized to be unsatisfactory and dangerous by many crises, there has been a growing motivation to invite FDI. Here the crucial question came to be "how to realize the potential Turkey has." As I have noted above Turkey has an advantage in terms of providing a large market, lower cost of labor and proximity to Western markets in general even if these advantages vary according to different types of FDI and specifics of every individual sector. However, political and economic instability, taxation, lack of infrastructure and some structural barriers proved to important impediments in the Turkish experience. These impediments on the other hand seem to be improving due to the influence of EU and structural changes undertaken to fulfill Copenhagen criteria; that is why the influence of EU and relative position of Turkey in the international FDI market deserves more attention. To be able to make a deeper analysis I will be discussing the issues I mentioned above under two clusters. These clusters can be titled as external and internal dynamics. While doing that I am fully aware of the fact that these two cannot be separated from each other since they are very much intertwined and react against changes within each other. To be able to see these factors at work more clearly I will also provide two case studies for comparison: Argentina and Romania. I hope that these two cases will be helpful to designate the role of EU and respective internal dynamics as well as to contextualize my arguments in this chapter.

CHAPTER III

FDI IN TURKEY: POST-1999 ENVIRONMENT

The year 1999 is a milestone in Turkey's journey through the reform processes both in politics and economics brought by the EU conditionality. This is the year that Turkey gained the formal candidate status at Helsinki Summit.(Öniş: 2004) That is why the Turkish case is analyzed in this thesis with a special focus on 1999, with the developments before and after this year. As mentioned before, the comparative cases of Turkey, Romania and Argentina that will be explored in the following chapters are chosen to point out that an external anchor (political or economical) functions as an assistant to the host country to prosper in the highly challenging competition of FDI attraction. Considering this fact, once again shall be underlined that EU, not directly, but indirectly by pushing Turkey to conform the Copenhagen criteria contributed a lot to the credibility of Turkey which was proved by the significant process in political space in such a short period of time.

I would like to open discussions about Turkey by stating certain facts as has been presented in the country brief of the World Bank in 2002. (World Bank 2002) The opening statement starts to define Turkey as a dynamic emerging market economy. After briefly mentioning the demographic data and the developments in the EU membership process, it closes the opening phrase by noting that "Although Turkey is the world's 17th most industrialized nation, it ranks 85th out of 173 countries in terms of Human Development Indicators, as measured by the UNDP in 2002." These kinds of statements "although Turkey has a positive X, it fails to do Y" has been quite common regarding the political economic situation of Turkey. As I have discussed in the introduction one such typical example was "Turkey has a big potential for attracting FDI due to various reasons but it fails to realize this potential" The aim of this chapter would be to explore the hows and whys of such a statement.

It has been well known that developed countries are the main receivers of FDI inflows if we follow the example of the infamous triad I have mentioned in the introduction. They have suitable determinants for attracting FDI. Therefore, it would not be wrong to assume that the amount of FDI a country receives is also related to the level of development as well as the strength of the economy and specific advantages that can be discussed through Dunning's model.

3.1. Changing World and FDI

John H. Dunning, being one of the most influential theoreticians of FDI, evaluates the period of the last two decades as a significantly changing environment of FDI. (Dunning 2002a: 222-38) Of course this change is very much related to the change in world economic relations and globalization the effects of which were started to be felt in the beginning of the 1980s. In a nutshell we can point to these changes with respect to the position of FDI and country positions in seven categories in Dunning's words (Dunning 2002: 224);

- Renaissance of the market system
- Globalization of the economic activity
- Enhanced mobility of wealth-creating assets
- Increasing number of countries approaching 'take-off' stage in development.
- Convergence of economic structures among advanced countries, and some industrializing countries
- Changing criteria by which governments evaluate FDI
- Better appreciation by governments of the costs and benefits of FDI.

As can be seen from the categories mentioned above FDI in our world is usually related to competitiveness. FDI can be seen as positive for long-terms foreign capital flows but one has to be hesitant to make generalizations that FDI is something positive for the economy. The point that has to be taken into account is FDI's "contribution to the improvement of the competitiveness of the resources and asset-creating capabilities located within their areas of jurisdiction." (Dunning 2002: 228) This being the case productivity and comparative advantage would be the two most important aspects that we should emphasize.

Consequently there is a need of fine tuning to be aware of different types of FDI. Broadly speaking we can distinguish two tendencies within FDI one being initial and the other being sequential. Initial FDI was based on resource seeking or market seeking which was dominant type of foreign direct investment till 1980s. (Dunning 2002:233) However the most dominant type of FDI came to be efficiency seeking and strategic asset seeking in the 1990s which changed the advantages of hosting FDI significantly. If we again follow Dunning's argument we can categorize and distinguish these types as follows (Dunning 2002a:233):

1-Resource seeking:

(Physical/human resources) mainly motives for

2-Market seeking: initial FDI

(Domestic/regional markets)

3-Efficiency seeking: rationalization of production
to exploit economies of specialization and scope
(product/process specialization)
4- Strategic (created) asset seeking:
(technology/ organization/ market)

mainly motives for sequential FDI

The main reason that I have mentioned above categories is that what FDI seeks is directly related to what it gives to the host country's economy. In the cases of market or resource seeking type of FDI the structural benefits for the host economy would be secondary since they would at first hand contribute to domestic competition, rising product quality, access to foreign markets and fostering of backward supply linkages. On the other hand third and fourth type of FDI would affect international division of labor, structural adjustment, cross-border networking, new finance capital and strategic assets which are far more crucial for economic structure of the hosting countries. This latter cluster of types exists as the phenomena of mostly 1990s and that vary depending on the differences in sectors. Turkey also witnessed these types of FDI especially in automotive and textile industries. However, due to the problems I will discuss below this type of FDI remained below the potential.

3.2. Profile of Turkey: An Under-Performer

If we turn from theoretical discussions to our case study, it can be argued that 1999 stands as a breaking point in Turkey's political and also economic journey. It is the year when Turkey launched an extensive economic reform program to overcome chronic high inflation and restore sustained growth. It is also the year when Turkey became a candidate for EU membership at the Helsinki Summit in December. However, before proceeding with the discussion of post-1999, it would be better to mention some of the characteristics of pre-1999 environment.

The decade of 1970s was marked by Import Substitution Industrialization with an emphasis on statism. This environment was very hostile for FDI inflows and thus between the year 1970 and 1980 the total amount of FDI was about 90 million USD. (General directorate of Foreign Investment: 2002) 1980s brought change in economic policies which can be summarized as a shift from protectionist statist policies towards export orientation and economic liberalization. This shift resulted in an increase in FDI inflows for Turkey but the picture remained more or less stagnant during the 1990s. This stagnation became the starting point of asking why Turkey can not realize her potential. I would also like to draw attention to the discrepancy between the permitted FDI and actual FDI at this point. There are significant differences in different years which is quite telling yet alerting. This discrepancy shows a willingness on the part of the investors which could not be realized. If we consider that generally permissions are twice as much as the actual FDI, this discrepancy once again forces us to question the unfulfilled potential. As I have shown in table 2 above, there are fluctuations in FDI inflows mostly due to economic and political crisis.

International Finance Corporation (IFC) is one of the bodies that work in cooperation with the World Bank. Regarding Turkey, one of the goals of IFC , as stated in their website is to "As the government's privatization program picks up steam, *IFC will put additional emphasis on the broader infrastructure sector,* including electricity, ports, and logistics, and on supporting flagship privatizations, attracting foreign interest, and stimulating the flow of foreign direct investment." (IFC 2008)As I have mentioned before FDI is seen crucial for the restructuring of Turkish economy which is considered almost as a rule for most of the developing countries. Therefore, deficiencies in the area of FDI are indicative of the problems of Turkish economy in general and worth closer study.

Asım Erdilek (Erdilek: 2003) makes a summary of the existing literature with the question of "why Turkey lagged behind in attracting FDI compared to other developing countries?" Here again we see two different types of problems: Economic and non-economic problems. The author provides a long list of mostly structural problems.

> "Economic causes include high transactions costs of entry and operation for foreign investors (due to excessive bureaucracy and red tape, and widespread corruption), chronic high inflation, increasing economic instability, inward orientation until 1980, lack of protection of intellectual property rights, lack of inflation accounting and internationally acceptable accounting standards, failure of privatization, insufficient legal structure and inadequate infrastructure (especially energy). Non-economic causes include chronic political instability, internal conflicts (especially the Kurdish problem), historical animosity towards foreign economic presence (dating back to the Capitulations during the Ottoman Empire), fear of foreign political domination within the civilian and the military bureaucracy, lack of FDI promotion (indicating an unwillingness or reluctance to attract FDI), and the structure of Turkish business (family-owned and controlled and closed to foreign takeovers)." (Erdilek 2003:2)

Economic causes are more or less similar to what exists in the literature, however, in the non-economic part there are not only structural political problems but also characteristics of Turkish political culture is also mentioned. We can see this in two of the factors mentioned above, namely, historical animosity towards foreign economic presence and fear of political domination within the civilian and military bureaucracy. I believe these claims deserve attention in explaining the impediments against reforms which would prepare a hospitable environment for FDI. In stating these problems and the following comparison of inflow and outflow of FDI in Turkey, Erdilek uses John H. Dunning's eclectic ownership-location-internalization (OLI) paradigm and its dynamic version, the Investment Development Path model which I have mentioned earlier. Based on this paradigm and looking at the statistics, the author concludes that by the year

2003, relationship with the EU and participation to the Customs Union did not have a significant effect on FDI inflows mainly due to the reasons I have listed above. Consequently, here again, the idea is that the EU would be a major source of dynamism to ensure political and economic stability increasing the potential of Turkey for receiving FDI but this potential is not realized due to domestic facts and bureaucratic impediments.

An interesting indicator of Turkey's poor performance is UNCTAD's categorization. UNCTAD divides countries according to their FDI Performance and Potential Indices. There are four groups, namely; front runners, above potential economies, below potential economies and under-performers. As has been pointed out by Erdilek Turkey is listed among the under-performers, which are generally poor countries, for both the 1988-1990 and the 1998-2000 periods. This is all the more interesting if Turkey's FDI outflow is compared with its performance in inflow. Even if Turkey is far behind from her potential as a host country, her place is improving as an investor starting with 1994. (Erdilek 2003).

A related factor for this stagnation is of course the case of privatization. By the year 2002, the share of privatization related FDI in Turkey is just 30% of the total FDI. This figure is rather low especially when we compare it with the figures of the transition economies of Central and Eastern Europe.(Begün 2003)

Here at this point, some statistical data would be very helpful to analyse the current situation in Turkey. The FDI reports that are prepared by the General Directorate of Foreign Direct Investment assist to a great extent in this means. According to Table 2 below, we see a sharp increase in FDI in 2005, almost five times of the FDI attracted in 2004. However again in 2008, we observe a decrease for the first 5 months compared to the same months of the last year. It can be argued that this may be related to the political ambiguity in Turkey under the AKP government.

(Million $)

	2003	2004	2005	2006	2007	January-May	
						2007	2008
International Direct Investment Total (Net)	1.751	2.785	10.031	19.989	22.205	11.107	6.053
International Direct Investment	753	1.442	8.190	17.067	19.253	9.897	5.030
Equity Investment (Net)	737	1.092	8.134	16.982	18.702	9.604	5.000
Inflows	745	1.190	8.535	17.639	19.445	9.611	5.008
Liquidiation Outflows	-8	-98	-401	-657	-743	-7	-8
Intra Company Loans**	16	350	56	85	551	293	30
Real Estate (Net)	998	1.343	1.841	2.922	2.952	1.210	1.023

Table 2: International Direct Investment in TR (Inflows)

Source: General Directorate of Foreign Investment (GDFI). July 2008. International Direct Investment Bulletin

The relative position of Turkey compared to the other FDI attracting countries shall also be underlined while analyzing the numbers in Turkey to get a better comprehension. According to the World Investment Report of 2007, Turkey ranks 5th among the developing countries while being 16th worldwide whereas China taking the lead of the developing countries as usual by being 5th worldwide.

2003		
Rank	Country	FDI
1	China	53.5
2	USA	53.1
3	France	42.5
4	Belgium	33.5
5	Germany	32.4
6	Spain	25.8
7	Ireland	22.8
8	Netherlands	21.0
9	UK	16.8
10	Switzerland	16.5
53	**Turkey**	**1.8**
	World Total	564.1

2004		
Rank	Country	FDI
1	USA	135.8
2	China	60.6
3	UK	56.0
4	Belgium	43.6
5	Australia	36.0
6	Hong Kong	34.0
7	France	32.6
8	Bermuda	25.5
9	Spain	24.8
10	Mexico	22.4
38	**Turkey**	**2.9**
	World Total	742.1

2005		
Rank	Country	FDI
1	UK	193.7
2	USA	101.0
3	France	81.1
4	China	72.4
5	Netherlands	41.6
6	Germany	35.9
7	Belgium	33.9
8	Hong Kong	33.6
9	Canada	28.9
10	Spain	25.0
23	**Turkey**	**9.8**
	World Total	945.8

2006		
Rank	Country	FDI
1	USA	175.4
2	UK	139.5
3	France	81.1
4	Belgium	72.0
5	China	69.5
6	Canada	69.0
7	Hong Kong	42.9
8	Germany	42.9
9	Italy	39.2
10	Luxembourg	29.3
16	**Turkey**	**20.1**
	World Total	1,305.6

Figure 4: Top ten FDI recipient countries and Turkey

Source: UNCTAD, World Investment Report 2007

3.3. Structural Changes

June 2003 is a breaking point in the history of FDI in Turkey. On 17 June 2003, a new law, "Foreign Direct Investment Law", was passed abolishing the necessity to have permission from the state to make FDI and turned into a system of disclosure. This brought a sharp increase in FDI inflow. Till 2003, to establish a firm, a foreign investor had to get permission from the General Directorate of Foreign Investment (GDFI) which operates in the Undersecretariat of Treasury. After the permission the investor had to go through another series of bureaucratic procedures. After this level is passed succesfully the investor had to face another layer of problems to own real estates which becomes even more troublesome if it is related to public-owned lands. (Begün 2003: 20)

I have to remind that this law was also backed by new incentives issued for the coming foreign investment which accelerated FDI inflows. Formation of the Improvement of the Investment Environment Coordination Board (IIECB) was also a crucial step since it proved that the Turkish government is very determined about attracting FDI.

	1954-1999	2000	2001	2002	2003	2004	2005 Oct	Total
New	3.928	356	351	371	899	1.608	1.887	9.400
Total	4.580	492	504	517	1.141	2.150	2.323	11.707

Table 3. Foreign Investment Firms by the year 2005

Source: Hazine Müsteşarlığı, Doğrudan Yabancı Yatırım Raporu,2005

When we look at the "Foreign Investment Report 2005" issued by the Undersecretariat of Treasury we see that more than half of FDI originates from EU countries(top three being Germany, Holland and UK) which stands as an interesting drawing point of our discussion of impact of EU on FDI in the case of Turkey. More importantly, in the years of 2004 and 2005 more than 80% of capital investment originates from EU countries.(Hazine müsteşarlığı 2005:3) If we remember the political climate it was only on 16 December 2004 that the EU leaders decided to start accession negotiations with Turkey which was to start from 3 October 2005. Even if there was some tension and ambiguity as to the prospect of membership, liberalization of laws and incentives seem to be coupled with a prospective membership.

2004 also marks formation of an interesting body, Investment Consultation Council. In the report it is stated that formation of such a body "aims to provide an international perspective to decrease the impediments in front of investment and to improve the image of Turkey as a country profitable for investment in the international arena and finally to improve the conditions of investment by the government. To this end, this body is created in the form of a platform composed of managers of leading multinational corporations (MNCs)." (Hazine Müsteşarlığı 2005) In the first meeting in 2004 the council advised the government to abolish the hampers created by the bureaucracy, enlarge the incentives to provide an investment area to draw attention of the foreign firms and businessmen, to strengthen Small and Medium Size Enterprises (SME), to improve educational and infrastructural conditions as well as judicial facilities. These points seem to have provided a road map for the government when the reforms following 2004 are considered. Interestingly, this council seems to have gained a wide recognition by important actors of FDI. In the second meeting in 2005 we see participation of 19 top ranking managers from MNCs, presidents of World Bank,IMF, European Bank of Investment together with representatives from Turkish private sector. In this meeting social security and institutional governmentality was added to the agenda of improvement for increasing FDI inflows. (Hazine Müsteşarlığı, 2005) The council held meetings in 2006 and 2007 as well. In the reports announced afterwards, there were very positive comments about the achievements of the government and advice to increase the incentives for FDI and improve infrastructure.

3.3.1. Stability

This variable is easy to generalize but one has to be careful before going into deeper analysis. The first point that has to be clarifies is to determine what kind of stability we are talking about. Stability is seen as an important factor in almost all models explaining FDI; however, there is a tendency to distinguish political and economic stability. If we recall table 1 I discussed in the introduction, both of these were seen as fundamental indicators, yet we need a fine-tuning here. What is meant from political stability may not necessarily mean long-term strong governments in power. Rather than that we have to take a look at the macro level analysis. In the case of economy it would be macro economic indicators and vulnerability of a specific country to possible economic crises that can be caused by negative domestic dynamics or by fluctuations in the global market. In the political realm, it would mean long term consistency of policies and structural stability of the regimes and lack of fundamental societal conflicts. This can be seen in the comparative analysis of Mustafa Begün. When Poland and Turkey are compared both of the countries seem to have suffered of political instability in terms of constant government changes in the 1990s but these political circumstances do not seem to have a negative effect on Poland as a major FDI hosting country in the Central and Eastern Europe.(Begün 2003: 74)

However, maybe a third aspect of stability should be added here to explain FDI behavior which would be related to stability in the legal framework. Legal framework in Turkey has been improving to be more satisfying for conditions of FDI, nevertheless, when it comes to implementation the picture becomes ambiguous. Foreign Investment Advisory Service report presents serious concerns at this point. In this report, a vital signal is mentioned about the inconsistency in the implementation of law, time-consuming procedures and decision-making processes and the following uncertainty caused by this inconsistency. (Erdilek 2003) Of course, this is partly related to political instability but it has more immediate effects on FDI decisions. This problem was targeted by many advisory bodies and serious steps were taken to overcome this instability. Here, prospective EU membership was one of the most important tools as an external anchor. Once legal framework has been revised according to create better incentives for FDI and reach the standards of EU, they are expected to remain consistent.

3.3.2. Privatization

Privatization is seen crucial for the liberalization of economies. Although starting from the 1980s Turkey took a path towards privatization, the progress is proved to be slow. There can be many reasons behind this slow pace but we should not undermine the lack of political incentive that is at stake. There were political concerns against fast privatization due to the negative image in the public which associates privatization with the capitulations of the Ottoman times. This point of view may seem absurd at first glance but it is very common to find criticisms of privatization in reference to foreign powers taking control of Turkish economy. As has been noted by Asım Erdilek, existence of such a discourse stands as a political risk for governments. This discourse is sometimes coupled with “selling country to outsiders” or betrayal of Atatürk’s principles such as statism. Consequently, it is not surprising to observe that rapid privatization took place in the immediate aftermath of economic crisis so that it becomes easier to justify not mentioning the guidance from the World Bank and the IMF.

After the 2001 crisis the picture started to change considerably with acceleration in privatization. The upwards trend Turkey experienced in receiving FDI in the last five years is also related to this wave of privatization. Firstly, it was an indicator of commitment to liberalization. Secondly and more importantly as can be seen in the FDI figures of 2004 and 2005 considerable amount of FDI Turkey attracted in these years is created by privatization.

Year	Privatization Amount	FDI Inflows Through Privatization
2000[a]	3,302	585
2001[a]	2,579	2,369
2002	537	-
2003	187	-
2004	1,283	49
2005	8,222	1,500
2006	8,095	1,768
2007	4,230	-
Total	**28,435**	**6,271**

Figure 5: Privatization Figures for Turkey (in USD million)

Source: Turkish Privatization Administration

Previously, there were series of bureaucratic and legal barriers against privatization which led investors to think that Turkey does not favor FDI and there is a continuous mistrust against foreigners which are naturally very discouraging for investors. (Lowendahl and Ertugal 30) This obstacle of legal instability can be said to overcome with the structural reforms as a result of stand-by agreements and reforms to fulfill EU criteria. One of the most successful reforms that directly affected FDI in terms of legal stability would be the "Foreign Direct Investment Law" of 2003.

3.3.3. Market Size and Market Growth

So far I have mentioned different factors which are not necessarily strictly economic. However, market size being obviously an essential economic indicator, plays a big role in forming the basis of the potential of Turkey as a major FDI target. Different scholars, such as Erden, Erdal and

Tatoloğlu (1996) argue that this is the biggest asset of Turkey in attracting FDI. Turkey has a big potential for providing cheap labour as well as strategic location which is coupled with the advantage of the market size. This list of advantages stands as non negligible pull factors which also affect the choices of FDI about the sectors.

When the breakdown of FDI in sectors is analyzed through years it seems that service sector is growing at a regular pace which is an indicative of Turkey's advantage in providing labour to foreign firms. I have to note that new FDI operations have changed the structural composition of overall FDI activity in Turkey, in favor of service industries such as tourism, banking, trade and other business and financial services. (Demirbag et.al. 2007)

Yet this also indicates a growing need for a qualified labor which necessitates proper education for Turkey's growing youth population. When the reports of the World Bank and International Finance Corporation are considered Turkey has already started to receive signals to put more emphasis on education. However, the indicators so far do not seem to be satisfactory and advisory bodies continue to underline the importance of an educated labour force to attract further FDI.

Sectors	Number of firms as of the year 2005
Agriculture	154
Mining	197
Manufacturing	2.539
Construction	658
Commerce	4.293
Hotels and restaurants	926
Telecommunications	994
Real estate	1.156
Others	790
Total	**11.707**

Table 4 -FDI by sectors

Source: Foreign Direct Investment Report, Undersecretariat of Treasury,2005

3.3.4. Impact of EU

I will actually analyze the impact of EU in the next chapter through comparisons with Argentina and Romania but it needs to be at least briefly mentioned here as it is claimed to be a catalyst as an external anchor for FDI inflow for Turkey.

John H. Dunning analyses the impact of Internal Market Program (IMP) regarding the European Community. This was quite an earlier measure to enhance FDI within Europe but what has come out of it is very enlightening to comprehend the impact of European Union.(Dunning 2002b) IMP was a quite good working catalysis for enhancing intra-EC FDI flows. Its main contribution seems to be on market size, income levels and the structure of economic activity which were crucial for the economies of Spain and Portugal. This being the case we can safely conclude that it helped to lay a solid basis for European Union and its FDI flows.

Lowendahl and Ertugal argue that European countries have a tendency to channel FDI within the borders of EU. Consequently EU membership becomes an advantage for attracting FDI from EU countries. It can be argued that in the current picture, the relationship with the EU has already started to show its effects on FDI since EU countries are the biggest investors with increasing shares (Table 5). It is also related to the entering the triad of FDI I mentioned in the introduction. Examples of Central and East European countries are very promising in that sense.

Countries	Number of Firms
EU members (25)	6.076
Germany	2.013
Holland	922
Britain	907
France	458
Italy	421
USA	605
Total	**11.707**

Table 5 - Number of foreign firms by the year 2005 compared in terms of country of origin

Source: Foreign Direct Investment Report, Undersecretariat of Treasury, 2005.

Secondly, EU membership has been considered as a central political and economic anchor. (I will discuss the status of anchor in my comparison of Romania and Turkey) It is sufficient to say that reforms undertaken to fulfill the Copenhagen criteria and to start negotiations of membership made a considerable positive effect on political stability and the liberalization of the economy. The restructuring of the Turkish economy according to the neo-liberal principles are in fact making progress under the influence of two important actors: IMF and EU.(Öniş and Bakır: 2007) While IMF provides important guidance in terms of the economic structures, EU provides a double influence, both political and economic. Since my argument in this thesis is the predominance of the political factors over the economic ones in attracting FDI when certain structural prerequisites such as free markets is realized, then EU carries a heavy weight to evaluate FDI flows to Turkey.

Turkey has started negotiation talks, which is a good sign for attracting more FDI from the EU network. However, Turkey is a bit disadvantageous by being a latecomer to the European Union because there are already countries from Central and Eastern Europe that have become members of the EU and in the case of a slow-down in the accession process of Turkey the advantages I have mentioned above have a potential to turn into disadvantages. This uncertainty on the other hand can be a restraint for potential investors. Therefore, it is exactly the point where politics and economy are intertwined to the extent that becomes impossible to distinguish.

One case in point is the position of Central European countries and their relationship with the EU. Nina Bandelj argues that EU integration may not have affected countries in this region equally not only due to specific economic characteristics of countries but also due to the difference of political relationships with the previous members of the EU.(Bandelj 2002) This argument clearly highlights the political aspects of the equilibrium and hints that the tricky role of politics is not limited to the legal framework and stability issues when it comes to FDI. I will discuss this argument further in the next chapter but I would like to make a few notes before closing this one. If what Bandelj argues is the case, then we can safely claim that EU should have a far more significant impact on the developments of FDI inflow in Turkey than can be measured or observed directly. Moreover, depending on the nature of accession talks, EU can have even a bigger impact be it positive or negative.

3.4. Conclusion

Murat Karaege argues that Turkey had failed to provide two main determinants of FDI: policy framework (i.e. performance of the economy, political stability,privatization strategy, tax policy) and business facilitation (i.e. administrative procedures, corruption). (Karaege 2006:41) There seems to be considerable improvement in both of the determinants with the introduction of new reforms and the "foreign investment law". These incentives made the administrative procedures easier for investment. Moreover, the road taken with stabilization program of IMF seems to be going smoothly so far together with growth and inflation control (though there are some fluctuations recently) In this process reforms undertaken to fulfill EU integration process also affected both economic and political environment, increasing the credibility of Turkey as an FDI hosting country. All these developments reflected themselves in the statistics.

However, this does not mean that Turkey no longer has any problems concerning foreign direct investment. Stability remains to be a crucial issue on the agenda due to the history of chronic economic and political crises. Even if laws were passed to change the legal framework to make it easier to invest, some barriers still remain. One of the existing barriers is the haunting ghost of capitulations. In the media, when foreign direct investment was discussed, we still see hesitations of a possible foreign domination of economy. At times when political issues started to be tense between the government and the opposition, this fear is more prone to occur. In line with what Asım Erdilek notes (Erdilek 2003), suspicion towards FDI continues in the bureaucracy and the legal circles as can be seen in the discussions of privatization.

What is even more interesting is the fact that there is still an unknown deck of cards on the table and that is the future of EU integration. Membership talks have started and they proceed in a fluctuating pace. Due to political uncertainty on the part of the EU members about Turkish membership, the situation continues to be ambiguous. This ambiguity is of course coupled with domestic signals of political and economic problems. Yet this ambiguity and slow pace of developments puts Turkey into a disadvantageous situation. New members are already far ahead of securing their places in the European Union network of investments and ambiguity unfortunately contributes to Turkey's position of dwelling more on the level of potential and less on the level of realization.

CHAPTER IV

FDI IN PERSPECTIVE
PUSH AND PULL FACTORS

Central Europe and Latin America as regions provide us different aspects of liberalization and FDI attraction. In the literature Central and South Eastern Europe is discussed within the framework of transforming into market economies and integration to European Union. Latin America on the other hand is generally referred within the framework of political economic transformations (liberalization and democratization), crisis and advantage of proximity to the USA. Of course none of these regions are highlighted as much as East Asia as the source of miracles and recovery. In this section I will emphasize some aspects of FDI environment of two countries from these two regions. My examples will be focused on Romania and Argentina. I hope that their experience in terms of FDI attraction can provide a solid ground for comparison with Turkey which I explain below. In doing so, I hope that this section will be helping more to enlighten about Turkish experience in perspective.

Latin America has an interesting story of foreign direct investment. Although the historical background shows that Latin American countries were early comers in this area, the literature refers 1980s as the "lost decade" for Latin America. The main reason of failure was the high inflationary environments and failure in liberalization attempts in the economy which were coupled with constant political crises. Since then privatization came to be one of the highest priorities for the countries that try to implement liberal economic policies after the failure of import substitution model in the 1970s. This part of the story resembles the Turkish experience considerably. Just like Turkey, many Latin politicians opted for short-term economic assistance rather than facing the difficulty in implementing privatization policies since the public had a negative attitude due to the economic hardships. (Biglasier and Brown 2005: 671-680)

Nina Bandelj (Bandelj: 2002) offers an interesting framework which emphasizes the role of social relations in FDI. The starting point of the author is that previous research deemphasizes the role of the host countries while presenting them as passive receivers of FDI which is far from the case. Secondly, according to Bandelj the countries in Central and Eastern Europe which were evaluated as the most developed and least risky for investment did not have the biggest share of FDI in the region. Consequently the author comes up with a relation approach:

> In sum, prior research on the determinants of FDI flows focuses, without exception, on the effects of country characteristics. This research treats foreign investment markets as atomistic, assuming that economic actors are independent from one another. But actors "are so constrained by ongoing social relations, that to construe them as independent is a grievous misunderstanding" (Granovetter 1985:482). Nation-states are embedded - connected to each other through political relations, migration and trade flows, or associational alliances. These supra-organizational factors shape the choice of FDI locations and the size of investments. It is thus necessary to treat the relations between investor and host countries as influences on FDI.(Bandelj 2002:416)

Here the most interesting point of the arguments goes as follows. In Central and Eastern Europe there are two types of institutional regulations that are relevant for FDI flows. These are bilateral agreements and the framework of European Union. Interestingly, Bandelj argues that we have to emphasize political alliances more because such economic transactions do not take place in a vacuum but they are affected by the general atmosphere of international relations. The political alliances pave the way for information exchange which is the "sine qua non" for FDI decisions. Of course the existence of some other relational determinants such as organizational and interpersonal networks cannot be denied. However, for purposes of generalization and relevancy for the Turkish case I will be mostly dealing with the emphasis on the effects of political alliances.

The effects of political alliances can be considered as supra-organizational factors which are based on the assumption that nation-states are embedded, in other words connected through political relations. Following this assumption in her research Bandelj looks at host-investor dyads. "Hosts are 11 countries of Central and Eastern Europe. Investors are the world's 20 largest foreign investors and any other country that invested at least $ 5 million between 1995 and 1997 in one Central or East European country."(Bandelj 2002: 423) According to the model built by Bandelj, the most significant factor that affected FDI decisions seems to be the political stability which is also related to the political alliances a state is in. What is even more interesting is the argument that institutional arrangements such as EU do not directly affect FDI in the case of Central and East European countries.

> Both BITs and EU agreements are official rules, or formal contracts. They regulate what is often a very context-specific practice of foreign direct investment, where formal provisions between the members of a country dyad are overridden by informal considerations, such as cultural knowledge, political connections between hosts and investors, or the presence of personal and business networks that facilitate information flows and promote certain investment opportunities over others.(Bandelj 2002:433)

In the conclusion the author deduces that even if the research is region specific, it can be argued in general framework of economic globalization these political ties may give flexibility and a range of options to choose between different FDI patterns; so that the hosts also have quite visible influences in the global market.

We can argue that the institutional framework offered by the organization of the European Union may not have a direct effect on FDI but still it affects enormously in terms of increasing credibility of a certain host country and helps to build political and economic networks within the EU which helps the state to construct the most crucial ground for FDI. This aspect was argued by Bandelj as a factor of political alliances and cultural resemblance. She uses this argument to refute the impact of EU when she looks at the economic parameters but I believe it can be used on the contrary. It is possible to argue that EU by offering the networks and political alliances affect FDI as we can see from the example of Romania. By arguing that I do not disregard the economic reform aspect such a prospect includes like Bandelj doe but I try to combine it with the political aspect as I have already discussed in the previous chapter. A case in point is the difference between the Balkans and Central Europe. Due to their political alliances the instability during the transition period of the Central European countries were overlooked and in time decreased significantly as a result of the integration to EU. Balkans on the other hand due to their lower perspective of membership and high level of political instability remained to attract lower

FDI compared to their potential.(Kutan,Yiğit and Brada: 2006) In this respect, I would like to make a closer analysis of these transition economies by taking the example of Romania.

4.1. Romania

I decided to take Romania as an example of a transition economy with prospects of EU membership. FDI here is seen as a key tool operates to transform state socialism into free market democracy. Therefore, it was crucial for integration to the global economy. According to many experts FDI was a main macroeconomic variable that affected key indicators such as employment rates and balance of payments together with the know-how to restructure the state owned economic enterprises. When we look at the general picture of FDI in Central and Eastern Europe we definitely see lots of significant variations. These variations will be helpful to analyze Turkey as a case for FDI.

Romania became a European Union member in 1 January 2007 together with Bulgaria after the application process to EU membership following Poland and Hungary. The accession date was set at the Thessaloniki Summit in 2003 and confirmed in Brussels in 2004. 1990s were not very bright for Romania since she was suffering from political instability and also suffered taxes from the US between 1988 and 1994. However, it seems that Romania has recently enjoyed a boom economy with 6-7% rates of growth per year and becoming a major center for FDI in Central and Eastern Europe as a result of the accession process. In 1995, Romania became an Associated State of the EU and in the immediate aftermath till the point of full membership we see an upward swing in FDI flows.

FDI inflows to the top 10 recipient countries in Central and Eastern Europe, 1996 and 1997 (in millions of U.S. dollars) Country	1996	1997
All Central and Eastern Europe total	13 074	19 114
Russian Federation	2 452	6 241
Poland	4 498	5 000
Hungary	1 982	2 085
Czech Republic	1 428	1 301
Romania	265	1 224
Ukraine	521	623
Bulgaria	109	497
Latvia	382	418
Lithuania	152	355
Croatia	533	348

Table 6: FDI inflows to the top 10 recipient countries in CEE in 1996-1997

Source: UNCTAD Press Release - 11 November 1998

As can be seen from the table it is possible to make a rough differentiation between first movers and late comers to liberalization reforms in the region. In this picture Romania stands some where in the middle. Poland, Hungary and Czech Republic are not only well advanced in liberalization reforms and attracting FDI but compared to Romania they managed to enter EU at an earlier date which brought them a significant advantage. Geographically speaking this distinction reflects itself between Central and Southeastern European countries. Of course one cannot ignore the impact of war and ethnic conflict in Southeastern Europe which affected countries such as Romania even if they did not participated in these conflicts.

If we take another criterion for comparison, the data provided by World Investment Report on potential and performance FDI indexes of countries could be very helpful. I will take the year 2004 as a year of comparison since Romania started accession talks in February 2000, we will be able to see the effects of EU candidacy on more solid grounds.

2004	Inward FDI Performance Index Ranking	Inward FDI Potential Index Ranking
Turkey	115	68
Romania	35	81*

Table 7: FDI ranking, Romania and Turkey Comparison

*This ranking is based on 2003 estimates, the lower the number the better in ranking

Source: UNCTAD World Investment Report 2005

Based on the table above, we can safely conclude that reforms undertaken by Romania for accession to European Union together with the progress in accession talks (even if there were some political ups and downs in the process) contributed to Romania's performance which exceeds her potential by far.

4.2. Argentina

Argentina provides an interesting case study since being labeled as a promising emerging market it, has been seen in the top 10 of emerging markets by various economic authorities in terms of FDI attraction and expected growth rates. From this perspective it is comparable to Turkey in terms of market size and discourses of "big potential." According to the statistics based on the year 2004 there is an interesting chart that ranks countries according to FDI potentials. In this chart we see Turkey just following Argentina, latter being 67 and former 68 in Inward FDI Potential Index. (UNCTAD 2006a) However, when we look at the actual statistics we see a huge discrepancy in terms of realization of this potential and fall far behind in actual FDI.

Consequently, the main focus of this section would be to see what Argentina achieved outside the influence of European Union as a developing country. I have chosen Argentina as an example comparable in market size and structural problems both of the economies face. In the following decades of 1980s Turkey and Argentina followed more or less similar paths of crisis and high inflationary environments. Both of the countries were presented as virgin grounds with potential yet unstable, both were under the guidance of IMF and had to sign stand-by programs to normalize their economies. All of these economic factors also triggered political problems yet there remain also differences. One of such difference was the social outburst which was lacking in Turkey after the big crises of 2000 and 2001. More importantly, what Turkey have in addition was the presence of EU as an important political anchor that helped to stabilize the political environment which had essential effects for the economy as well. One can argue that the US could have performed such an anchor role but the relations between the US and Argentina does not allow such a position and the US does not provide the same ground for commitment as EU provides for Turkey.

In the beginning of the 1980s Argentina was seen as an interesting country with a huge amount of debt while being a successfully growing economy. This Latin American developing state, just like Turkey, shared a period of economic liberalization led by military regimes after the failure of Import substitution Industrialization. 1970s was a period of ISI and political polarization of the society. Under the military rule between 1976 and 1983 Argentina started to follow liberal economic policies which resemble the period that started with the October 24th decisions of liberalization in Turkey. In this period the intervention of the state to the economy started to decrease considerably in Argentina. (Pillonel 2002: 53-57)

However, early 1980s was a period of disillusionment with a huge foreign debt and a stagnating economy. (Stiles 1987: 57) Political instability started to increase and finally military regime came to an end with the end of the Falkland War with Britain. What followed 1983 in Argentina was a struggle towards democratization and liberalization. All these efforts meant transformation of the state structure as well as the socio-economic structure. Therefore, on the political front, the path followed by both Turkey and Argentina seem to overlap. Argentina of late 1990s was dominated by political instability and yet when we came to the year 2001 the world was surprised to see such a major socio-economic crisis in Argentina. Argentina just like Turkey at the time was under IMF projection and the authorities were trying to implement strict fiscal policies. However, these measures were not enough and economic crisis hit Argentina hard. Economic crisis turned into social and political crisis resulting in riots in the streets. Since Turkey was also suffering from crisis environment, news in Turkish media also compared the case of Argentina with Turkey at the time with a motto of "Turkey will not be Argentina"

Based on the World Investment Report 2007 the share of FDI in Argentinean economy is more than 25% when compared to total GDP in the years 2005 and 2006.(UNCTAD 2007) These numbers are more than twice the case in Turkey. World Investment Report again shows Turkey as a country that has a long way to go in terms of FDI's share in the economy. The percentage of FDI compared to GDP remains at the level of 11.6 in the year 2005. (UNCTAD 2006b) We already know that Argentina has been a country that has faced a far serious economic and social crisis at the year 2002; nevertheless its FDI inflow level is far more than Turkey. Although Argentina is more or less following the average of FDI attraction in the league of developing countries whereas Turkey ranking far under than the average, it is still a good case for comparison. (UNCTAD 2007)

Country	FDI stocks as a percentage of GDP for 2005
Argentina	29,7
Turkey	11,6
Average of Developing Countries	27,0

Table 8: FDI stocks as a percentage of GDP in 2005

Source: World Investment Report 2006. UNCTAD, *World Investment Report 2007*; www.unctad.org/wir or www.unctad.org/fdistatistics.

From another perspective things look rather negative for Argentina. Starting with late 1990s Argentina entered a period of recession and the beginning of the 21st century hit Argentina hard. Economic crisis let to social crisis and huge displacement and protests among the workers. Years of 2001 and 2002 were marked by turmoil in the society and Argentinean politics. President Fernando de la Rua resigned on 20 December 2001, following amid violent street protests in which 25 people were killed. The subsequent political instability led to four presidents succeeding him in only 10 days. Soon bank accounts were frozen and the currency - the peso - was devalued, ending a decade-long fixed link with the US dollar. In this period one of the biggest investors to Argentina, USA cut its investments and things started to normalize only starting with 2003. (Enders et.al. 2006:520)

In 2002, Argentina defaulted on an $800m debt repayment to the World Bank, having failed to re-secure IMF aid and the World Bank threatened to not to give further loans to Argentina. All these developments resulted in unstable and changing coalition governments in the political realm. Only towards the end of 2003 Argentina managed to strike a deal with IMF. Together with strict economic policies by the year 2006, Argentina repaid its multi-billion-dollar debt to the IMF.

This picture of positive trends was due to the economic management, demand from the international markets and the peso's cheapness. What are even more important are the indicators of foreign direct investment. When the crisis of 2001 in both Turkey and Argentina were compared from the perspective of international investors Turkey proved to be a much more reliable country with the support of IMF and European Union. However despite huge negative growth, economic indicators started to be more positive and together with the relative stability in the country FDI takes off once more. Of course, Argentina has a long way to go before she realizes her "potential." According to the data of 2006, Turkey manages to attract four times more FDI, Turkey attracting 20.1 billion dollars worth of FDI while Argentina remains at 4.8. (UNCTAD 2008)

What is interesting here in the situation of Argentina is that after such a collapse it again starts to attract investment. In this respect, stability, economic reform and incentives granted by the hosting government once again proves themselves as important variables to attract FDI as can be seen from the case of Argentina.

4.3. Compare and Contrast

Inward FDI Performance Index 2004-2006	TURKEY	ROMANIA	ARGENTINA
RANK	73	21	83

Table 9: Inward FDI Performance Index 2004-2006

Source: United Nations Conference on Trade and Development (UNCTAD) data

Table 9 can provide us a good starting point to discuss three of the countries together: Turkey, Romania and Argentina. Coming from different regions and backgrounds they offer quite different examples to determine the effects of country specific characteristics and relations with international actors. As I have mentioned before I have taken Romania and Argentina as examples from Central European and Latin American regions since they are comparable to Turkey in size, potential and political economic relations.

As can be seen from the above table Romania stands as a success story mainly due to accession to European Union and reforms made for integration. Argentina stands as a country that tries to get rid of the negative effects of 2001 crisis which was particularly harsh due to mismanagement and absence of a stabilizing anchor. Turkey on the other hand seems to be standing somewhere in between, still trying to realize her potential.

Turkey is in an advantageous position compared to Argentina since she managed to deal with the crisis better. It is also undertaking major steps to reform the economy after having the bitter lessons of economic crisis. Starting with the year of 2003 Turkey has been spending more effort with more emphasis on FDI and together with the relatively more stable environment and start of the accession talks for EU membership, foreign direct investment is following a positive trend. Still when we compare the share of FDI in the overall GDP ratio, it is less than half of developing countries together with Argentina.

Romania on the hand is smaller if the size of the economy is concerned when compared to Turkey. However, it provides a recent example of impact of EU on the economy in general and FDI in particular. Romania has a far different background as a transition economy but it can be said that even if Turkey had early advantage in liberalization and democratization, Romania seems to have surpassed Turkey in these matters. This has a direct effect on

FDI as a result of accession to European Union and getting a place in the European network of FDI.

All in all, three of the cases point out to the fact that structure of the economy, privatization and liberalization, stability and international networks matter considerably when we discuss general trends of FDI inflows.

CHAPTER V

CONCLUSION

In this thesis I have discussed different components of foreign direct investment inflows from the perspective of hosting countries. I argued that political factors, among them especially the issue of stability, becomes a primary factor to attract FDI after a certain level of economic structuring is reached as has been the case with Turkey in recent years. EU membership is an important case that needs to be discussed not only from the perspective of economic reforms but also its anchor role in political stability. I also argued that the ambiguity in the negotiation talks is a serious disadvantage and if this ambiguity is lengthened, the process of negotiation can become a disadvantage for Turkey. To reach this conclusion I drew a general picture of FDI before discussing specific concerns about Turkey and then provided a comparison to highlight the role of the EU.

Since foreign direct investment has been accepted as an important tool for the development of economies, it has taken particular attention by governments and there has been a huge competition to attract FDI. In this respect due to the political and economic structures of countries, there are certain advantages that reflect themselves as potentials of countries. Turkey in this respect is one of the countries that are discussed in terms of her potential and failure to realize this potential. I have tried in the previous three chapters to discuss what can be the factors behind such a failure. To be able to analyze the roots of this failure, I combined political and economic factors and discussed drawbacks and improvements after 1999. In this process I paid particular attention to the European Union both as an actor and as an anchor in Turkey's history of FDI.

Among problems of Turkey concerning the low levels of foreign direct investment inflows we can count chronic high inflation, increasing economic instability, inward orientation until 1980, lack of privatization, failure to create incentives for investors, bureaucratic impediments, political instability and the fear of foreign domination of economy.

Turkey experienced in the last five years a wave of privatization which had a considerable affect on FDI for two reasons. Firstly, it was an indicator of commitment to liberalization. Secondly and more importantly as can be seen in the FDI figures of 2004 and 2005 considerable amount of FDI Turkey attracted in these years are mainly led by privatization.

June 2003 is a breaking point in the history of FDI in Turkey. On 17 June 2003, a new law, "Foreign Direct Investment Law", was passed which abolished the necessity to have a permission to make FDI and turned into a system of disclosure. This new law that eases the bureaucratic operations, and assists to the creation of a more FDI-friendly environment, contributed to the increase in FDI inflow. Obstacle of legal instability can be said to overcome with this law, the structural reforms as a result of stand-by agreements and reforms to fulfill EU criteria.

In fact reforms made to fulfill EU criteria were only one among many influences of EU on FDI inflows. European countries have a tendency to channel FDI within the borders of EU. Consequently EU membership is an important advantage for attracting FDI from EU countries. Signals of this advantage when coupled with the geographical position of Turkey showed itself in statistics of FDI in Turkey.

Furthermore, prospective EU membership has been considered as an important political and economic anchor at times of crisis as can be seen in the comparison between Argentina and Turkey concerning the crisis in 2001. However, this is a mixed blessing. Membership talks have started and they proceed in a fluctuating pace. Due to political uncertainty on the part of the EU members about Turkish membership, the situation continues to be ambiguous and this ambiguity is likely to be transformed into a disadvantage in time. As I have mentioned in the previous chapter three of the cases-Turkey, Romania and Argentina- point out to the fact that structure of the economy, privatization and liberalization, stability and international networks matter noticeably when we discuss general trends of FDI inflows.

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