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TURKEY'S NEW OPEN-DOOR POLICY OF DIRECT FOREIGN INVESTMENT: A CRITICAL ANALYSIS OF PROBLEMS AND PROSPECTS

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1) INTRODUCTION

In Erdilek (1982), I investigated the reasons for (1) the relatively limited role direct foreign investment (DFI) played in the development of Turkish manufacturing as a source of external resources, and (2) the meagerness of even the proportional net benefits that Turkey derived from the DFI that did take part in its manufacturing development during 1950-1980.

In this paper, I turn my attention to the new open-door DFI policy which went into effect with the 24 January 1980 economic stabilization and liberalization program and which gained renewed emphasis after the Motherland Party (MP) came to power in December 1983. I examine critically the problems and prospects of this new DFI policy in light of the experiences of both Turkey and other developing host-countries. In particular, I focus on the actual and potential linkages between the new open-door DFI policy and the evolving open-economy policies, aimed at integrating the Turkish economy with the world economy.

2) THE DFI ENVIRONMENT BEFORE JANUARY 1980

During 1950-1980, as had also been the case during much of 1930-1950, Turkey's basic strategy of development was to industrialize by replacing imported goods with their domestically produced substitu-

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tes. This import-substitution strategy, although initially selective and efficient, became progressively haphazard and inefficient. The Turkish economy instead of integrating itself with the world economy on the basis of international division of labor and mutually beneficial trade, chose to largely isolate itself from the forces of international competition. As a closed economy, it strived toward greater self-sufficiency at increasing economic, political, and social costs. The role of markets largely disappeared; state intervention and bureaucratic meddling in the economy became extreme; and, most Turks lost their basic economic freedoms to engage in both privately and socially beneficial transactions. The Turkish economy came to resemble a self-shackled giant, an economy of great potential that retarded its own development by insisting to reach an elusive autarky.

Paradoxically, but not surprisingly, instead of becoming less dependent on the world economy, the Turkish economy become more and one-sidedly dependent. Rather than developing its export potential by recognizing and coming to terms with global competitive conditions, it became addicted to foreign credits which were used to finance many inefficient domestic industries. Twice in two decades, in 1958 and 1978, the Turkish economy fell into international insolvency. It simply could not service its rising foreign debts out of stagnant export earnings.

Until 1980, under these policies, the Turkish economy failed to attract significant DFI. Much of the DFI that came in was domestic-market-oriented, in other words, concentrated in the import-substitution industries. It did not contribute significantly to the development and growth of Turkish exports. The foreign investors should not have been blamed for this unsatisfactory outcome. They had merely followed the wrong signals given to them by Turkey's self-defeating economic policies. But they were frequently blamed, especially for not exporting. Consequently, many of them found doing business in and with Turkey less and less rewarding, especially after the mid-1970s. Turkey acquired an unenviable reputation as one of the riskiest host-countries in the world for foreign investors (Erdilek 1985a and 1985b). It did not matter that Turkey had one of the most liberal foreign investment laws in the world; that it had become an associate member of the European Economic Community (EEC) and aspired to full membership; that it had never unlawfully confiscated any assets belonging to foreigners; and that it had never defaulted on any of its foreign debts. The real nemeses of foreign investors in Turkey were **statism** and the **bureaucracy.**

3) THE DFI ENVIRONMENT AFTER JANUARY 1980

In January 1980, Turkey took the first step toward making a clean break with its economic past. It instituted a comprehensive economic stabilization and liberalization program, which was the brainchild of Turgut Özal. This program successfully revived Turkey's stagnant economy, brought inflation under control, and restored the country's international creditworthiness. These were its initial achievements under the economic leadership of Özal until July 1982. During the 18 months after July 1982, Özal, who resigned from his post as Deputy Prime Minister, was not in charge of the Turkish economy. Those who were in charge failed to implement the January 1980 program effectively although it did remain the official basis of all economic policies (OECD, 1984).

Let me now review briefly the recent legal and political reforms in terms of their favorable effects on Turkey's investment environment. Turkey was ruled by the military between September 1980 and December 1983. The military regime saved the country from the brink of civil war. It enabled Özal to carry out the January 1980 economic program more forcefully than he could before September 1980. It prepared the country for a secure return, after the present transitional period, to democracy. Unlike military regimes elsewhere, it kept its word to voluntarily relinquish power back to civilians. Its leader, General Kenan Evren was elected the Republic's president by an overwhelming majority of Turkish voters in November 1982. Evren, now a civilian, will serve as president, with broad powers under the new constitution, until 1989.

Under the military regime, major legal reforms were achieved. A new constitution was drafted and submitted to a popular referendum in 1982. It was approved by 91 per cent of the voters. The 1982 Constitution is primarily aimed at preventing the recurrence of political polarization and weak governments. It is supported in this aim by the new laws, also enacted under the military regime, regulating political parties and elections. In short, much of Turkey's legal and institutional infrastructure was overhauled in order to achieve lasting political stability. Foreign investors could thus count on a strong government to act decisively and expeditiously on their proposals. This had not been the case during the 1970s.

Other legal reforms accomplished under the military regime include new legislation governing the activities of labor unions and labor-management relations. The new laws provide a disciplined framework for collective bargaining, strikes, and lock-outs. Therefore, foreign investors could be assured of sane and stable relations with labor, under the watchful eye of a strong government determined to protect the public interest.

In understanding Turkey's strategic decision to move from a closed economy to an open economy, the present Prime Minister Turgut Özal's background and experiences tell us a great deal. He is himself a former bureaucrat who has gone through a remarkable transformation. He seems to have become, after working for many years in both public and private sector jobs, convinced about the futility and even perversity of excessive government intervention in the economy. There must be millions of other Turks besides Özal who have reached the same conclusion on the basis of their own personal experiences and observations. Otherwise, Özal and his Motherland Party (MP) could not have easily won the parliamentary elections in November 1983 after campaigning on a free-enterprise platform.

The MP was founded less than a year before coming to power, under Özal's leadership, by a group of successful bankers, industrialists, and engineers, with an average age of 37. Ten of the 22 ministers in the Özal cabinet are former businessmen trained as engineers. Today's Turkey is led by a new generation of business-minded politicians who have experience as managers in the private sector.

Let me now focus on the economic reforms, beginning with the January 1980 program. Under that program, Law 6224 (for the Encouragement of Foreign Investment) remained as the basic legal framework for foreign investors. Several decrees were enacted, however, in order to clarify some of the vague legal provisions of Law 6224. These decrees also contained the various institutional changes that were aimed at increasing the effectiveness of Law 6224 in its implementation. In essence, Özal wished to attract foreign investors by telling them exactly and explicitly where and how they could do business in Turkey and by getting the bureaucracy off their backs.

The Framework Decree on Foreign Investment (Decree No. 8/168) was put into effect in January 1980. It is still in effect after several revisions, most significantly under Decree No. 28 (on the Protection of the Value of Turkish Currency) in December 1983 and the Commu-nique No. 84/1 (on Foreign Capital Movements, clarifying Decree No. 28) in April 1984. It spelled out in detail Turkey's new foreign investment policy in terms of the sector-specific rights and responsibi-lities of foreign investors. A newly created Foreign Investment Depart-ment, within the State Planning Organization, acquired the consoli-dated authority (which had been previously split among several dif-ferent government agencies) to administer, with minimum red-tape, Turkey's relations with foreign investors. This new department was staffed with Özal's close associates, young, global-minded, engineering and business school graduates with private-sector experiences. Its first head was Hüsnü Doğan, Özal's close relative and long-time fri-end, who is now the Minister of Agriculture in the Özal cabinet.

During my several visits to Turkey between 1980 and 1984, I had the chance to talk at length with the officials of the Foreign Invest-ment Department. I was favorably impressed by their enlightened and pragmatic attitudes toward foreign investors. Interviews with several foreign business executives and foreign embassy officials in Turkey confirmed my favorable impressions. Published statements of many observers of the Turkish DFI scene were likewise positive (YASED, 1983b). The statistics on new foreign investment activities also provi-ded objective evidence. The January 1980 economic stabilization and liberalization program of Özal stopped and reversed the exodus of foreign investors from Turkey.

Despite my various criticisms of the several inconsistencies and inadequacies of the legislative changes in Turkey's DFI policy since January 1980, I should emphasize that there has been a remarkable and progressively favorable liberalization in almost all areas of con-cern to foreign investors. Since my analysis of the Framework Decree (together with law 6224) is contained in Erdilek (1982: 11-17 and 240-250), I confine my attention here to the major revisions since De-cember 1983. Most importantly, (1) all commercial and services sectors have been opened to DFI, (2) foreign **portfolio** equity investment in Turkish firms has been made easier, (3) purchases of foreign tech-nology have been accorded more flexible treatment, and (4) the emp-loyment of foreign personnel by DFI firms has been put under fewer restrictions.

To summarize, the ultimate aim of the January 1980 program was to restructure and rationalize the Turkish economy by subjecting it to market forces and foreign competition. Its long-term commitment was to reducing the role of government in economic activity, providing strong incentives to exporters, and integrating Turkey's economy with the world economy. DFI was assigned a major role in its outward-orientation. After Özal and his MP came to power in December 1983, these long-term objectives seemed to acquire renewed force and immediacy. The Özal government put into effect a set of sweeping measures which it described as only the first steps toward the westernization of Turkey's economy. They appeared to be the most far-reaching economic reforms in the Turkish Republic's entire six-decade history.

4) PROSPECTS FOR TURKEY AND FOREIGN INVESTORS

As a country of almost 50 million people today, expected to reach about 70 million by the year 2000, Turkey has a huge domestic market potential. It is a newly industrializing country (NIC) with a per capita income close to $ 1,000. Its people have diversified demands. They are eager to satisfy those demands by working hard and earning the required incomes. Therefore, in almost any sector foreign investors will find a ready domestic market.

They would be well-advised, however, not to invest in Turkey unless they can also profitably and significantly contribute either directly or indirectly to Turkish exports. The days of producing for only the captive domestic market, behind prohibitive import restrictions, appear to be over. Instead of investing, they should export to Turkey or license technology to Turkish firms, if their only interest is in the domestic market. Turkey seems determined to become a major trading nation during the 1980s. It wants to double (as it did during 1979-1982), even triple its exports so that it can import more and also service its outstanding foreign debts.

Foreign investors should consider Turkey as a potential major export-base for either their own products or the domestic industrial users of their products. Turkey is ideally suited for that role for the following reasons:

(1) Turkey has a superb geographical location at the joining of Europe and Asia. It is an associate member of the

EEC, determined to become a full member. It is the only member of NATO and the OECD which is also a member of the Islamic Nations Conference. In fact, it chairs the Economic and Commercial Cooperation Committee of the Islamic Nations Conference. It has excellent ties with all the Arab countries. It is a member of the Regional Cooperation for Development, a trade pact with Iran and Pakistan. It is politically the most stable country in the Near and the Middle East, with increasingly close commercial ties with all its eastern and southern neighbors.

(2) Turkey, although only about the size of Texas, is blessed with far more diversified climatic conditions and natural resources. Cultivation of a very wide range of crops is possible. Many important mineral resources, including significant deposits of coal and oil, are available. It is an unspoiled tourists paradise, with breath-taking natural beauty and wonderful historical monuments left behind by many different civilizations that had flourished in Anatolia during the last 5000 or more years.

(3) But more important than any of these assets, Turkey has rich human resources. It can offer foreign investors first of all, a large pool of relatively inexpensive, hard-working, and disciplined labor force. Furthermore, it can supply them its own skilled and educated manpower of technicians, engineers, and managers who are the equals of their counterparts in many industrialized countries, but can be hired for much less.

(4) To all these advantages can now be added Turkey's newly established (but not yet fully operational) free-trade-zones that will offer foreign investors tax exemptions and more liberal currency regulations. They were approved in 1982 in order to strengthen Turkey's unique role as the commercial link between the West and the Middle East, especially through export-oriented DFI. The government has already designated two of them, in Antalya and Mersin, both southern port cities, with excellent connections to the Middle East. Three more zones are expected to be designated in the near future.

It is now generally accepted that **agro-industry** in Turkey has the least developed but greatest potential for foreign investors (Agricultural Bank of the Republic of Turkey, 1983). The Framework Decree on Foreign Investment lists the following fields in which foreign investment is encouraged:

— Production of seeds
— All kinds of animal breeding
— Production of fodder plants
— Projects for integrated animal husbandry
— Production of fresh fruits and vegetables for export
— Other investments to accomplish a technological development in agriculture.
— All food industry investments (with 30 percent export requirement)

Turkey's great agricultural potential is to be found in the solutions to the following problems:

1– Low ratios of yields per hectare
2– Small sizes of individual farming enterprises
3– High rates of fallow areas

For higher ratios of yields per hectare, Turkish agriculture needs:

— More and better irrigation
— More chemical fertilizers
— More mechanization
— Better seed selection
— Better pest control

In Turkey, the limits of arable land have been reached. Therefore, output has to be increased by using more productive technologies. Turkey is now committed to building new dams like the Atatürk dam (the largest in Europe) to provide ample irrigation which can easily triple Turkish agricultural output. (Of course, the dams will also help meet the needs of industry for electricity). Although the global ratio of irrigated land to arable land is 14 per cent, in Turkey the ratio is only 7 per cent presently. Moreover, in Turkey almost one-third of arable land is left fallow, which is too high a ratio.

Over 50 per cent of Turkish agriculture is devoted to production of wheat, barley, rye, oats, corn, etc. The share of grains in daily calories for nutrition is about 70 per cent, 45 per cent of which is derived from bread alone. There is a great potential for animal-based protein consumption in Turkey as well as in the Middle East.

Only about 10 per cent of the raw agricultural products are used as inputs by the food processing industry. (This ratio is 50 per cent higher in countries with well developed food industries). Also, the share of the food industry in total Turkish exports is only 8 per cent, although the share of agro-industry (including industrial products based on agricultural inputs) is about 50 per cent.

Food processing may well be now the fastest developing industry of the country. It may soon replace textiles and apparel as the single largest exporting sector. Frozen foods in Turkey are still in their early infancy since the country lacks the technology as well as the required high per capita income for their development and growth.

In October 1982, a joint U.S. Department of Agriculture-OPIC mission including 27 executives from 22 U.S. firms, visited Turkey to explore the country's potential for foreign investors in agriculture. They found approximately 400 projects waiting for foreign partners. As a result of this mission 15 U.S. firms announced their intention to explore 24 agriculture-related investment projects (OPIC, 1983). The agro-industry potential in Turkey is now fully appreciated by both the country's economic decision-makers and the prospective foreign investors.

It is significant that Özal's Minister of Agriculture is Hüsnü Doğan, the former director of the Foreign Investment Department who established that department and successfully implemented, during 1980–1983, the initial phase of Turkey's open-door investment policy. Among his main objectives is the promotion of DFI in Turkish agriculture.

Next to agro-industry, **tourism** is noteworthy as the sector with great potential for DFI. The Framework Decree on Foreign Investment accords certain exceptional advantages to investments in tourism that are not available in other sectors. One of them is that the foreign ownership can be 100 per cent without any involved negotiations with the Turkish government.

Turkey's western and southern shorelines are among the least developed in the Mediterranean region. They are studded with historical remains from the Greco-Roman and Ottoman periods. The northern Black Sea coast, of great natural beauty, is also underdeveloped. The interior of the country offers an impressive collection of lakes, mountains, historical towns and other scenic attractions of wide appeal.

With all these enviable assets, Turkey attracts only about 1.5 million tourists a year with a gross receipt of only about \$400 million. Spain, on the other hand, attracts about 40 million tourists a year who spend close to \$10 **billion**. Yet, Turkey has much more to offer to tourists, but lacks the capacity to host them. Turkey needs many more hotels to increase its bed capacity, not just luxury hotels, but also budget hotels with western standards, to appeal to middle-class tourists.

In 1982, Turkey enacted a new tourism promotion law (Law No. 2634 for the Encouragement of Tourism Investments). Land and credit allocations to tourism ventures have been liberalized. Many regulations have been streamlined and simplified. Turkey's present Tourism Development Plan hopes to create 10 thousand new beds a year over the next 5 years, surpassing a total capacity of 100 thousand beds. Presently, Turkey accounts for only about 4 per cent of both the global number of tourists and the global tourism revenues. In cooperation with foreign investors, Turkey can easily double that ratio during the next decade.

Petroleum industry, especially crude oil exploration and production, deserves attention next. Turkey is situated in the "oil belt" of the world. Its land is virtually unexplored. Turkey has had only about 100 drillings a year recently, whereas in Texas there are every year close to 30 thousand drillings. Admittedly, exploring and finding oil in Turkey is no easy task since it is, geologically speaking, a very battered, complex land. There is a need to drill down to 3 thousand feet or more. For that, the most advanced technology is needed.

Today, Turkey is able to produce only 2.5 million tons of its total crude oil consumption of 16 million tons a year. This means about one half of its total import payments have to be allocated to oil. Turkey is determined to speed up its domestic production. With proven crude reserves of 65 million tons and potential reserves of 750 million tons, Turkey enacted a new petroleum law in 1983 (Law No. 2808 on Petroleum Operations) to exploit those reserves more effectively. This law has increased and broadened the incentives for foreign oil firms to invest in Turkey (TPAO, 1983).

In addition to petroleum, Turkey has a considerable and diverse mineral base. Until 1980, DFI in mining was either discouraged or banned. Since January 1980, the mining sector has been open to DFI. Especially chromite, copper, magnesite, and coal can benefit from DFI (Etibank, 1983).

Another very promising industry for Turkey and foreign investors is **electronics** .According to the Framework Decree, foreign investors are encouraged to consider all possible projects either on their own or in joint ventures with TESTAŞ, the state electronics corporation. Passive components such as resistors and capacitors are already manufactured locally. There is good potential in manufacturing active components such as transistors and integrated circuits. Computer assembly operations, especially in the forthcoming free trade zones, appear quite attractive. Within a decade, Turkey may well have its own microcircuitry and computer industries. That may help the further development of its telecommunications industries, especially in terms of digital technologies.

As for **electrical machinery and appliances**, there is already significant domestic production, especially in white goods, audio-visual products, and the consumer durables. But this industry has been a heavily protected and primarily assembly-type operation. It is now begining to face import competition. It will have to modernize and rationalize itself like all other branches of Turkish manufacturing.

There appear to be a better potential in **industrial machinery** and **machine tools**. Machinery for construction, mining, textile productions, and food processing may be worth considering.

As for **textiles and apparel**, which have been Turkey's single largest foreign exchange earning manufacturing sector since the late 1960s, there is still potential for Turkey and foreign investors, especially if Turkish exports to the heavily protected U.S. market can be increased. The Framework Decree requires that foreign investors export at least 50 per cent of their output of these products. Even without this export requirement, however, the domestic market potential for new producers would not be very significant. Synthetic-fiber-based textiles appear much more promising than natural (cotton) fiber-based textiles. The free trade zones, when fully developed, could be a boon for apparel producers who supply the U.S. market with designer-label clothes.

Finally, let me touch upon the **transportation equipment** industry which has been, since the mid-1960s, Turkey's most important import-substitution sector, especially in terms of its **automotive products**. They include passenger cars, buses, and trucks. Like the electrical machinery and appliances industry, this sector is faced with serious cost and quality problems. There are too many producers, too many product varieties for the domestic market alone. To achieve international competitiveness, the industry will have to modernize, rationalize itself, and reach a reasonable scale of operation on an individual product basis, especially for components as opposed to final products. Production of buses, a relatively labor-intensive operation, which has also been relatively most successful in exporting among automotive products, appears most promising. As I have argued in Erdilek (1982, 96-100), this industry's international competitiveness can not be secured without the **full** 'integration of the Turkish subsidiaries' operations into their parents global production and marketing networks.

5. PROBLEMS FOR TURKEY AND FOREIGN INVESTORS

As noted earlier, since becoming Prime Minister in December 1983, Mr. Ozal has tried to revive and widen the scope of his January 1980 economic stabilization and liberalization program. He has brought about some potentially significant legal and administrative changes in order to open the Turkish economy to foreign competition. He has begun to streamline the inefficient State Economic Enterpises (SEEs) and to expose them to market forces. Much of this, however, has predictably engendered strong opposition from vested interests in both private sector and the bureaucracy. Along with that opposition, Mr. Özal has encountered widespread and deepening popular dissatisfaction due to still high inflation, rising unemployment, and declining real wages and salaries.

Faced with strong opposition and still politically insecure, Mr. Özal has not yet acted decisively and effectively in liberalizing the economy despite his government's frequent rhetoric of free enterprise and competition. For example, Mr. Özal has repeatedly revised, beginning with Decree No. 28 in December 1983,but not repealed the half-century-old Law 1567 (for the Protection of the Value of Turkish Currency) governing Turkey's international economic transactions that has kept the Turkish lira inconvertible, allowing the bureaucracy to run the country's foreign exchange and trade business from Ankara. Also, interest rates are still not freely determined by market forces.

In fact, Mr. Özal has paradoxically **increased** the centralization of all economic decision-making in his government, after repeated administrative reorganizations, based on well-intentioned but ill-conceived plans to cut red-tape. The creation of a new office, the Undersecretariat of the Treasury and Foreign Trade, in the Prime Ministry, by Decree No. 28, has led to a long series of seemingly arbitrary and discriminatory decisions that might have adversely affected the country's balance of payments. This office has become the symbol of the Özal government's futile attempt to manage the national economy single-handedly, as if it were a centrally planned one, in contradiction of Mr. Özal's public commitment to free-market principles.

Private business leaders, except those whom the government favors in its specific decisions, complain that the IMF-sanctioned stabilization program, implemented with varying forcefulness since 1980, seems to be getting nowhere. They press the government to stimulate domestic demand to relieve their excess capacity and overdue-debt problems. The government, however, urges them to seek foreign markets and foreign credits instead. Exports, which the government has thus far emphasized over domestic demand to spur output, are now also begining to slow down, after increasing at an annual rate of about 30 per cent during the first 9 months of 1984. This is due to the reduction in generous export-subsidies, the lower demand in the Middle Eastern markets, and the tougher import restrictions in the United States and Western Europe. Private short-term foreign indebtedness is on the rise again after Turkey's **de facto** international bankruptcy in 1978, causing concern about the country's ability to solidify its regained creditworthiness. In 1985, Turkey's debt servicing burden will increase substantially as the grace period gained under the 1980 debt restructuring and consolidation agreement with its creditors comes to an end. Furthermore, the government's attempts to hold back rises in nominal wages through restrictions on collective bargaining are meeting stiff resistance from labor unions as real wages continue their four-year old decline of almost 50 per cent.

The 1985 expansionary budget, which, like the 1984 budget, is certain to result in a huge deficit that can not be financed entirely by public borrowing, will force the government to rely further on the Central Bank's money-creation prowess. This will make it very difficult to bring inflation much below its 1984 rate of at least 50 per cent. The government projection of 45 per cent increase in 1985 public revenues, based on the value-added tax scheduled to go into effect in January 1985, is too optimistic. Spending should be cut to match revenues. There is no other way to bring inflation down. Unless Turkey reduces its inflation to a single-digit rate, it will not be regarded as a financially stable host country by foreign investors.

The newly enacted Fifth Five-Year Development Plan (1985-1989) (T.C. Resmi Gazete, 1984) has come under severe criticism from both the left and the right for the modesty of its targets (e.g., 6.3 per cent average annual real growth) and the vagueness of its policy pronouncements. All in all it actually is a sensible document as national development plans go, professing the government's general commitment to economic liberalization, but it lacks specific and timely measures. For example, it states that the Turkish lira's free-market valuation and convertibility will be secured after 1989, but does not provide for concrete steps toward that objective. The Özal government mistakenly regards free-market-based convertibility of the lira as a distant target of liberalization, when it is in fact an urgent and essential tool for integrating the Turkish economy with the world economy. Furthermore, the Plan's feasibility is contingent on availability of foreign credits totalling $16 billion, which may not be easily forthcoming, given the serious contraction in lending to LDC's and NIC's by private international banks.

Import liberalization has been thus far largely confined to either lifting the prohibitive restrictions on luxury imports, such as French perfumes, Scotch whiskey, and German cars, that used to be smuggled in earlier, or allowing occasionally limited quantities of imported foodstuffs, such as meat, cheese, and margarine, in order to put downward pressure on domestic prices. The government often publicly threatens to discipline the high-price local industries with the freer importation of cheaper substitutes, but has actually **increased** the overall protection for many of them by imposing heavy import surcharges. These surcharges go into a new Subvention and Price Stabilization Fund, established by Decree No. 28, and are supposed to subsidize various activities such as housing construction. This fund and its administrator, the Undersecretariat of the Treasury and Foreign Trade may have thus far hindered, not promoted, the liberalizition of Turkey's foreign trade and payments regime. All trade restrictions should be reduced gradually over time according to a publicly announced schedule. They should not be changed upward or downward unexpectedly and repeatedly, as has been the case during 1984. Such sudden and reversible changes create great uncertainty and thus discourage long-term decision-making by investors.

Although several foreign banks, mostly from the United States, have recently established branches in Turkey, other foreign investors still take a wait-and-see attitude. As noted earlier, there is a great deal of foreign-investor interest especially in the agro-industry and tourism sectors, but political uncertainty, coupled with the remaining legal and administrative obstacles, prevent Turkey from attracting much needed foreign capital and technology on a significant scale. However, the presence of foreign banks in Turkey augurs well for future DFI in the non-banking sectors. Foreign banks in the country can not only provide a source of confidence to potential foreign investors but also serve their financing needs once they decide to invest in Turkey. Furthermore, the foreign banks can expedite the establishment of the Turkish lira's convertibility by providing much needed expertise in private foreign exchange market operations.

Clearly, an essential step in increasing the confidence of potential foreign investors would be the further liberalization of the Framework Decree (together with its revisions under Decree No. 28 in 1983 and Communique No. 84/1 in 1984) and its incorporation into Law 6224, as was earlier suggested in YASED (1983c) and OECD (1983). It is a source of concern and puzzlement to many foreign investors why the Turkish government has not yet moved to fully codify its liberal DFI policy after almost five years of implementation. The Özal government, with its comfortable parliamentary majority, should move quickly to take this crucial step, which is explicitly mentioned in the Fifth Five-Year Development Plan among its DFI policies.

As of the end of 1983, there were 185 foreign-investment firms **authorized** to operate under Law 6224. (The earlier corresponding numbers were: 100 in 1980, 127 in 1981, and 170 in 1982). The total **authorized** foreign investment by these 185 firms was $932.3 billion. (The earlier corresponding amounts were: $325.1 million in 1980, $662.6 million in 1981 and $829.6 million in 1982) (YASED, 1984a and TUSIAD, 1984 : 113-114). These figures do clearly indicate a post-January 1980 upsurge of foreign investor interest in Turkey. It should be noted, however, that the bulk of this upsurge was to be financed through the less-than-voluntary conversion of the unguaranteed foreign commercial credits in arrears into DFI capital under

Law 6224. This conversion process has now almost run its course and further increases in even authorized DFI will have to be strictly voluntary. Given the present global slow-down in DFI by developed countries (DC's) in less developed countries (LDC's), which are competing fiercely among themselves to attract DFI, such voluntary increases may prove to be much more difficult to achieve than many people believe in Turkey. Moreover, since 1980 the **actual** new DFI has significantly lagged behind the **authorized** new DFI, as shown by the State Planning Organization data (in $ million) below:

Year	Authorized DFI	Actual DFI	Realization Rate
1980	97	53	0.55
1981	337	60	0.18
1982	167	55	0.33
1983	103	87	0.84
1984 (9 months)	377*	44	0.12
1980–84	1,081	299	0.28

*201 of this total is for a single tourism project proposed by a Syrian investor

According to the Fifth Five-Year Development Plan, Turkey expects to receive the following amounts of DFI (in $ million):

1985	1986	1987	1988	1989	1985–89
135	190	285	300	325	1,235

These projections although ambitious are not beyond reach if Turkey continues to improve its DFI environment along the lines suggested in this paper. In fact, these amounts could well prove to be rather conservative, especially if the **global** economic conditions develop favorably for DFI activity in general.

On the other hand, it might be argued that Turkey has actually lost since 1980 its potential attractiveness for foreign investors because it is no longer willing to guarantee them closed, sellers' markets in which they were able, before 1980, to earn above normal profits. As I argued at length in Erdilek (1982), that type of DFI is what Turkey can and should do without. Instead, Turkey should and can attract DFI that is willing to participate in its export-oriented industries within an open-economy on the basis of global competition.

The global debt crisis of the last few years has marked the end of runaway growth in international lending during the 1970s. Debtridden LDCs are no longer able to borrow significant amounts of capital at even relatively very high real interest rates. Many banks, especially the smaller regional ones, in the DCs no longer participate in any international lending consortia. Commercial bank lending to LDCs and NICs is expected to drop by 50% during the next decade. The resources of the World Bank and the International Monetary Fund can not possibly make up for this major shortfall in commercial bank lending. Consequently, many LDCs and NICs now realize that they have no choice but to rely almost entirely on DFI as their source of foreign capital. Debt-led growth is no longer within their reach.

This means that LDCs and NICs have to make themselves much more attractive host-countries for DFI than they were in the 1970s. Furthermore, they have to compete among themselves, as well as with developed host-countries, for equity capital. This tough competition has already started. Many LDCs and NICs, from the entire range of the political and ideological spectrum, are busily liberalizing their DFI policies and vying for the attention of foreign investors. Financial publications in the major source-countries are frequently featuring many pages of LDC/NIC advertisements that are aimed at impressing potential foreign investors with the host governments' newly formed belief in the great benefits of DFI (e.g. the 7-page advertisement "Investment Update: Latin America" in **The Wall Street Journal,** 12 November 1984). Turkey is only one of these many LDCs and NICs that include almost all those in Latin America and East Asia. Several countries, such as China, Mexico, South Korea and Yugoslavia, that had limited the foreign ownership to 49% of a venture are now consenting to up to 100%.

Now, more than ever, Turkey will have to compete with other host-countries for DFI from DCs. It should be emphasized that Turkey's present eagerness to attract DFI has coincided with an intensified global competition among host-countries that has never existed before. That competition, which is bound to increase further, is influenced by host-country incentives offered to and requirements imposed on foreign investors. Turkey's incentives for DFI (YASED, 1984a; Central Bank of the Republic of Turkey, 1983) although attractive, are not among the most generous in the world (YASED, 1983a and 1984b). Most importantly, Law 6224 bars any favorable discriminatory treatment of foreign-investment firms relative to all-Turkish firms. Therefore, under the present law, Turkey can not, for example, offer special tax holidays to foreign investors, as do Ireland, South Korea, and Taiwan. On the contrary, there are still some corporate-income-tax provisions in Turkey that discriminate **against** foreign investors (Tuncer, 1984). For example, foreign-owned branches are not allowed to claim investment and export allowances. Furthermore, there are witholding taxes on foreign investors' dividends and branch profits. These result in higher effective tax rates for foreign investors than those for local investors.

Furthermore, Turkey continues its old practice of imposing substantial and inefficiency-causing performance requirements on DFI firms which are also discriminatory **against** them. Although these performance requirements have become less doctrinaire and relatively more flexible since January 1980, they still constitute major obstacles to attracting DFI from the world's major multinational corporations (MNCs), most of which regard any type of performance requirement as an obstacle to integrating fully their LDC / NIC subsidiaries into their global production and marketing networks.

Another major obstacle such globally dominant MNCs as IBM and General Motors face in countries such as Turkey is local currecy inconvertibility and the associated restrictions on their international financial operations. Given the secular rise in intra-firm international trade as part of the global sourcing of materials and components for the world's major MNCs, any host-country currency restrictions and the resulting difficulty in managing their foreign-exchange risk exposures globally, discourage such firms from becoming seriously involved in that host country (Sesit, 1984). This was increasingly the case in Turkey during the 1970s. Although slightly improved since January 1980, Turkey's cumbersome foreign-exchange regime, which still entails an inconvertible national currency, remains a major obstacle to the inflow of large amounts of DFI from the world's largest and technologically most advanced MNCs.

An additional potentially significant payoff from convertibility would be the inflow of foreign **portfolio** equity capital into Turkey's still infant stock market. The public offering of the shares of a well-diversified mutual fund in New York, London, and Tokyo, similar to the recent Korea Fund offered to foreign investors by South Korea, could also help to internationalize and develop Turkey's financial institutions.

Turkey's post-January 1980 DFI policy, according to the Framework Decree on Foreign Investment, discriminates among DFI **source**-countries, as I have noted and criticized in Erdilek (1982: 243-245). It favors especially the petroleum-exporting countries of the Middle East, with the hope that their surplus foreign earnings from oil can be attracted into DFIs in Turkey. This hope has not yet materialized on a significant scale and it is doubtful that it ever will. Arab and other members of OPEC have preferred, not surprisingly, portfolio **non**-equity investment (i.e., debt instruments) over DFI in investing their balance-of-payments surpluses. Theories of DFI explain why both source-country-specific and firm-specific advantages, especially in technological and managerial know-how, are required, in addition to financial capital, for preferring DFI over portfolio non-equity investment. Besides, since 1982, the global oil-market has been in a serious slump, causing the balance-of-payments surpluses of many OPEC members to turn into deficits. It is highly unlikely that there will be in the foreseeable future yet another round of substantial increases in the price of oil, as there were in 1973-74 and 1979-1980, to boost the financial resources of oil-exporting countries (Erdilek, 1984). Turkey should, of course, continue to strengthen its commercial ties with its Middle Eastern neighbors but should not count on them heavily as sources of either DFI or debt capital. Therefore, its DFI policy should be non-discriminatory with respect to source-countries unless and until discrimination can be clearly justified on either economic or political grounds.

6) CONCLUSION

Since the advent of the January 1980 economic liberalization and stabilization program, Turkey's direct foreign investment (DFI) environment has improved significantly. The exodus of foreign investors from Turkey stopped and new foreign investors began to be attracted to the country. Although this is, in comparison with the past, an important improvement, Turkey's new DFI policy will not be fully effective until the national economy becomes much more open and outward-looking than it is now, coupled with continued political stability. Furthermore, Turkey's DFI policy would have to become more liberal relative to those of several other host countries that have been successful in attracting foreign investment on a significant scale. This might require the elimination of most if not all performance requirements. Since January 1980 much has been achieved but much more remains to be achieved by Turkey in taking full advantage of foreign capital and technology.

Time and patience are required before the post-1980 favorable DFI environment begins to pay off. Unfortunately, foreign investors still remember the pre-1980 unfavorable conditions and need time, along with repeated reassurances, for their memories to fade. Turkey should **actively** promote DFI in all sectors of its economy (except those few closed to DFI for national security reasons) as if it were **a developed** host-country. In other words, it should keep in mind that more than two-thirds of the global DFI activity is among the **developed** countries and that their share has been rising steadily since 1960. In general, being politically stable and economically open serves well as a substitute for being economically developed from the perspective of foreign investors.

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