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Working Paper — Digitized Version

The direct foreign investment process in Turkish manufacturing

Kiel Working Paper, No. 100

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Suggested Citation: Erdilek, Asim (1980) : The direct foreign investment process in Turkish manufacturing, Kiel Working Paper, No. 100, Kiel Institute of World Economics (IfW), Kiel

This Version is available at:

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Kieler Arbeitspapiere

Kiel Working Papers

Working Paper No. 100

The Direct Foreign Investment Process
in Turkish Manufacturing

by

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March 1980

Ag 1421 80 Weltwirtschaft
Kiel

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ISSN 0342-0787

The Direct Foreign Investment
Process in Turkish Manufacturing¹

I. Introduction

This working paper is the first in a series of working papers by this author that will contain the preliminary findings of a two-year research project on the microeconomic effects of direct foreign investment (DFI) on the development of Turkish manufacturing.

The forthcoming working papers will discuss the preliminary research results on ownership structure and control, financial structure, sales, production costs, employment, capacity utilization, technology, imports and import substitution, exports and export promotion of DFI firms in Turkish manufacturing.

These working papers, although initially self-contained and independent of each other, will later be published together, in their revised versions, as a book. Consequently, the joint analysis and integration of the project's full set of findings will not be attempted in the individual working papers.

¹ The author is Associate Professor, Department of Economics, Case Western Reserve University. - This project was financed by the Alexander von Humboldt Foundation and the Kiel Institute of World Economics, the Federal Republic of Germany, while the author was an Alexander von Humboldt fellow at the Kiel Institute during 1977-79.

II. Direct Foreign Investment Process and Climate

The direct foreign investment (DFI) process refers collectively to the initiation and formalization of the DFI idea, the application to and negotiations with the host-country government for DFI authorization, the implementation of the DFI project, and its actual private profitability relative to the initial and present expectations of the investors.

The DFI process is, of course, a complex one involving economic, political and social factors, as it takes place in the host country's DFI climate that is itself shaped by those factors. Understanding the evolution of the host-country's DFI climate is essential to the analysis of the DFI process. Therefore, our analysis of the DFI process in Turkish manufacturing will frequently refer to the salient aspects of the past and present DFI climate in Turkey. No effort will be made here, however, to present a complete and systematic discussion of the DFI climate in Turkey.

Throughout the analysis of our quantitative findings, we will frequently refer to the results of our interviews with the executives of DFI firms and Turkish government officials. Our objective in doing so will be both to compare the questionnaire results with those of the interviews and to clarify the former in terms of the latter.

On the whole, the interview results show that there was an adversary relationship between DFI firms and the Turkish government. The former accused the latter of hostility toward DFI, reflected in deliberately obstructionist and blatantly discriminatory policies that were claimed to be often in violation of Turkish laws. The latter, on the other hand, accused the former of bad faith, paranoia, and deceptive, even criminal, behaviour in their activities, which had to be brought under more effective control by stricter regulations.

Neither side trusted the other to any degree. Each side traced its problems to the other side's attempt to realize unfair and/or illegal gains at its expense. In other words, both sides appeared to view DFI activity in Turkish manufacturing as a zero-sum game.

Furthermore, each side accused the other of breaking the rules of the game, that is, cheating. In fact, through their mutual accusations and reciprocal violations of the rules of the game, both sides seemed to have converted DFI into a negative-sum game.

Now, the results of the interviews with DFI firms, when considered in conjunction with their questionnaire responses as well as the results of the interviews with government officials, indicate the following: DFI firms, despite their either justified or unjustified complaints against the government, were actually quite successful in adapting to the unfavorable if not hostile DFI climate in Turkey. Their adaptation was evidenced repeatedly, leaving no doubt in our mind that they were far from helpless in finding ways to neutralize the government's discriminatory, obstructionist and often contradictory DFI policies. Their adaptation was undoubtedly made easier by the fact that their most serious and justified complaint against the Turkish government was the same one that all private firms had against the government: Short-sighted, incoherent, unpredictable and excessive direct government intervention on both the microeconomic and macroeconomic levels. Moreover, such ambitious government intervention, aimed at directing all economic activity at all levels was not all that effective. The government was simply incapable of realizing its interventionist aims, lacking the resources required to enforce the implementation of its directives.

The government did succeed, however, in pushing the DFI and all-Turkish firms into illegal, short-sighted and inefficient ways of doing business, which it then took as evidence for the crookedness of

the private business sector, and as justification for yet stricter and more sweeping direct intervention. In short, there was evidently a vicious circle between direct government intervention and business adaptation to it that drove both sides toward increasingly extreme and desperate moves to come out on top. Well, the business sector came out on top more often than the government. However, during this process, as it involved DFI activity specifically, the DFI firms and the government both contributed to converting DFI into a negative-sum game. The ultimate losers were obviously neither the DFI firms nor the government, that is, politicians and bureaucrats themselves, but the Turkish manufacturing sector and the national economy as a whole. In other words, the feud between the DFI firms and the government retarded the development of Turkish manufacturing and thereby reduced national economic welfare. DFI can be, of course, a cooperative, positive-sum game if the foreign investors and the host-country government are able to deal with each other on the basis of a minimum level of mutual trust after agreeing on and then obeying the rules of the game. This was not, however, the case with DFI in Turkish manufacturing.

III. The Institutional Framework for Regulation of DFI in Turkish Manufacturing under Law 6224

Despite the Turkish government's persistent attempts to direct all activities of DFI firms on a firm-specific level, there was no one single specialized agency with adequate authority and resources that could spearhead such attempts. On the contrary, governmental authority was split haphazardly among mainly the Ministry of Commerce (MOC), the State Planning Organization (SPO), the Ministry of Finance (MOF), and the Ministry of Industry and Technology. There was no effective cooperation and coordination among them. In fact, they were often at odds with each other thanks to their political and bureaucratic rivalries that made it impossible for them to form a united front against DFI firms.

Therefore, when we referred previously to "the government" as the adversary of DFI firms, we overlooked the fact it had deprived itself of a unified and sharply focused authority in regulating them. This was clearly the other very important reason why DFI firms were able to neutralize its discriminatory, obstructionist and often contradictory DFI policies. Those policies could not be adequately implemented by different government agencies working frequently at cross-purposes and almost never together. These agencies although acting separately were successful, nevertheless, in forcing DFI firms to resort often to illegal and inefficient business practices. They were not very successful, however, by their own admission in coping with such practices which the DFI firms appeared to have developed for survival. Ironically, some of those practices such as transfer-pricing might have well enabled several foreign investors to increase the net benefits from their Turkish ventures above the levels that they would have obtained otherwise.

We now review briefly the official procedures that investors had to follow in establishing a DFI firm in Turkish manufacturing under Law 6224.

- 1) DFI application was submitted to the Ministry of Commerce (MOC).
- 2) The MOC reviewed the application, checking its informational content and completeness.
- 3) If the application was in compliance with its requirements, the MOC sent the application to the State Planning Organization (SPO).
- 4) The SPO evaluated the net economic and technological benefits to Turkey of the proposed project, within the framework of the current National Five-Year Development Plan.
- 5) If the SPO's evaluation was favourable, the application received bureaucratic (as opposed to political) conditional approval. The SPO's approval was conditional on the investors' acceptance of certain commitments and requirements that were written into a draft decree by the SPO. If its evaluation was unfavourable, the SPO prepared a report explaining its reasons.

- 6) The SPO sent its decision to the MOC. The MOC then informed the investors of the SPO's decision, forwarding them the draft decree in case of a favourable decision.
- 7) The investors could appeal an unfavourable decision to the High Planning Council, a body of cabinet ministers and high-level bureaucrats with responsibilities in economic matters. In case of a favourable decision, the investors could either accept their draft decree as it was or ask that certain changes be made in it to their advantage. In case of the latter, they would be bargaining with the SPO for a revision of their draft decree, the MOC acting as the intermediary between them.
- 8) Either the original or revised draft decree after its acceptance by the investors was sent by the MOC to the Council of Ministers (COM) for political approval. The COM's approval had to be unanimous. In other words, the draft decree had to be signed by all cabinet ministers before it could become the final decree. The final decree went into effect, acquiring the force of law, with its publication in the Official Gazette.

Before it could be officially established, however, following the publication of its final decree, a DFI firm had to comply with all the relevant provisions of the Turkish Commercial Code. This could take some time. Furthermore, a DFI firm had to wait until the publication of its final decree before it could apply to the Ministry of Finance for approval on foreign equity and credit transfer to Turkey, and to the Ministry of Industry and Technology for receiving industrial investment incentives in the implementation of the project described in its final decree.

After a new DFI firm was established on the basis of a founding decree or an existing one was permitted to grow on the basis of an expansion decree, there was little systematic, coordinated and effective government regulation to ensure that the firm complied with all the conditions of its decree. Such a regulatory task was not owned

up to by any of the government agencies mentioned earlier. First, no agency had a clear-cut statutory authority to serve in that role. The Ministry of Commerce seemed to be closest to possessing that authority but was unwilling to claim it. Second, no agency had the capability to fulfill that role even if it were to have the statutory authority, as the author was told by the agencies concerned themselves.

In short, the government, behaving paradoxically, tried to direct all DFI activities on a firm-specific basis, often throwing the DFI firms into a maze of often conflicting, inconsistent and unrealistic regulations, but failed to establish an effective regulatory system for enforcing those regulations. Obviously, such regulations could be effectively enforced only at the expense of wiping out, if not all, almost all DFI activity from Turkish manufacturing. Even not effectively enforced, however, those regulations were quite harmful to the interests of foreign investors but more so to the interests of Turkey. They helped create a DFI environment of mutual antagonism and distrust whose levels went far beyond the normal levels found in many other host-countries.

IV. Data and Methodology

There are no published DFI statistics in Turkey. The Turkish government collects but does not publish any DFI data. Although the author was able to gain access to some of Turkish government's DFI data, they were not used in arriving at the findings reported here, unless indicated otherwise.

The DFI firm-specific confidential data of this study were obtained by the author himself from the individual firms directly through extensive interviews and also a questionnaire, designed by the author specifically for this study. Interviews were also conducted with prominent Turkish businessmen as well as Turkish government officials who were directly concerned with DFI activities in Turkish manufacturing. All interviews were conducted by the author himself, who spent a total of nine months in Turkey to collect the data used in this study.

All firms and individuals were promised strict confidentiality concerning their identity and participation in this study. Consequently, the names of firms or individuals who cooperated with the author cannot be revealed. As might be expected, not all firms and individuals whose cooperation was sought were willing to cooperate, especially in completing the questionnaire, despite the author's promise of strict confidentiality. Several firms that consented to be interviewed, refused, either at the outset or later, to complete the questionnaire for different reasons.

The author attempted to include in his sample all but the relatively very small DFI firms that were covered by Law 6224 for the Encouragement of Foreign Investment and engaged in manufacturing operations. According to Turkish government statistics, at the end of 1977, there were 86 manufacturing DFI firms. The author's initial investigation in the field revealed, however, that only 73 of them were either already or still active DFI firms. Some of them had not yet initiated production and the rest were no longer DFI firms, since their foreign equity shares had been sold to Turkish nationals. Of the 73 active DFI firms, 62 were chosen (according to their total size and/or foreign equity share) for investigation.

Of these, 6 refused any cooperation and 10 consented to be interviewed but, either initially or later, refused to complete the questionnaire. So, 46 of the 62 DFI firms that were approached participated in the study in both ways, by giving interviews and returning a partially or fully completed questionnaire.

The sample included only DFI manufacturing firms. Although the author realized that it would be highly desirable to work with a bifurcated sample of DFI and national manufacturing firms in order to conduct a comparative analysis according to ownership and/or control characteristics, he decided to concentrate instead on DFI firms only and maximize their coverage subject to his research resource constraints. Some of the questions raised by this study about the behaviour of DFI firms can be answered, however, only by a future comparative investigation of DFI and national firms, based on a bifurcated sample.

The 46 firms with questionnaire data have been classified into nine sectors by the author:

1. Food and beverages (3 firms)
2. Rubber (3 firms)
3. Chemicals (8 firms)
4. Pharmaceuticals (5 firms)
5. Transportation Vehicles and Tractors (7 firms)
6. Non-electrical Machinery and Metal Products (5 firms)
7. Electrical Cables (3 firms)
8. Electrical Machinery and Electronics (10 firms)
9. Building Materials (2 firms)

This classification scheme differs from the Turkish government's own scheme of fifteen manufacturing sectors, used in compiling official (unpublished and confidential) DFI data. Except for sectors

1 and 2 above, the two schemes are not comparable. Our classification scheme was devised after the data collection on the basis of the coverage of our 46 firm sample.

The empirical findings of this paper are first presented for manufacturing as a whole, consisting of all the 46 DFI firms in our sample, and then the sectoral findings are selectively discussed in order to elucidate the aggregate findings. A complete and systematic analysis of the sectoral findings themselves will be attempted later on in individual sectoral studies, incorporating all other aspects of DFI besides the DFI process which is focused on here. As regards the intersectoral comparisons of our empirical findings, it should be kept in mind that they have different relative levels of statistical reliability because of the different numbers of respondents in individual sectors.

The questionnaire data were processed and all the computations were performed by using the Statistical Package for the Social Sciences (SPSS) on the Harris System at Case Western Reserve University. The author acknowledges the valuable assistance of Mr. Adil Talaysum, a Ph. D. candidate in economics at CWRU, in data processing.

V. Empirical Findings

1. Initiator of the DFI Idea

Table 1 - Initiator of the DFI Idea

	<u>Absolute Frequency</u>	<u>Relative Frequency (%)</u>	<u>Adjusted Frequency (%)</u>	<u>Cumulative Frequency (%)</u>
Parent firm	17	37.0	39.5	39.5
Parent firm's government	0	0.0	0.0	39.5
Turkish private firm	21	45.7	48.8	88.4
Turkish government	1	2.2	2.3	90.7
Other	4	8.7	9.3	100.0
No answer	2	4.3	Missing	100.0
Not available	1	2.2	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

The figures above corroborate the conclusion that had been reached on the basis of the DFI firm interviews that in most cases the DFI idea was initiated and promoted by Turkish interests. In almost all of these cases, the Turkish partners were previous importers and distributors of the parent firms' products. Turkey's import-substitution-oriented industrialization drive and recurrent balance of payments crises that restricted imports of manufactured products either motivated or forced them to become domestic producers of such products. Since they frequently lacked the patents and/or know-how required for all-Turkish ventures and also wished to share the financial risks with foreign interests, they approached the foreign firms, whose products they distributed and thus were most familiar with, to start joint-ventures in Turkey.

This pattern is also explained by the fact that Turkish governments have either willingly or unwillingly failed to make Turkey an attractive host-country for DFI. Especially for export-oriented DFI seeking relatively low unit costs of a disciplined labor-force denied the right to strike, as in South Korea and Taiwan, Turkey has been totally unattractive. It is especially this type of DFI that is, in general, initiated by the parent firms themselves, as opposed to DFI that is local market-oriented in a country such as Turkey with at best a lukewarm official attitude toward any type of DFI.

During the interviews with DFI firms, several Turkish as well as foreign executives underlined their parent firms' initial reluctance to commit themselves to investing in Turkey after being approached by their Turkish partners. Some of these executives described their parent firms' initial as well as present view of their DFI experience in Turkey in terms of their "Turkish adventure", stressing the relatively high degree of risk they associated with their ventures.

Against this background, however, still almost 40 percent of the respondents identified their parent firm as the DFI idea initiator. Therefore, it would be misleading to over-generalize and create the impression that sceptical and unwilling parent firms had to be more or less dragged into their Turkish (ad)ventures by their local partners. Some foreign firms, especially European ones, had been determined to invest in Turkey without any prodding from anyone and were still committed to a long-run presence in Turkey against all odds.

Now let us look at the sectoral pattern of the role of the parent firm as the DFI idea initiator:

Table 2 - Parent Firm as the DFI Idea Initiator

<u>Sector</u>	<u>Parent Firm as the DFI Idea Initiator - Adjusted Frequency (%)</u>
1. Food and Beverages	66.7
2. Rubber	100.0
3. Chemicals	85.7
4. Pharmaceuticals	60.0
5. Transportation Vehicles and Tractors	33.3
6. Non-electrical Machinery and Metal Products	80.0
7. Electrical Cables	50.0
8. Electrical Machinery and Electronics	30.0
9. Building Materials	100.0

What we find is that only in sectors 5 and 8 was the parent firm relatively unimportant as the DFI idea initiator. Interestingly, these two sectors together accounted for about 40 % of all DFI assets under Law 6224 during 1976-78, having increased their shares rapidly since the late 1960's. Therefore, it may be concluded that during the last decade, which witnessed the concentration of new DFI activity in the Turkish automotive and electrical consumer durable sectors, coupled with the toughening of Turkish DFI policies, the role of the parent firm as the DFI idea initiator declined considerably.

2. Formalizer of the DFI Idea

Table 3 - Formalizer of the DFI Idea

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Parent firm	27	58.7	67.5	67.5
Parent firm's government	0	0.0	0.0	67.5
Turkish private firm	9	19.6	22.5	90.0
Turkish government	1	2.2	2.5	92.5
Other	3	6.5	7.5	100.0
No answer	4	8.7	Missing	100.0
Not available	2	4.3	Missing	100.0
Total	46	100.0	100.0	

Formalization of the DFI idea refers to its quantitative analysis through a project appraisal. Not surprisingly a significant majority, about 68 percent, of the respondents listed their parent firm as the DFI idea formalizer.

Table 4 - Parent Firm as the DFI Idea Formalizer

<u>Sector</u>	<u>Parent Firm as the Formalizer of the DFI Idea - Adjusted Frequency (%)</u>
1. Food and Beverages	66.7
2. Rubber	100.0
3. Chemicals	85.7
4. Pharmaceuticals	100.0
5. Transportation Vehicles and Tractors	60.0
6. Non-electrical Machinery and Metal Products	20.0

<u>Sector</u>	<u>Parent Firm as the Formalizer of the DFI Idea - Adjusted Frequency (%)</u>
7. Electrical Cables	100.0
8. Electrical Machinery and Electronics	30.0
9. Building Materials	100.0

We observe that in sectors 6 and 8 the role of the parent firm as the formalizer of the DFI idea was substantially less significant than in the others. We might expect this role to increase with the technological and financial complexity of the DFI project as well as the size of the foreign equity share. In the present case, the latter explanation appears to be more plausible.

In sector 6, although 80 percent of the respondents identified the parent firm as the DFI idea initiator, only 20 percent identified it as the idea formalizer. In sector 8, however, the corresponding figures were the same, and relatively low, at 30 percent. On the other hand, in sector 5, although only about 33 percent of the respondents identified the parent firm as the DFI idea initiator, 60 percent identified it as the DFI idea formalizer. These marked sectoral differences in the relative roles of the parent firm in DFI idea initiation and formalization will be investigated in a later stage of our work.

3. Investment Decision-Application Lag

Mean = 5.9 months (m)	Standard Deviation = 9.1 m
Standard Error = 2.1 m	
Minimum = - 12.0 m	Maximum = 21.0 m
Valid Observations = 19	Missing Observations = 27

There was an average lag of almost 6 months between the final DFI decision and the formal application to the Turkish government for authorization. Interestingly, 4 of the 19 firms, for which this statistic could be computed, showed negative values, ranging between - 12 and - 1 months. This may be interpreted in terms of either the

investors' uncertainty about the outcome of the bargaining with the Turkish government on the terms of their DFI authorization decrees or their preemptive moves to position themselves in the Turkish market in anticipation of rival DFI applications. Until recently the DFI authorization decrees did not contain a time limit for their implementation, enabling their holders to keep their DFI options indefinitely while precluding at least some rival DFI ventures. This is no longer entirely possible as all DFI authorization decrees now specify that authorized investments must be made within specific time periods. Unimplemented decrees are cancelled by the Turkish government.

Table 5 - Sectoral Investment Decision - Application Lags

<u>Sector</u>	<u>Investment Decision - Application Lag Sectoral Mean (months)</u>
1. Food and Beverages	Not available
2. Rubber	2.5
3. Chemicals	10.7
4. Pharmaceuticals	-1.5
5. Transportation Vehicles and Tractors	2.7
6. Non-electrical Machinery and Metal Products	20.0
7. Electrical Cables	6.0
8. Electrical Machinery and Electronics	5.4
9. Building Materials	12.0

There is clearly considerable variation among sectors. In terms of the changing sectoral pattern of DFI concentration over time, however, this lag appears to have declined substantially. It should also be noted that the timing of a DFI application after the investment decision has been made, is significantly influenced by the expected changes in the host country's political and economic conditions in the short-run. During the interviews with the existing DFI firms, the author was told by several executives that although they had decided to seek authorization for either new or expansion projects, they were forced by Turkey's deteriorating political stability and still unsettled international bankruptcy to postpone application. They emphasized that a new strong government and restoration of Turkey's international creditworthiness were the necessary conditions for them to initiate formal DFI applications. We would expect this to be true for most potential, i.e. not yet formed DFI firms as well.

4. Were Changes Demanded by the Turkish Government in the DFI Project Proposal?

Table 6 - Were Changes Demanded by the Government?

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Yes	20	43.5	45.5	45.5
No	24	52.2	54.5	100.0
No answer	2	4.3	Missing	100.0
Total	46	100.0	100.0	

Slightly more than one half the respondents indicated that their proposals were accepted by the Turkish government without any changes. During the interviews with DFI firms, we discovered, however, that it was no longer expected to have any DFI application approved by the government without making some changes in the application. Most firms regarded the government's demands for such changes as unrealistic and unreasonable.

Table 7 - Changes Were Demanded by the Government

<u>Sector</u>	<u>Changes Were Demanded by the Turkish Government - Adjusted Frequency (%)</u>
1. Food and Beverages	0.0
2. Rubber	0.0
3. Chemicals	42.9
4. Pharmaceuticals	40.0
5. Transportation Vehicles and Tractors	83.3
6. Non-electrical Machinery and Metal Products	20.0
7. Electrical Cables	33.3
8. Electrical Machinery and Electronics	70.0
9. Building Materials	50.0

Sectors 5 and 8, in which the role of the parent of firm as the DFI initiator was seen to be the least significant among all sectors, are also the two sectors in which changes in the DFI project proposals were most frequently demanded by the Turkish government. These are the two sectors that accounted for the most rapid DFI increases after the late 1960's, which also witnessed the toughening of Turkish DFI policies. These policies became increasingly more demanding of new DFI projects, especially in terms of minimum export and local-content

requirements. This conclusion is also strongly supported by the author's comparative analysis of DFI authorization decrees for more than 100 firms, issued since the early 1950's. The decrees issued in the 1970's contain several specific conditions and requirements that had to be met by DFI firms, whereas those issued in the 1960's and especially the 1950's contain very few or none.

5. Changes Demanded by the Turkish Government in the DFI Project Proposals.

Table 8 - Types of Changes Demanded by the Government

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)
Changes in technology	2	4.3	10.0
Relocation of project	1	2.2	5.0
Changes in product-mix	5	10.9	25.0
Changes in product specification	3	6.5	15.0
Changes in financing	10	21.7	50.0
Changes to joint-venture	1	2.2	5.0
Change to minority foreign ownership	1	2.2	5.0
Increase in export-commitment	8	17.4	40.0
Increase in capacity	3	6.5	15.0
Decrease in capacity	3	6.5	15.0
Increase in local-content	8	17.4	40.0
Increase in Turkish employees	3	6.5	15.0
Other	5	10.9	25.0

Table 9 - Changes Demanded by the Turkish Government in the DF1
Project Proposals by Sector - Adjusted Frequency (%)

<u>Changes</u>	<u>Sector</u> [*]								
	1	2	3	4	5	6	7	8	9
Changes in technology	0.0	0.0	0.0	0.0	20.0	0.0	100.0	0.0	0.0
Relocation of project	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Changes in product-mix	0.0	0.0	0.0	50.0	40.0	0.0	0.0	14.3	100.0
Changes in product specification	0.0	0.0	33.3	0.0	20.0	0.0	0.0	14.3	0.0
Changes in financing	0.0	0.0	0.0	50.0	60.0	0.0	0.0	71.4	100.0
Change to joint-venture	0.0	0.0	0.0	0.0	20.0	0.0	0.0	0.0	0.0
Change to minority foreign ownership	0.0	0.0	0.0	0.0	20.0	0.0	0.0	0.0	0.0
Increase in export commitment	0.0	0.0	0.0	50.0	40.0	0.0	100.0	57.1	0.0
Increase in capacity	0.0	0.0	66.7	0.0	20.0	0.0	0.0	0.0	0.0
Decrease in capacity	0.0	0.0	0.0	50.0	20.0	0.0	0.0	0.0	100.0
Increase in local-content	0.0	0.0	33.0	0.0	60.0	0.0	0.0	57.1	0.0
Increase in number of Turkish employees	0.0	0.0	33.0	50.0	0.0	0.0	0.0	14.3	0.0
Other	0.0	0.0	33.0	0.0	40.0	100.0	0.0	14.3	0.0

* 1. Food and beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals 5. Transportation vehicles and tractors
6. Non-electrical machinery 7. Electrical cables 8. Electrical machinery and electronics 9. Building materials

The most frequently demanded change appears to have been in the financing of the DFI projects, followed by increases in export-commitment and in local content. Financing changes were often in terms of the Turkish government's insistence that the DFI projects reduce their dependence on domestic credits. Both the export-commitment and the increasing local-content considerations have become paramount recently in the Turkish government's review of new and also existing DFI projects. Most of the DFI firms interviewed complained that the Turkish government had become too rigid and unreasonable in its demands on these two issues. These complaints and the responses of government officials will be examined in some detail after reviewing the sectoral differences in the changes most frequently demanded by the Turkish government.

Not surprisingly, the two sectors with the largest number of changes demanded are sectors 5 and 8. In sector 5, changes in financing and increases in local-content were demanded with the highest and equal frequency. In sector 8, however, changes in financing were most frequently demanded, followed by increases in export-commitment and increase in local-content with the next highest and equal frequency.

During the interviews conducted with DFI firm executives, the Turkish government's demands for increases in export-commitments and increases in local-content were criticized more frequently and harshly than its restrictions on the local credits available to DFI firms. In fact, the government's pressure on those existing DFI firms with majority foreign ownership to reduce their foreign ownership was complained about more bitterly than the restrictions on local financing.

What has to be kept in mind here is the important distinction between the process of all-new DFI authorized by the founding decree of a DFI firm and the process of expansion or modernization DFI authorized by the post-founding decrees. Unfortunately, however,

the questionnaire results could not make this distinction sufficiently clear by themselves. Consequently, their interpretation requires reliance on the interview results. So, we now turn to the latter, beginning with the complaints of DFI firms about the increasing local-content requirements and export-commitments.

A. The Controversy on Local-Contents and Exports

Especially the DFI firms officially classified as Assembly Industry¹ firms and, thereby, subjected to the special regulations, administered by the Ministry of Industry and Technology, concerning increasing local-content, claimed that the government pursued contradictory policies toward them. Either by their decrees or by the annual sectoral Assembly Industry regulations, these firms were required to increase their local-contents year after year and on a product by product basis. Their annual import licenses for CKD (completely knocked down) components and other imported intermediate inputs were made conditional on meeting the increasing local-content requirements imposed on them. In fact, each year every Assembly Industry firm was told by the government which components it could import and which components it had to obtain locally. It could either begin to produce itself the components whose importation was prohibited or purchase them from other local producers if there were any.

¹ The Assembly Industry Code, enacted in 1964 and since then periodically revised, was aimed at expediting the development of the "screw-driver" industries, resulting from Turkey's ambitious import-substitution drive for industrialization, into genuine national industries with high local-content. The Code covered both DFI and all-Turkish manufacturing firms. The most important of the assembly industries was the automotive sector.

The DFI firms that had to comply with increasing local-content requirements voiced the following complaints:

- (1) The annual local-content requirements were formulated too ambitiously, without due regard for their cost-increasing and quality-decreasing effects. The single-mindedness of the government to increase local-contents across the board in manufacturing was singularly at odds with efficiency and quality.
- (2) Many DFI firms had to increase their physical capacities, i.e. purchase fixed assets for expansion, in order to comply with their increasing local-content requirements, but faced serious difficulties in obtaining expansion decrees from the government. They could not easily meet their requirements by purchasing locally the components previously imported, since local suppliers were either non-existent or unreliable to fulfill orders with the speed, cost-effectiveness and engineering-tolerance needed.
- (3) Many DFI firms had official export-commitments, as minimum physical or monetary export quotas, written into their decrees. It became harder to meet these commitments as the local-content requirements increased. These requirements eroded further the already weak international competitiveness of Turkish manufacturing, in terms of both higher unit costs and poorer quality. The government either failed to realize or chose to ignore the fact that successful export performance was incompatible with local-content maximization.
- (4) Furthermore, the government prohibited the DFI firms that had export commitments in their decrees to export whenever serious domestic supply shortages developed. The government's short-term political justification for such a ban on exports was well-understood. It did not, however, alter the fact that such interference in the firms' decisions as to which markets to supply played havoc with their long-term export development strategies.

- (5) As their local-content requirements increased over time, the firms were forced to buy locally a higher proportion of their intermediate inputs. The prices of these local inputs, however, were often much higher than those of the previously imported ones, not to mention their other disadvantages. The local input prices were also less frequently subjected to government controls than the prices or profit margins of the final assembly firms. Consequently, these firms suffered a steady erosion in their profitability over long periods of time until the government could be convinced, after prolonged negotiations, to grant them price increases.

These complaints of the DFI firms were discussed by the author with several government officials and their responses were solicited. We now present those responses.

- (1) The officials of the Department of Encouragement and Implementation in the Ministry of Industry and Technology rejected the complaint about the over-ambitiousness of Assembly Industry Code, concerning the ascending local-content requirements. They argued that the Code had been vital to the development of Turkish manufacturing. Without it very few firms would have come even close to the prevailing local-content levels. Firms had to be pushed along, even if initially the efficiency and quality effects might have been adverse. In the long-run, as Turkish manufacturing gained experience with increasing local-content levels, such effects would become progressively less important.

In fact, these officials claimed, the Assembly Industry Code had already accomplished its mission and its appropriateness could no longer be a relevant issue for debate. Almost all the sectors it had originally covered had reached the relatively high local-content levels that made it no longer appropriate to refer to those sectors as assembly industries. The Ministry of Industry and Technology had already drafted a new Manufacturing Industry Code to replace the Assembly Industry Code in the near future.

The DFI officials of the State Planning Organization (SPO) and the Ministry of Commerce subscribed to the same view. All the government officials interviewed strongly supported Turkey's general import-substitution strategy of industrialization and its corollary of local-content maximization. They showed little awareness of or belief in international intra-industry, i.e. component specialization, not to mention inter-industry specialization. Turkey could produce almost anything if the government pursued the right policies. The implicit main objective was to advance Turkey's self-sufficiency as far as possible and thereby minimize its dependence on the rest of the world.

- (2) All the government officials interviewed blamed the DFI firms themselves for whatever problems they might have had in meeting their local-content requirements. The SPO claimed that these firms had a built-in bias toward importing as many components as possible in order to maximize the scope of transfer-pricing and also prevent Turkey from increasing its industrial self-sufficiency. Many DFI firms sought delays in meeting their local-content requirements, often inventing excuses. The SPO was sympathetic whenever their requests for delay were due to unforeseen and unavoidable circumstances.

The Ministry of Commerce DFI officials wondered why the DFI firms failed to object initially to their insufficient physical capacity levels, legislated in their decrees, for meeting their local-content requirements over time. In most cases, firms deliberately understated their necessary, decree-authorized capacity projections. The reasons for the understatement were to restrict supply for earning excess profits in their captive markets and to purposefully fail in meeting their local-content requirements. Like their SPO colleagues, these officials argued that the government did not force DFI firms to reduce their

estimated necessary capacity levels when they applied for new or expansion decrees. On the contrary, they were often required to increase their projected capacities, during the negotiations preceding the issuance of their decrees. But even then firms sought delays in implementing their decree-authorized capacity-increase schedules with invented excuses for which the government had no sympathy.

- (3) All the DFI officials interviewed rejected the claim of DFI firms that their failure to meet export-commitments was related to the increasing local-content requirements. It was the firms' responsibility, during the decree negotiations with the government, to make sure that they would be able to meet all their commitments that were written into their decrees. If they were not sure, they could certainly withdraw their applications. And, whenever they could later prove to the government that their failure to meet some of their commitments on time was due to factors beyond their control, they would be granted the necessary delays.

The officials argued that the widespread reluctance of DFI firms to promote exports should be traced to reasons other than their increasing local-content commitments. The firms were accused of concentrating on domestic sales because of the higher profit margins, thanks to the protection the government provided from competitive imports. They were also suspected of preventing exports from Turkey in order not to spoil the foreign markets already supplied from non-Turkish operations of their parent firms.

- (4) The DFI officials of the Ministry of Commerce and the SPO claimed that the government had the right to license Turkish exports after giving priority to domestic demand. This was a natural right and responsibility of any government. Only a few DFI firms, such as the tire and margarine producing ones, had

their exports restricted or prohibited because of serious domestic shortages. If these firms had really wanted, they could have earlier built sufficient capacity to meet both domestic and foreign demand.

This complaint was regarded as a bogus issue by the government officials. It was just another excuse put forward by the DFI firms to justify their poor export performance.

Actually many DFI firms were unable to meet their export-commitments despite export incentives such as tax rebates and import allowances offered by the government.

- (5) Most of the DFI officials accepted the complaint of the DFI firms that their local input prices were above world prices and that the quality of the local inputs was also relatively deficient. The government had recognized this and offered the DFI firms, together with all-Turkish firms, several export promotion incentives to overcome their deficiencies.

Furthermore, the government was seriously considering subsidizing the intermediate input requirements of all primarily export-oriented manufacturing firms so that their prices to the firms would be no higher than the world prices. This would answer the complaint of the DFI firms to a large extent.

Even after discounting the complaints of DFI firms for the normal one-sidedness and exaggeration by taking into account the responses of government officials, our conclusion is that they appeared to have considerable justification. The expectations and demands of government officials concerning local-contents and export-commitments seemed to be based not on specific and detailed analyses of individual DFI projects but rather on their strong commitment to Turkey's indiscriminatory

import-substitution industrialization, which itself accounted for the basic failure of DFI firms to meet all such expectations and demands.

B. The Controversy on Foreign Equity Shares

Attention now turns to the complaint of DFI firms about the government's pressure to reduce foreign equity shares and the responses of government officials to this complaint.

Most DFI firms contended that the Turkish government exerted constant pressure on them for the reduction of the foreign equity share, especially when it was over 50 per cent. Often the government would insist on foreign equity share reduction as a condition for approving expansion decrees.

Furthermore, the government set conditions on how the DFI firms could go about reducing their foreign equity share. First, the government (the SPO) would have to approve to whom the foreign-owned shares could be sold. The foreign partners were not allowed to sell their shares to Turkish investors of their own choice. Second, the government (the Ministry of Finance) would have to approve the prices at which the foreign shares could be sold to Turkish investors. Often the government objected to the prices that had been freely agreed upon between the foreign sellers and Turkish buyers as too high.

The government adopted the simplistic view that Turkey's benefits from DFI projects could be always enhanced by limiting foreigners to minority ownership, without making any distinction among different types of projects. It insisted that any DFI firm in which the foreign investors had held majority interest at the outset would have to eventually make way for Turkish majority interest.

Several DFI firms that had been already operating in Turkey for many years with foreign majority interest, a few of them with 100 per cent foreign ownership, argued that it was unfair for the government to apply its anti-foreign-majority-ownership policy to them. It, of course, had the right to exclude foreigners from majority ownership in new DFI enterprises, letting them decide whether they would invest in Turkey under that condition. The old DFI firms, however, in which foreign majority ownership had been initially allowed, should be left alone as long as they continued to operate according to their decrees. By imposing on them the unreasonable and ideological demand for minority foreign ownership, the government violated its side of the bargain, created mistrust, and disrupted their smooth operation. What real economic benefits could Turkey derive from this short-sighted policy that exacerbated the deterioration of the DFI climate in the country? Could the government at least not allow the foreign investors to choose freely the Turkish investors to whom they wished to sell their equity interests at prices agreed on between themselves, without any official interference and pressure? Such interference and pressure often pushed the foreign investors to sell out completely and abandon their operations for once and all, vowing never to invest in Turkey again. A few firms, on the other hand, had refused to bow so quickly to the government's demand and gone to Danistay, the High Turkish Court, in order to maintain the status quo, at least during litigation.

There was a consensus among foreign investors that the relatively recent government drive to reduce foreign equity interests in the existing DFI firms across the board was just another manifestation of the SPO's general anti-DFI stance. This drive did not discriminate among sectors and firms. It ignored the fact that some firms could not continue their operations very effectively without foreign majority ownership that made foreign management control possible and worthwhile. Furthermore, it took no notice

of the fact that some foreign (parent) firms that had invested in Turkey had longstanding policies of not maintaining their presence in developing countries that denied them majority ownership and management control. Turkish DFI officials were uninformed or ill-informed about such critical sector-and-firm-specific characteristics. Their ignorance was, of course, not an innocent one, given their deeply entrenched ideological opposition to DFI. Increasing their access to relevant information would be unlikely to change their negative attitude.

The responses of government officials to these views of DFI firms were the following:

The SPO's officials denied that there was an indiscriminatory drive to reduce foreign equity shares, attributed to their alledged anti-DFI stance. In the first place, how could Turkey carry out such a drive, that would entail significant foreign exchange transfers abroad when the country was literally beset by international bankruptcy? Turkey simply had no current means to compensate in convertible currencies the foreign investors who wished, or were presumably forced, to transfer abroad the values of their Turkish DFI assets. This complaint, like most others put forward by the DFI firms, was unfounded, reflecting their paranoia and efforts to badmouth the Turkish government for their self-interest.

It was, however, conceded that the SPO favored, in general, the gradual reduction of foreign equity share over time after the establishment of a DFI firm. Why? Because over time DFI's economic contribution to a given enterprise and to the national economy was bound to decline. DFI's major expected contribution was the transfer of new technologies and organizational skills to Turkey. After a DFI firm had been in operation for many years, its existence as a foreign enterprise began to lose justification in terms of national interests. Turkish nationals would be able later on to keep that enterprise going without much, if any, foreign

technological and organizational know-how. In short, Turkey's interest warranted turkizing a DFI firm some time after its establishment, when it had "matured".

When asked whether they had considered formulating an explicit fade-out system in which each DFI firm would be turkized according to a time schedule specified at the outset, the SPO officials replied that they had indeed considered it for incorporation into the IV. Five Year Development Plan (1979-1984) but decided not to. There were several drawbacks to the operation of such a system that they did not know how to deal with. The specification of a time schedule for each firm that might later prove to be a miscalculation, and the protection of the long-term viability of an enterprise as the foreign interests in it decreased and became concerned solely with squeezing it for maximum terminal profits were mentioned as the major difficulties that would arise.

The SPO officials emphasized that they had imposed no fixed and rigid initial maximum foreign share on new DFI firms. It all depended on the project in question. For example, a project totally or primarily export-oriented would be permitted majority ownership, and even 100 per cent foreign equity. Projects for producing intermediate products and investment goods would also receive favorable consideration. In fact, the higher the expected contribution of the project in terms of transferring critical technological and organizational know-how to Turkey, and the higher the priority that had been assigned to the project in the national development plan, the greater the foreign equity share the SPO would permit in that project. In short, it was simply untrue that the SPO was opposed to foreign majority ownership in all DFI projects because of its alleged ideological aversion to foreign presence in the Turkish economy. If it had recently rejected several proposals that had been predicated on foreign majority ownership and management control, the reasons should be sought in the failure of these proposals to meet Turkey's urgent priorities that justified allowing foreign majority ownership and management control only in special cases.

Furthermore, the SPO expressed its willingness to postpone indefinitely the partial or complete turkizing of a DFI enterprise, if the foreign investors could demonstrate conclusively that they were continuing to transfer new technologies that were still unavailable to Turkey otherwise. Such a firm would receive preferential treatment regardless of the percentage of its foreign ownership.

Finally, the SPO officials defended the government's right to determine, when necessary, to which Turkish interests foreign investors should sell their shares. The SPO had no ideological bias in favor of State Economic Enterprises (SEEs) as candidates to take over the foreign interests in DFI firms. In a few recent cases, it had insisted on the sale of DFI assets to SEEs on pragmatic grounds and for national interest only. There existed also cases in which private Turkish interests were allowed to buy DFI assets. DFI firms had, however, played up the first type of cases, ignoring conveniently the second type. The SPO approached the question of the identity of Turkish interests who should or should not take over DFI assets, as it approached all other related questions; on a pragmatic, case-by-case basis, with the sole aim of protecting and promoting national welfare.

The DFI officials of the Ministry of Commerce argued that it had become a widespread policy all over the world, especially in the developing countries, to reduce gradually the foreign equity shares in DFI firms. Turkey had not invented this policy and was not unique in implementing it. Foreign investors should know better and realize that Turkey would not ignore global trends in DFI policy-making.

Although the government had not (yet) instituted an explicit fade-out system for the gradual turkizing of DFI enterprises, it was nevertheless determined to accomplish the basic objective. It would, however, recognizing exceptions, allow those DFI firms that could prove their continued significant contributions to the Turkish economy, to maintain their foreign majority ownership and management control. These officials doubted, however, that there could be many exceptions to weaken the general trend toward eventual turkizing.

Going beyond the views expressed by their SPO colleagues, these officials adduced another reason for foreign minority ownership. DFI firms were, in general, harder to regulate than all-Turkish ones. Those in which foreigners had majority ownership and management control were especially hard to regulate, in order to curb their illegal practices and make them serve better national economic objectives. Such firms refused to become fully integrated into the Turkish economy, preferring to remain as mere assembly operations, and frustrated the government in its efforts to implement effectively its import-substitution strategy of industrialization. The government was simply not (yet) capable of controlling these firms to its satisfaction. Until it could become a match for them, the government had no choice but to have as few of them around as possible.

The DFI officials of the Ministry of Finance, who responded to the complaint about government interference in the determination of the prices of foreign DFI assets sold to Turkish nationals, put the blame squarely on Law 6224. This law stipulated, in Article 4, Clause (a) Part (2) that foreign DFI assets would be sold "within reasonable prices", which were not defined in Turkish tax laws, creating yet another ambiguity. After all, these officials almost gleefully remarked, Law 6224 was not really a Turkish law in its genesis, since it had been drafted by an American expert, and,

therefore, it contained such defects. It was basically a "foreign" law and, therefore, foreigners had no real right to complain about it. They had imposed it on Turkey hoping to create for themselves the most favorable DFI conditions.

Foreign DFI asset prices could be determined by alternative methods. The Ministry of Finance preferred the method of capitalizing net earnings at the interest rates prevailing on long-term Turkish government bonds. DFI firms, on the other hand, preferred the stock market share prices method, arguing that the government's arbitrary method grossly undervalued their assets. The government, however, believed that the Turkish stock market, fledgling and thin, lent itself easily to manipulation for artificial price movements by interested parties. The method of taking the stock market prices as true values of DFI assets was no less arbitrary than the government's method, these officials claimed.

Furthermore, in the calculations for determining DFI asset values the government used the Turkish lira (TL) as the unit of account, whereas the foreign investors wished to work with convertible foreign currency units to protect themselves against inflation and/or devaluation while waiting for the Central Bank to find scarce foreign exchange for the necessary transfers. These officials appreciated the concern of foreign investors to protect the foreign exchange values of their assets, but the Turkish government could naturally use TL only as its unit of account. Besides, Law 6224 did not offer any foreign exchange guarantees to foreign investors. They had, therefore, no legal ground for requesting the use of a foreign currency unit in the negotiations for determining DFI asset sale values. They had to carry the foreign exchange risk as a cost of doing business in Turkey, as they did elsewhere.

On this issue of majority versus minority foreign ownership at least, the Turkish overnment officials appeared to be well-informed, flexible and pragmatic, contrary to the assertions of DFI firms.

The position of government officials was convincingly articulated to this author. Of course, their pronouncements were presumed to reflect their genuine convictions and form the basis of their actual decisions.

6. Investment Application - Approval Lag

Mean = 9.6 months (m)	Standard Deviation = 11.4 m
Standard Error = 2.3 m	
Minimum = 0.0 m	Maximum = 45.0 m
Valid Observations = 25	Missing Observations = 21

There was, according to the questionnaire results, an average lag of about 10 months between the DFI applications and their approval by the Turkish government. The interviews with DFI firms indicated that this lag had been increasing lately. Most DFI firms were highly critical of the government's failure to act on their DFI applications promptly and attributed it to the general and intensified anti-DFI stance of the Turkish bureaucracy. This complaint of the DFI firms and the responses of government officials will be examined below after the review of the sectoral differences in the investment application - approval lag.

Table 10 - Sectoral Investment Application - Approval Lags

<u>Sector</u>	<u>Investment Application - Approval Lag Sectoral Mean (months)</u>
1. Food and Beverages	Not available
2. Rubber	2.5
3. Chemicals	4.0
4. Pharmaceuticals	8.0
5. Transportation Vehicles and Tractors	7.0
6. Non-electrical Machinery and Metal Products	13.5

<u>Sector</u>	<u>Investment Application - Approval Lag Sectoral Mean (months)</u>
7. Electrical Cables	17.3
8. Electrical Machinery and Electronics	15.6
9. Building Materials	6.0

This considerable variation among the sectors could have several possible reasons. First, in terms of the specific years in which a sector's DFI applications were concentrated, we would expect the sectors with more recent applications to have suffered from longer lags, as a result of Turkey's steadily tightening DFI policies, partly a reflection of its increasing general ambivalence if not hostility toward all DFI. Second, different sectors might have different mixes of all-new DFI applications and expansion- or modernization-DFI applications. The latter would tend to be associated with longer approval lag as the discussion below of interview results indicates. Third, different sectors might be effective to different degrees in their legal and illegal efforts to influence the bureaucrats and politicians in Ankara for quicker action and decision. Fourth, periods of higher domestic political instability and weaker coalition governments would be more likely to cause longer approval lags for DFI applications made in such periods. Of course, there might be other plausible reasons.

A. The Controversy on the Review and Approval of DFI Applications

We now discuss in detail the complaint of DFI firms about the length of the investment application-approval lag and the responses of government officials to it.

It took too long for most DFI firms to have their decrees issued by the Council of Ministers. Recently, the average time between a firm's application for a decree and its publication in the Official Gazette had been about two years. The long delays were caused by either bureaucratic or political obstacles or both. The delays appeared to have been longer for expansion projects than for new ones.

The bureaucratic obstacles to processing of decree applications were most serious in the State Planning Organization (SPO). Sometimes months passed before the SPO got around to responding to firms' inquiries about the state of their decree applications. The SPO often refused to respond to oral inquiries, insisting that all communication between itself and the firms should be in writing. Occasionally, letters written by firms to the SPO or the Ministry of Commerce, and even a few draft decrees under consideration in the Council of Ministers, had been lost. Many firms were convinced that most of the bureaucratic obstacles that prevented the processing of their decree applications within a reasonable period of time, such as three or four months, were caused by the Turkish bureaucracy's, especially the SPO's, entrenched anti-DFI attitude.

The political obstacles were encountered after a draft decree prepared by the SPO, was sent by the Ministry of Commerce to the Council of Ministers, which had to be signed by all the ministers before its publication in the Official Gazette as a decree. During coalition governments, especially those in which the National Salvation Party had been a partner, some draft decrees were blocked for more than a year, sometimes lacking only one or two signatures to become official. Not all firms whose draft decrees had been blocked in the Council of Ministers blamed the National Salvation Party's ideological anti-DFI stance for their problems. Some accused other DFI or all-Turkish firms of intervening politically to prevent the approval of their draft decrees by the Council of Ministers. It was slightly amusing to hear during the interviews several DFI firms blame each other for resorting to such political pressures.

Firms argued that the long delays in getting their decrees issued forced them to make important changes in the feasibility studies underlying their original decree applications and to ask the SPO,

in the post-decree stage, to allow for such changes. Often the SPO responded unfavorably to these requests, compelling the firms to either give up the projects authorized by their decrees or go ahead with the necessary changes unofficially whenever possible. Of course, when a firm was not in strict compliance with its decree(s), it faced the danger of having its decrees annulled and operations terminated by the Turkish government. Nevertheless, some firms did deliberately step out of the bounds of their decrees and were not detected by either the Ministry of Commerce or the SPO, which were unable to regulate effectively the operations of DFI firms.

Neither the Ministry of Commerce nor the SPO denied that DFI firms had a legitimate complaint concerning the time it took for the issuance of their decrees. Both of them denied, however, that they themselves caused this problem because of their alleged anti-DFI attitude, although the Ministry of Commerce believed that the SPO came close to deserving its anti-DFI labelling by DFI firms.

The DFI Division, a part of the Encouragement and Implementation Department, in the Ministry of Commerce, by its own admission, was not equipped to serve as an effective regulatory agency. Besides lacking the statutory authority for performing such a role, it simply did not have the necessary manpower and expertise. In early 1979, this division consisted of three officials only, none of whom considered himself an expert on DFI.

The chief of this division noted that until January 1978 his division tried to carry out systematically technological and microeconomic evaluations of all DFI applications for new or expansion projects, by relying on the expertise of several technical consultants. These consultants had been hired on special work-contracts, enabling them to receive higher than

average salaries paid to regular bureaucrats. After the Ecevit government came to power in January 1978, however, these experts were summarily fired, on the suspicion that they had been political sympathizers of the previous, National Front government of Demirel. In order to avoid the (justified) accusation, and possible subsequent legal action, that the firings had been political, the government also eliminated the positions of these experts. In other words, no new experts were hired to replace the ones who had been fired.

Therefore, the chief of the Ministry of Commerce's DFI Division stated, his Division was no longer capable of evaluating DFI applications on a technical level. It simply forwarded them to the SPO after receiving them from established or prospective investors. In fact, it was both legally and technically restricted to acting merely as an intermediary between investors and the SPO. It had no active role to play.

The Ministry of Commerce was dissatisfied with its present passive intermediary role. In the words of its DFI Division's chief, it carried the drum on its back but the stick was in the hands of the SPO. It would prefer to have the drum taken off its back and let the SPO have both the drum and the stick. By being rid of its intermediary role in the DFI area, it would also shift all the blame for the long bureaucratic delays in the issuance of decrees to the SPO, which it considered to be often dogmatic and too strict with foreign investors.

Chief of the Ministry of Commerce's DFI Division conceded that occasionally letters of DFI firms were lost inside his division, blaming this on an inadequate filing system and the bad performance of poorly paid clerks. But he argued that this was not too serious and frequent a problem to account for most of the bureaucratic delays in the issuance of DFI decrees. He intimated

that the real problem was the SPO's inability and/or unwillingness to process DFI applications speedily enough.

He also acknowledged that frequently all-Turkish or DFI firms did intervene on either the bureaucratic or the political level to prevent the approval of DFI applications by present or prospective competitors in their sectors. Often the smaller all-Turkish firms were much more concerned about new or increasing competitive threats from the larger DFI firms. He surmised that that sort of thing could not have been special to Turkey. It had to be expected from any private firm threatened by new comers anywhere. He doubted that too many DFI applications had been rejected as a result of lobbying by rival investors, although their approval might have been considerably delayed.

The DFI Division of the SPO's Economic Planning Department denied that it was anti-DFI and that it deliberately delayed the processing of DFI applications or the issuance of DFI decrees. It claimed that the reasons for the deliberate delays in the issuance of decrees were political and that it had nothing to do with them. It did acknowledge, however, that being short of expert personnel, it was unable to process DFI applications as expeditiously as it should. The SPO's DFI Division consisted of two economists only, one of whom was on leave for most of the two years during which this study was carried out.

After receiving a DFI application via the Ministry of Commerce, this Division subjected it to a preliminary economic evaluation. If that was favorable, then the sector specialists of the SPO were asked to evaluate the technological aspects of the proposed project. These two steps took at least three to four months and often much longer. Now, both the two experts of the DFI Division and the sector specialists had other duties, most importantly those relating to the preparation of the five-year national

development plans and their annual implementation programs, besides evaluating DFI applications. It appeared that evaluating DFI applications was their neither top-priority nor major concern. When their more important tasks demanded their immediate attention and time, they simply put aside the DFI applications waiting for evaluation for later considerations. Hence, the usually long delays in the SPO's processing of DFI applications.

Evidently, the SPO did not view DFI as an important vehicle for Turkey's industrial development. Its skepticism, if not disbelief, about the actual and expected benefits of DFI came across during the talks with its top officials and experts. The long delays in its processing of DFI applications could not have been solely or directly due to the lack of adequate manpower. Instead, it appeared that the SPO did not wish to provide urgently the necessary inputs for this task which it considered to be, at best, of secondary positive importance, and at worst, of primary negative importance.

The SPO asserted that the DFI firms themselves occasionally engineered delays for the issuance of their own decrees as well as those of others. Some firms were alleged to keep on making changes in their decree applications after submitting them, insisting on lengthy consultations with their parent firms before responding to changes requested by the SPO, and not providing to the SPO all the information necessary for the evaluation of their applications. The SPO was convinced that occasionally DFI firms applied for certain projects in order to preempt, or possibly discourage other local or foreign investors, with no real intention, at least not immediately, of going ahead with those projects. With that aim, the SPO claimed, they were interested in neither the speedy approval of their applications nor the quick imple-

mentation of their decrees.¹ They simply wished to position themselves advantageously in Turkey against present and/or future competitors.

Although this assertion might have been true in some instances, the SPO appeared to over-generalize about the bad faith of DFI firms. Even if that assertion were true more often than not, it could be argued that the over-protection of Turkish manufacturing against foreign competition by the government itself created a favorable situation for DFI firms with bad faith, which wished to avoid or minimize competition. It would not be too difficult for the Turkish government to create an adequate competitive pressure on foreign and national investors to prevent them from trying to pre-monopolize their markets by taking out investment options that they do not wish to exercise immediately. A DFI decree should not necessarily become a preemptive device if it were readily available to all potential investors on equally attractive terms and if the market were not closed to all import competition. Furthermore, it should be noted that if the Turkish government were to issue DFI decrees more expeditiously, it would be more justified in insisting on their speedy implementation without any changes.

The SPO, too, acknowledged that DFI and all-Turkish firms often intervened on the bureaucratic and/or political levels to hinder the approval of rival DFI firms' decree applications. It claimed, however, that it itself was impervious to such intervention and lobbying. It was used to such pressures and ignored them when

¹ In order to prevent DFI firms from "sleeping on their decrees", as the SPO put it, all recent decrees were required to contain a specific time schedule for their implementation. But, the SPO complained, firms too often asked for changes and/or delays before implementing their decrees in their original forms.

evaluating DFI applications strictly on their own merits. It could not, however, do anything against them after it sent draft decrees, via the Ministry of Commerce, to the Council of Ministers for final approval. In fact, the SPO noted, against its own wishes several draft decrees were blocked in the Council of Ministers for several months, and some for more than a year. In such cases, it was sympathetic to requests of the firms involved to introduce modifications into the substance and/or implementation of their long-delayed decrees, when such firms confronted unfavorable technological and/or economic conditions, unforeseen at the time of their applications. This was confirmed by a few DFI firms during the interviews.

The head of the SPO's Economic Planning Department, in which the DFI Division was located, stated that the SPO was well aware of the problem of its anti-DFI reputation. He argued that this problem sprang from the SPO's efforts toward an increasingly effective bargaining with prospective and established DFI firms and also from the idiosyncrasies of Turkish bureaucracy.

Basically the SPO tried to maximize, he explained, the long-term benefits that would accrue to the local partner and to the Turkish economy from a DFI project. However, often the local partner was so interested in his short-term profits from a speedy approval and realization of the DFI project that he paid little attention to his and the country's long-term benefits. Consequently, like the foreign partner, he accused the SPO of obstructionism and ideological opposition to DFI. This was, the chief economic planner claimed, the real source of the friction between the SPO and DFI enterprises.

He argued that DFI firms should realize that the SPO tried to be a careful bargainer to protect the nation's economic interests. They should accept and not complain about this. In the past, many

DFI projects had been approved without much bargaining, leading to substantial losses for Turkey. He added that later on some of these projects had to be subjected to necessary re-bargaining to set some obvious wrongs right.

There was considerable truth in the complaint of DFI firms that the SPO's decisions on DFI matters were not quick enough. The reasons for this, however, were not the SPO's alleged obstructionism and ideological opposition to DFI. According to the chief economic planner, the reasons were the following:

- (1) Turkish bureaucracy was reluctant to make quick decisions because of the possible political distortions of its decisions. In order to protect itself against any future accusations it had to justify on paper and to document thoroughly all its decisions. It always found it to its disadvantage to be flexible, to make quick and/or sweeping decisions. Under the constant shadow of alleged improper and illegal dealings, favoritism, bribery, etc., it could not help being cautious and, therefore, often slow. The SPO was no exception to this.
- (2) The SPO had to reckon with the political priorities and preferences of the government in power in its decision-making. It had to be in tune with the views and objectives of the Council of Ministers and the High Planning Council. This was a serious constraint on the SPO's flexibility, especially when the government's position was not clearly defined or understood.
- (3) The SPO had to share its decision-making power and consult with other government agencies such as the Ministries of Commerce, Finance, and Industry and Technology. Often consultation and cooperation were difficult and time-consuming, especially when different political parties occupied different ministries in coalition governments.

Related to the last two problems was the lack of a definite sectoral and project-based industrialization strategy that would make it relatively easy to identify those DFI applications deserving the SPO's urgent attention. Such a strategy would have to entail a strongly selective and highly specific industrial investment incentives scheme, instead of the general and ineffective scheme administered by the Ministry of Industry and Technology at that time.

The head of the SPO's Economic Planning Department wished that the recently prepared yet unofficial DFI Implementation Code, supplementing Law 6224, (which is yet to become official) would help to alleviate the long delays in the processing of DFI applications. He emphasized that the SPO was not an enemy of DFI but should also never be expected to allow DFI to exploit Turkey as DFI had done in the old days.

The SPO was quite sympathetic about the difficult position of the Ministry of Commerce in the chain of the DFI application-evaluation process. Being caught between the DFI firms and the SPO, with no legal authority of making important decisions on its own about DFI, the Ministry of Commerce unnecessarily wasted both its own and the DFI firms' time and other resources, according to the SPO. It would be better for all concerned to free the Ministry of Commerce from its intermediary role, but this would require new legislation authorizing the necessary administrative changes.

From the interviews conducted at the Ministry of Commerce and the SPO a consensus emerged on the desirability of restricting the approval of the Council of Ministers to only the founding DFI decrees, i.e. those authorizing the establishment of new DFI firms. Then DFI decrees for expansion projects or any other purposes, such as increases in capitalization or changes in

foreign equity shares would acquire the force of law without going through the Council of Ministers. This could be done if the Council of Ministers, via an Authorization Decree, were to delegate its authority of approval to the SPO and the Ministry of Commerce for post-founding DFI decrees. Both government agencies agreed that this would save much time and trouble for both the established DFI firms and themselves. This could be considered a promising administrative reform, although not far-reaching, that would eliminate some, but by no means all of the deliberate delays caused by political (as opposed to bureaucratic) obstacles.

This would make, in our opinion also, eminently good sense in that although allowing the establishment of a new DFI firm could be argued to be a political decision as well as an economic one, approving its various aspects of development over time (to be sure, within certain political guidelines enunciated by the government) should be basically an economic, not political, decision. The present over-politicization in Turkey of all final-decision-making about DFI might be explained in terms such things as Turkey's unfortunate experience with the Capitulations and the lack of confidence in Turkish bureaucracy's ability to make economic decisions non-politically (since the bureaucracy itself is thoroughly politicized). Providing satisfactory explanations for this state of affairs does not, however, eliminate the necessity for separating the political and non-political aspects of DFI decisions, if Turkey wishes to utilize DFI more effectively for its development. For the Council of Ministers itself to serve as the custodian or watchdog of DFI firms, besides not providing an effective regulatory mechanism, actually creates an unfavorable environment in which an economic benefit-cost approach to analyzing the effects of DFI on Turkish manufacturing becomes almost irrelevant, if not impossible.

7. Investment Motives

We now turn to the motives for DFI in Turkish manufacturing. The important motives are clearly both a function of the Turkish industrialization policies and a determinant of the effects of DFI on the development of Turkish manufacturing. In other words, there is a definite feed-back process or mutual dependence between them.

DFI Motive 1: High Expected Rate of Return in Supplying Primarily the Turkish Market.

Table 11 - DFI Motive 1

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	9	19.6	20.9	20.9
1.	9	19.6	20.9	41.9
2.	17	37.0	39.5	81.4
3.	8	17.4	18.6	100.0
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* 0. Unimportant 1. Of little importance 2. Quite important
3. Very important

Mean = 1.558

Standard Deviation = 1.031

Standard Error = 0.157

Mode = 2

DFI Motive 2: Increasing Turkish Import Restrictions Which Began to Endanger Exports to Turkey and Forced Protection of the Turkish Market by DFI.

Table 12 - DFI Motive 2

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	15	32.6	34.9	34.9
1.	4	8.7	9.3	44.2
2.	10	21.7	23.3	67.4
3.	14	30.4	32.6	100.0
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 1.535 Standard Deviation = 1.279
Standard Error = 0.195 Mode = 0

DFI Motive 3: Rapid Expected Growth of the Turkish Economy and Increase of Demand for the DFI Firm's Products.

Table 13 - DFI Motive 3

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	4	8.7	9.3	9.3
1.	2	4.3	4.7	14.0

Table 13 Continued

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
2.	11	23.9	25.6	39.5
3.	26	56.5	60.5	100.0
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 2.372 Standard Deviation = 0.952
Standard Error = 0.145 Mode = 3

DFI Motive 4: Lower Unit Production Costs Than in Parent Firm's Country
Which Could Be Supplied by Exports from Turkey.

Table 14 - DFI Motive 4

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	30	65.2	69.8	69.8
1.	9	19.6	20.9	90.7
2.	3	6.5	7.0	97.7
3.	1	2.2	2.3	100.0
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

Table 14 Continued

* Same as above

Mean = 0.419	Standard Deviation = 0.731
Standard Error = 0.112	Mode = 0

DFI Motive 5: Direct Investments in Turkey by Other Foreign Firms.

Table 15 - DFI Motive 5

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	24	52.2	55.8	55.8
1.	10	21.7	23.3	79.1
2.	7	15.2	16.3	95.3
3.	2	4.3	4.7	100.0
No answer	1	2.2	Missing	100.0
Not available	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.698	Standard Deviation = 0.914
Standard Error = 0.139	Mode = 0

DFI Motive 6: Incentives and Guarantees Offered by the Turkish
Government for DFI.

Table 16 - DFI Motive 6

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	19	41.3	44.2	44.2
1.	10	21.7	23.3	67.4
2.	9	19.6	20.9	88.4
3.	5	10.9	11.6	100.0
No answer	1	2.2	Missing	100.0
Not available	2	4.3	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

* Same as above.

Mean = 1.000 Standard Deviation = 1.069
Standard Error = 0.163 Mode = 0

DFI Motive 7: Incentives and Guarantees Offered by the Parent Firm's
Government for DFI.

Table 17 - DFI Motive 7

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	30	65.2	69.8	69.8
1.	8	17.4	18.6	88.4
2.	4	8.7	9.3	97.7
3.	1	2.2	Missing	100.0

Table 17 Continued

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.442 Standard Deviation = 0.765
Standard Error = 0.117 Mode = 0

DFI Motive 8: Other Considerations

Table 18 - DFI Motive 8

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	33	71.7	76.7	76.7
1.	0	0.0	0.0	76.7
2.	0	0.0	0.0	76.7
3.	10	21.7	23.3	100.0
No answer	1	2.2	Missing	100.0
Not applicable	2	4.3	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Table 18 Continued

Mean = 0.698

Standard Deviation = 1.282

Standard Error = 0.196

Mode = 0

We can determine the relative importance of these eight DFI motives by the ranking of their mean values:

Table 19 - Relative Importance of DFI Motives

<u>DFI Motive (Number)</u>	<u>Mean</u>	<u>Level of Importance</u>
Rapid Expected Growth of the Turkish Economy (3)	2.372	Quite Important to Very Important
High Expected Rate of Return in the Turkish Market (1)	1.558	Of Little Importance to Quite Important
Increasing Turkish Import Restrictions (2)	1.535	Of Little Importance to Quite Important
Turkish Government Incentives and Guarantees (6)	1.000	Of Little Importance
DFI by Other Firms in Turkey (5)	0.698	Unimportant to Of Little Importance
Other Considerations (8)	0.698	Unimportant to Of Little Importance
Parent Firm's Government Incentives and Guarantees (7)	0.442	Unimportant to Of Little Importance
Lower Turkish Costs for Turkish Export Base (4)	0.419	Unimportant to Of Little Importance

The highest relative importance of the rapid expected growth of the host country's economy and increase in the demand for DFI firms' products has been confirmed by several previous studies, for different countries, in the empirical DFI literature. Since the early 1950's, Turkey's potential for rapid economic growth has been realized to a significant extent, despite serious strategic mistakes in economic policy-making. The most harmful of these mistakes was clearly the adoption of an indiscriminatory import-substitution strategy of industrialization that has deprived Turkey of a higher and more stable pattern of real growth than it has experienced. It should also be noted that Turkey has chosen to finance its basically autarchic and closed-economy industrialization by international (public and private) loans. It has suffered international bankruptcy twice (in 1958 and 1978) in twenty years because it could not meet its international debt obligations, having almost completely neglected the creation of industrial export-base. In short, Turkish economic growth has averaged a respectable real rate of about 7 per cent per annum during 1950 - 1977, but its unsteady pattern has exacted too heavy a cost in terms of: (1) an increasing and crushing international debt burden, (2) an internationally non-competitive industrial sector, which depends heavily on imported inputs, but fails badly to generate the exports that can pay for its imports and also contribute to financing Turkey's international indebtedness, and (3) an intensifying and spreading conviction on the Turkish political right and the left that Turkey is incapable of achieving speedy and self-sustaining industrialization under a system of Western parliamentary democracy and free private-enterprise.

Obviously, the next two important DFI motives for our questionnaire respondents, i.e. the high expected rate of return on DFI in supplying primarily the Turkish market and the increasing Turkish import restrictions which began to endanger the parent firm's exports to Turkey and forced it to protect its Turkish market by DFI, are very closely related to the most important DFI motive, i.e. the rapid

Table 20 - Sectoral Mean Values of DFI Motives

DFI Motive	Sector [*]								
	1	2	3	4	5	6	7	8	9
1. High Expected Rate of Return	1.000	2.667	1.429	1.600	1.143	1.800	1.333	1.778	1.000
2. Import Restrictions	0.000	1.667	1.286	2.600	2.286	1.000	1.000	1.667	0.000
3. Rapid Expected Economic Growth	3.000	2.667	2.571	2.000	2.714	1.600	1.667	2.778	1.500
4. Lower Turkish Costs for Export Base	0.000	1.333	0.143	0.400	0.000	0.200	1.000	0.778	0.000
5. DFI by Other Firms	0.000	0.667	0.571	1.800	0.429	0.000	2.000	0.667	0.000
6. Turkish Government Incentives	0.500	0.667	1.286	1.200	0.857	0.600	0.667	1.444	0.500
7. Parent Firm's Government Incentives	0.500	0.000	0.143	0.000	0.857	0.200	0.667	0.778	0.500
8. Other Considerations	0.000	0.000	0.429	0.600	1.286	1.200	0.000	0.667	1.500

* 1. Food and beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals 5. Transportation vehicles and tractors
 6. Non-electrical machinery 7. Electrical cables 8. Electrical machinery and electronics
 9. Building Materials

expected growth of the Turkish economy and increase of demand for the DFI firm's products. Their close complementarity is a manifestation of the Turkish import-substitution strategy of industrialization that has become more and more markedly indiscriminatory since the mid-1960's. It is this strategy that also explains the lowest revealed importance of lower unit production costs than in the parent firm's country that could help create a Turkish export base. In turn, the lowest revealed importance of this DFI motive explains why DFI firms in Turkey have done actually so little exporting.

We observe that DFI motive 3, the rapid expected growth of the Turkish economy and increase of demand for the DFI firms' products had the largest mean value in sectors 1,2,3,5,8 and 9 and the second largest mean value in the other three sectors among all the DFI motives. Therefore, we can conclude that this DFI motive was a highly important one for all the individual sectors.

8. DFI Incentives Provided by the Turkish Government After DFI Projects Were Approved

These incentives refer to the special ones that were granted to the DFI firms on an individual basis, going beyond those that were available prior to the approval of the DFI projects in question.

Incentive 1: Higher Tariffs on Competitive Imports

Table 21 - DFI Incentive 1

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	34	73.9	81.0	81.0
1.	4	8.7	9.5	90.5
2.	3	6.5	7.1	97.6

Table 21 Continued

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
3.	1	2.2	2.4	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* 0. Unimportant 1. Of Little Importance 2. Quite Important
3. Very Important

Mean = 0.310 Standard Deviation = 0.715
Standard Error = 0.110 Mode = 0

Incentive 2: Tighter Quotas on Competitive Imports

Table 22 - DFI Incentive 2

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	23	50.0	54.8	54.8
1.	3	6.5	7.1	61.9
2.	5	10.9	11.9	73.8
3.	11	23.9	26.2	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

Table 22 Continued

* Same as above.

Mean = 1.095	Standard Deviation = 1.322
Standard Error = 0.204	Mode = 0

Incentive 3: Tariff Reductions on Imports of Equipment

Table 23 - DFI Incentive 3

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	25	54.3	59.5	59.5
1.	2	4.3	4.8	64.3
2.	6	13.0	14.3	78.6
3.	9	19.6	21.4	100.0
No answer	3	6.5	Missing	100.0
Not applicable	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.976	Standard Deviation = 1.278
Standard Error = 0.197	Mode = 0

Incentive 4: Tariff Reductions on Imports of Raw Materials and Other
Intermediate Inputs

Table 24 - DFI Incentive 4

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	30	65.2	71.4	71.4
1.	5	10.9	11.9	83.3
2.	1	2.2	2.4	85.7
3.	6	13.0	14.3	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.595 Standard Deviation = 1.083
Standard Error = 0.167 Mode = 0

Incentive 5: Tax Rebates on Exports

Table 25 - DFI Incentive 5

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	25	54.3	59.5	59.5
1.	7	15.2	16.7	76.2
2.	6	13.0	14.3	90.5
3.	4	8.7	9.5	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

Table 25 Continued

* Same as above.

Mean = 0.738	Standard Deviation = 1.037
Standard Error = 0.160	Mode = 0

Incentive 6: Investment Tax Credits

Table 26 - DFI Incentive 6

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	31	67.4	73.8	73.8
1.	1	2.2	2.4	76.2
2.	4	8.7	95	85.7
3.	6	13.0	14.3	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.643	Standard Deviation = 1.144
Standard Error = 0.176	Mode = 0

Incentive 7: Accelerated Depreciation Allowances

Table 27 - DFI Incentive 7

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	35	76.1	33.3	83.3
1.	5	10.9	11.9	95.2
2.	0	0.0	0.0	95.2
3.	2	4.3	4.8	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

* Same as above.

Mean = 0.262 Standard Deviation = 0.701
Standard Error = 0.108 Mode = 0

Incentive 8: Government-supplied Infrastructure Facilities

Table 28 - DFI Incentive 8

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	37	80.4	88.1	88.1
1.	4	8.7	9.5	97.6
2.	0	0.0	0.0	97.6
3.	1	2.2	2.4	100.0
No answer	3	6.5	Missing	100.0
Not available	1.	2.2	Missing	100.0

Table 28 Continued

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Total	46	100.0	100.0	

* Same as above.

Mean = 0.167 Standard Deviation = 0.537
Standard Error = 0.083 Mode = 0

Incentive 9: Guaranteed Government Purchases of the DFI Projects'
Products

Table 29 - DFI Incentive 9

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	38	82.6	90.5	90.5
1.	2	4.3	4.8	95.2
2.	0	0.0	0.0	95.2
3.	2	4.3	4.8	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.190 Standard Deviation = 0.671
Standard Error = Mode = 0

Incentive 10: Other Incentives

Table 30 - DFI Incentive 10

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	40	87.0	95.2	95.2
1.	0	0.0	0.0	95.2
2.	0	0.0	0.0	95.2
3.	2	4.3	4.8	100.0
No answer	3	6.5	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 0.143 Standard Deviation = 0.647
Standard Error = 0.100 Mode = 0

We can determine the relative importance of these ten Turkish government DFI incentives by the ranking of their mean values:

Table 31 - Relative Importance of DFI Incentives

<u>Incentive (Number)</u>	<u>Mean</u>	<u>Level of Importance</u>
Tighter Quotas on Competitive Imports (2)	1.095	Of Little Importance to Quite Important
Tariff Reductions on Equipment Imports (3)	0.976	Unimportant to Of Little Importance
Tax Rebates on Exports (5)	0.738	" " " "
Investment Tax Credits (6)	0.643	" " " "

Table 31 Continued

<u>Incentive (Number)</u>	<u>Mean</u>	<u>Level of Importance</u>			
Tariff Reductions on Intermediate Inputs (4)	0.595	Unimportant to Of Little Importance			
Higher Tariffs on Competitive Imports (1)	0.310	"	"	"	"
Accelerated Depreciation Allowances (7)	0.262	"	"	"	"
Guaranteed Government Purchases (9)	0.190	"	"	"	"
Infrastructure Facilities (8)	0.167	"	"	"	"
Other (10)	0.143	"	"	"	"

The obvious conclusion is that special Turkish government incentives offered to DFI projects were on the whole of little importance, if not unimportant. This is not at all surprising since Turkey has never had an active official DFI promotion program and has never offered foreign direct investors any special incentives. Law 6224, in fact, states very clearly that DFI firms can be treated no differently from all-Turkish firms. All the incentives received by DFI firms could also be available to all-Turkish firms in their respective sectors. Actually, during the interviews, many DFI firms complained that they were discriminated against by the Turkish government in the administration of special industrial investment incentives and that this was in violation of Law 6224's equal treatment guarantee for DFI firms. This complaint and the responses of government officials will be examined in detail in the section dealing with the expansion difficulties encountered by DFI firms.

9. Was an Export Commitment Made to the Turkish Government When DFI Project Was Approved?

Table 32 - Was an Export Commitment Made?

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Yes	14	30.4	30.4	30.4
No	32	69.6	69.6	100.0
Total	46	100.0	100.0	

Less than one third of the respondents had made an export commitment when their DFI projects were approved. This relatively low ratio reflects the fact in the 1960's and especially the 1950's, the Turkish government did not as a rule demand many commitments or impose many requirements in return for approving DFI applications. In the 1970's, however, very few applications were approved without some explicit conditions that had to be met by DFI firms during the implementation of their authorization decrees.

Table 33 - Sectoral Frequencies of Export Commitment

<u>Sector</u>	<u>Export Commitment - Adjusted Frequency (%)</u>
1. Food and Beverages	33.3
2. Rubber	0.0
3. Chemicals	25.0
4. Pharmaceuticals	20.0
5. Transportation Vehicles and Tractors	42.9
6. Non-electrical Machinery and Metal Products	0.0
7. Electrical Cables	33.3

Table 33 Continued

<u>Sector</u>	<u>Export Commitment - Adjusted Frequency (%)</u>
8. Electrical Machinery and Electronics	50.0
9. Building Materials	50.0

The relatively high frequencies of export commitment in sectors 5 and 8 are explained again in terms of the increasing concentration of DFI activity in these sectors during the 1970's, which witnessed the emergence of more demanding government DFI policies in Turkey.

10. Forms of Export Commitment

Table 34 - Forms of Export Commitment

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
1.	3	6.5	23.1	23.1
2.	6	13.0	46.2	69.2
3.	2	4.3	15.4	84.6
4.	1	2.2	7.7	92.3
5.	1	2.2	7.7	100.0
Not applicable	32	69.6	Missing	100.0
Not available	1	2.2	Missing	100.0
Total	46	100.0	100.0	

*

1. Minimum value of exports or minimum percentage of total sales
2. Minimum absolute level or minimum percentage of physical output
3. Minimum percentage of transferable profits
4. Minimum percentage of transferred profits with a minimum absolute level of physical output

Table 34 Continued

5. Minimum percentage of the total foreign exchange payments for imported inputs, compensation of foreign personnel and license fees
-

During the interviews with Turkish DFI officials, the author was told that when Turkey had begun to require export commitments from DFI firms, it inadvertently gave them too much leeway in the choice of what to export, by specifying their export commitments in general value terms. Many firms were said to have exported products unrelated to their own, even agricultural commodities, to meet their export commitments. This practice was condemned by government officials as one of the several instances in which DFI firms were able to defeat the aims of Turkish DFI policies, by taking advantage of the legal loopholes in their authorization decrees. As a result of that experience, however, Turkey had lately begun to insist on a DFI firm's own physical output form of export-commitment in most cases. Therefore, the highest frequency of this form of export-commitment reported by our questionnaire respondents reflects a rather recent development. The sectoral frequencies of this form of export-commitment, presented below, show its total absence from some sectors and concentration in the others.

Table 35 - Export Commitment Based on Physical Output

<u>Sector</u>	<u>Adjusted Frequency of Export-Commitment Based on DFI Firm's Own Physical Output (%)</u>
1. Food and Beverages	0.0
2. Rubber	0.0
3. Chemicals	50.0
4. Pharmaceuticals	0.0
5. Transportation Vehicles and Tractors	33.3

Table 36 Continued

<u>Sector</u>	<u>Investment Approval - Production Lag Sectoral Mean (months)</u>
6. Non-electrical Machinery and Metal Products	7.5
7. Electrical Cables	18.7
8. Electrical Machinery and Electronics	21.4
9. Building Materials	32.5

There could be several diverse technological and financial constraints on how rapidly a DFI project could be started and brought to completion. It is obviously impossible to generalize about them. There is one specific issue, however, that should be mentioned in this connection.

During the interviews with the author, the DFI firms and government officials blamed each other for delays between the approval of DFI projects and their completion. The firms complained that after their projects had been authorized by the Council of Ministers, they encountered bureaucratic obstacles in (1) obtaining special industrial investment incentives from the Ministry of Industry and Technology, (2) transfer approval of their incoming foreign funds from the Ministry of Finance, and (3) customs clearance of their imported capital equipment from the Ministry of Customs and Monopolies.

These obstacles created delays in implementing their authorization decrees. And, in some cases they invalidated the initial feasibility studies that justified the undertaking of their DFI projects, necessitating revisions in their authorization decrees.

The government officials, although not rejecting that there were some administrative delays caused by lack of inter-ministry coordination and inadequate manpower, claimed that the DFI firms themselves were sometimes guilty of deliberately delaying the start and completion of their authorized projects. The firms were accused of occasionally inventing excuses for delays so that they could renegotiate their authorization decrees to obtain more favorable terms from the government. Furthermore, some firms were claimed to have obtained expansion or modernization authorization decrees with no intention of implementing them as long as they were earning oligopoly rents from contrived supply restrictions. Such firms also allegedly prevented others from seeking authorization for new or expansion DFI projects, by virtue of having obtained preemptive initial authorization in their respective sectors..

We believe that most post-decree delays in the start and completion of DFI projects could not have been engineered, that is, caused deliberately, by either the government officials or the firms themselves. Most post-authorization bureaucratic obstacles appeared to have resulted from the lack of inter-ministry coordination and the typical general slowness of the Turkish bureaucracy. On the other hand, although a few firms might have dragged their feet in implementing their decrees for whatever reasons, most of them seemed to have done their best to start and complete the projects for which they had received authorization. In short, neither the DFI firms nor the government officials had much justification for their mutual accusations. The basic problem was, of course, again the lack of mutual trust and effective communication between the two sides.

12. Was Additional Productive Capacity Built Since the Initial Capacity Went into Production?

Table 37 - Was Additional Capacity Built?

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Yes	36	78.3	80.0	80.0
No	9	19.6	20.0	100.0
No answer	1	2.2	Missing	100.0
Total	46	100.0	100.0	

Four out of five respondents reported increasing their productive capacities beyond the initial levels authorized by their founding decrees. In other words, most of the DFI firms responding had grown, whether at the rate they wished to or not, since coming into existence. Below we present the sectoral frequencies of affirmative replies to the additional capacity question:

Table 38 - Additional Capacity Was Built

<u>Sector</u>	<u>Additional Capacity Was Built - Adjusted Frequency (%)</u>
1. Food and Beverages	66.7
2. Rubber	100.0
3. Chemicals	75.0
4. Pharmaceuticals	100.0
5. Transportation Vehicles and Tractors	71.4
6. Non-electrical Machinery and Metal Products	75.0
7. Electrical Cables	66.7

Table 38 Continued

<u>Sector</u>	<u>Additional Capacity Was Built - Adjusted Frequency (%)</u>
8. Electrical Machinery and Electronics	80.0
9. Building Materials	100.0

We see that at least two out of three respondents in each sector reported building additional capacity. The variation of the sectoral frequencies could have been due to several different causes, among them, obviously, the length of time firms in individual sectors have been in existence. Older firms would be expected to have built additional capacity with higher frequency than younger firms.

13. Additional Capacity Built as a Percentage of Initial Capacity

Mean = 299.6 Standard Deviation = 357.4
Standard Error = 62.2
Minimum = 10.0 Maximum = 2000.0
Valid Observations = 33 Missing Observations = 13

The average additional capacity built appears to have been triple the initial level, with significant variation among the individual respondents. Again, we would expect older firms to have built relatively more additional capacity than younger firms, but obviously this expectation would be stronger on an intrasectoral basis than on an intersectoral one. We now turn to the intersectoral variation in the percentages of additional capacity built:

Table 39 - Sectoral Additional Capacities

<u>Sector</u>	<u>Additional Capacity Built as a Percentage of Initial Capacity</u>
1. Food and Beverages	2000.0
2. Rubber	420.0
3. Chemicals	155.2
4. Pharmaceuticals	284.0
5. Transportation Vehicles and Tractors	98.0
6. Non-electrical Machinery and Metal Products	183.3
7. Electrical Cables	150.0
8. Electrical Machinery and Electronics	308.8
9. Building Materials	360.0

The relatively very high rate of expansion in Sector 1 is that of a single respondent, which was one of the oldest DFI firms in Turkey. The lowest rate of expansion shown by Sector 5 is most likely due to the fact that most of its respondents were among the youngest DFI firms in the country. A thorough explanation of the intersectoral variation of capacity expansion rates requires detailed analyses of the individual sectors, which will not be attempted here.

14. Evaluation of Recent Rate of Capacity Expansion in Light of Present Demand

DFI firms were asked to evaluate their recent rates of capacity expansion in light of the present demand for their products. It should be mentioned that during the period this research was carried out Turkey was nearing international bankruptcy. No legal transfers of foreign exchange for intermediate input or equipment spare parts imports were feasible for most private manufacturing firms in the country, and the economy's real rate of growth had sharply dropped

to about 2 per cent per annum. Many manufacturing firms, among them several DFI firms, were forced to operate at less than 50 per cent capacity. Consequently, the results of DFI firms' own evaluation of their expansion rates below should be interpreted against this relatively dismal background.

Table 40 - Evaluation of Recent Rate of Capacity Expansion

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Too low	28	60.9	66.7	66.7
About right	14	30.4	33.3	100.0
Too high	0	0.0	0.0	100.0
No answer	4	8.7	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

Two thirds of the respondents considered their recent expansion rates as "too low". Not a single one regarded its rate of expansion as "too high". This outcome is rather surprising, given the deterioration in Turkey's DFI environment, coupled with the over-all worsening of economic conditions in the country that coincided with the duration of our investigation.

During the interviews, however, many DFI executives expressed their optimistic belief that Turkey's international bankruptcy would not be allowed by the Western industrialized countries to go too far in damaging Turkish industrialization prospects and thereby pushing Turkey toward severing its political and military alliance with the West. They argued that the West could not afford for strategic reasons to let Turkey go down the drain, and therefore, it would before long bail the "Sick Man of Europe" out once more, as it had done earlier in 1958. Some also speculated that Turkey might even be persuaded

or forced into assigning a far bigger role to DFI in its future industrialization efforts. In short, the DFI firms interviewed were on the whole bullish about their long-term presence in Turkey, despite the fact that the current conditions they faced were quite discouraging. Several foreign managers of DFI firms did confess, however, that their positive views were not shared by their parent-firm executives who from outside viewed Turkey as a lost cause.

Table 41 - Sectoral Evaluation of Recent Rate of Capacity Expansion - Adjusted Frequency (%)

	<u>Sector</u> [*]								
	1	2	3	4	5	6	7	8	9
Too low	100.0	100.0	50.0	80.0	85.7	75.0	0.0	66.7	0.0
About right	0.0	0.0	50.0	20.0	14.3	25.0	100.0	33.3	100.0
Too high	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

* 1. Food and Beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals
5. Transportation Vehicles and Tractors 6. Non-electrical Machinery Products 7. Electrical Cables 8. Electrical Machinery and Electronics 9. Building Materials

In all but sectors 7 and 9, at least one out of two respondents considered their rates of capacity increases as "too low". In the next section, attention turns to the reasons offered by DFI firms that regarded their present capacity levels as insufficient.

15. Reasons for Too Low Rates of Capacity Expansion

Low Capacity Reason 1: Underestimation of the Rate of Increase in Demand.

Table 42 - Low Capacity Reason: 1

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	17	37.0	60.7	60.7
1.	6	13.0	21.4	82.1
2.	5	10.9	17.9	100.0
3.	0	0.0	0.0	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	100.0
Total	46	100.0	100.0	

* 0. Unimportant 1. Of Little Importance 2. Quite Important
3. Very Important

Mean = 0.571 Standard Deviation = 0.790
Standard Error = 0.149 Mode = 0

Low Capacity Reason 2: Restrictions Placed on Expansion by the
Turkish Government's DFI Licensing Process

Table 43 - Low Capacity Reason 2

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	0	0.0	0.0	0.0
1.	0	0.0	0.0	0.0
2.	2	4.3	7.1	7.1
3.	26	56.5	92.9	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	100.0
Total	46	100.0	100.0	

* Same as above.

Mean = 2.929

Standard Deviation = 0.262

Standard Error = 0.050

Mode = 3

Low Capacity Reason 3: Difficulties in Financing Capacity Expansion

Table 44 - Low Capacity Reason 3

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	12	26.1	42.9	42.9
1.	1	2.2	3.6	46.4
2.	11	23.9	39.3	85.7
3.	4	8.7	14.3	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	

Table 44 Continued

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Total	46	100.0	100.0	

* Same as above

Mean = 1.250 Standard Deviation = 1.175
Standard Error = 0.222 Mode = 0

Low Capacity Reason 4: Difficulties in Importing Capital Goods Due
to the Turkish Government's Restrictions on
Foreign Exchange

Table 45 - Low Capacity Reason 4

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
0.	6	13.0	21.4	21.4
1.	2	4.3	7.1	28.6
2.	5	10.9	17.9	46.4
3.	15	32.6	53.6	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	100.0

Total 46 100.0 100.0

* Same as above

Mean = 2.036 Standard Deviation = 1.232
Standard Error = 0.233 Mode = 3

Low Capacity Reason 5: Shortages of Qualified Manpower

Table 46 - Low Capacity Reason 5

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	18	39.1	64.3	64.3
1.	7	15.2	25.0	89.3
2.	1	2.2	3.6	92.9
3.	2	4.3	7.1	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	100.0

Total	46	100.0	100.0	
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* Same as above

Mean = 0.536	Standard Deviation = 0.881
Standard Error = 0.167	Mode = 0

Low Capacity Reason 6: Other Reasons

Table 47 - Low Capacity Reasons 6

<u>Code</u> [*]	<u>Absolute Frequency</u>	<u>Relative Frequency</u>	<u>Adjusted Frequency</u>	<u>Cumulative Frequency</u>
		(%)	(%)	(%)
0.	22	47.8	78.6	78.6
1.	0	0.0	0.0	78.6
2.	0	0.0	0.0	78.6
3.	6	13.0	21.4	100.0
No answer	4	8.7	Missing	100.0
Not applicable	14	30.4	Missing	100.0

Table 47 Continued

<u>Code</u> *	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Total	46	100.0	100.0	

* Same as above.

Mean = 0.643	Standard Deviation = 1.254
Standard Error = 0.237	Mode = 0

In terms of their relative levels of importance, the six low capacity reasons yield the following ranking:

Table 48 - Relative Importance of Low Capacity Reasons

<u>Low Capacity Reason (Number)</u>	<u>Mean Value</u>	<u>Level of Importance</u>
Government DFI licensing restrictions on expansion (2)	2.929	Quite important to very important
Government restrictions on foreign exchange transfers for capital goods (4)	2.036	" " " "
Financing difficulties (3)	1.250	Of little importance to quite important
Other reasons (6)	0.643	Unimportant to of little importance
Underestimation of the rate of increase in demand (1)	0.571	" " " "
Shortages of qualified manpower (5)	0.536	" " " "

What emerges is that by far the most serious constraint on capacity expansions of the respondents was the Turkish government's DFI licensing restrictions. This was a direct and DFI-firm specific official constraint. The next most important and also official constraint, government restrictions on foreign exchange transfers for capital goods, was only partially direct and DFI firm specific. In other words, not all such foreign exchange transfer restrictions were applied to only the DFI firms. All-Turkish firms, too, faced them, given Turkey's pervasive direct government controls on all types of foreign exchange transfers.

Before we review the interview results concerning the complaints of DFI firms in the general area of capacity expansion, and the responses of government officials, we note below the near unanimity among sectors, in which respondents reported insufficient capacity, about the highest relative importance of the DFI licensing process as a reason for insufficient capacity levels:

Table 49 - Sectoral Importance of DFI Licensing as a Low Capacity Reason

<u>Sector</u>	<u>Mean Value</u>	<u>Level of Importance</u>
1. Food and Beverages	3.00	Very important
2. Rubber	3.00	" " "
3. Chemicals	3.00	" " "
4. Pharmaceuticals	3.00	" " "
5. Transportation Vehicles and Tractors	3.00	" " "
6. Non-electrical Machinery and Metal Products	3.00	" " "
7. Electrical Cables	*	*
8. Electrical Machinery and Electronics	2.667	Quite important to very important
9. Building Materials	*	*

* Not applicable since all respondents in the sector considered their rates of capacity expansion as "about right".

A. The Controversy on Capacity Expansion

DFI firms complained that they found it too difficult to expand because of the various official restrictions imposed on their activities. Many argued that they could not even maintain their existing productive capacities. They were being deliberately run into the ground. They felt that they were discriminated against by the Turkish government vis-à-vis their all-Turkish rivals despite the provision for equal treatment contained in Law 6224.

An all-Turkish firm needed no permission from the government in order to increase its productive capacity but a DFI firm had to get a new decree, i.e. an investment license. Even if a DFI firm could finance its expansion project out of its non-remitted earnings or bring in additional capital from abroad, with no need for domestic external financing, it still found it extremely hard to obtain an expansion decree.

In fact, the more profitable it was, and therefore, the more able to finance its expansion internally, the greater became the opposition of the government to its growth. The government disliked highly profitable DFI firms and treated them as if they owed their success to objectionable means of doing business. This attitude of the government forced some DFI firms deliberately to conceal their profitability in order to avoid unfriendly measures that might be taken to punish them for being too profitable. For example, the more profitable a DFI firm was, the more frequently it was likely to be audited by the Ministry of Finance, increasing the chance that some of its transferable profits would be blocked at the Central Bank.

Usually when a DFI firm applied for an expansion decree, the government confronted it with various drastic and unreasonable changes

in its old decrees as a condition for permitting it to expand. Such changes could involve a reduction in the foreign equity share, a new or higher export commitment, a decrease or elimination of the technology transfer payments to the foreign parent firm, and the like. Sometimes the government's conditions for accepting the expansion application were so unfavorable to a DFI firm that it preferred to withdraw its application. In fact, the government resorted to this tactic of demanding what it knew would be hard or impossible to accept revisions in a firm's old decrees, whenever the firm requested a new decree for a merely operational objective, such as changing its name, as well as for an expansion project. Furthermore, even if a firm did not offer the government an opportunity for revising its old decrees by applying for a new decree, the government occasionally declared that they had been revised unilaterally. Then the firm could either accept this fait accompli or take the government to Danistay, the High Turkish Court, for a prolonged litigation.

Some firms, fully aware of the difficulty if not impossibility of obtaining expansion decrees, had increased their productive capacities stealthily. They argued that there was no choice if they were to stay alive. They had to grow with the market or fall by the wayside. Eventually the government would find out about their unauthorized expansions and decide to crack down. But then the government itself would be presented with a fait accompli and forced to come to terms with them.¹ In such cases, the firms and the government entered into a bargaining. That resulted in

¹ The government could, of course, accuse them of illegal conduct and thereby annul their decrees, forcing them to shut down. But this alternative, which incidentally the government had never chosen, would create serious problems such as supply shortages and unemployment of industrial workers with political clout.

the issuance of decrees, containing certain concessions by the firms, declaring their de facto expansion de jure, and authorizing suitable increases in their nominal capitals to match the already accomplished increases in their fixed assets.¹ During the bargaining, however, the government occasionally blocked the transferable profits of the foreign partners, attributable to the unauthorized investments.

Several of the firms that had confronted the government with de facto increases in their capacities argued that modernization of their facilities, rather than just a straightforward expansion with old technology, accounted for their higher capacity levels. In fact, they had tried to convince the government that the gradual replacement of old plant and equipment as a result of the normal depreciation process, necessarily led to increases in productivity and this should not be considered as unauthorized expansion.

It should be noted, however, that DFI firms that wished to expand either legally or illegally, or simply to replace their old plant and equipment, could not easily obtain the necessary capital goods. First, all imports of capital goods were subject to government licensing and/or required foreign exchange allocation. Since at least 1973, the National Annual Economic Programs had contained a discriminatory provision concerning imports of producers' goods: The foreign exchange allocations by the Ministry of Commerce for the imports of investment goods by the private sector had been restricted for DFI firms only to those requests that did non enable them to increase their capacity and production. This was another instance of discrimination against DFI firms, contrary to Law 6224, which provided for equal treatment for all firms operating in the country.

¹ Often the firms were able to increase their nominal capitals by dipping into their ordinary and extraordinary reserves, which they had accumulated during the expansion of their productive capacities. So, only a shifting around of internal funds in their balance sheets was involved in this process.

Secondly, even if a DFI firm applied for no foreign exchange allocation and simply wanted permission to import investment goods not produced in Turkey, by financing them out of its own or parent's foreign exchange credits, it found it rather difficult to obtain such permission from the government. Even when it had already obtained an expansion decree, it took too long first to get an import license and then to clear the imported goods through the Turkish customs. Its expansion decree did not entitle it automatically to the several possible industrial investment incentives that were administered by the Ministry of Industry and Technology. Among these incentives were total or partial exemption from customs duties and the payment of these duties on installment. And, it could not apply for any of these incentives, before obtaining an expansion decree.

Several firms, faced with the various problems in importing capital goods, had initiated their local production. They had either produced them themselves or contracted out their separate components to different local producers after providing them with the necessary blue-prints and technical assistance. These firms stated that their forced self-sufficiency had decreased their efficiency and product quality, but enabled them at least to survive. Some firms had made deals with all-Turkish firms that imported the investment goods needed, in their own names, but later sold them as used equipment to these DFI firms at a premium.

Concerning the domestic financing of a DFI firm's investment expenditures there were three complaints:

- (1) As regards new or expansion projects, the Ministry of Finance discriminated against DFI firms in the distribution of investment tax credits, which were among the several industrial investment incentives administered by the Ministry of Industry and Technology. The Ministry of Finance restricted the benefits DFI firms could derive from these credits by tying them to the level of local equity participation.

- (2) The Ministry of Finance severely restricted the allocation of depreciation funds for the replacement of old equipment. Ignoring such important factors as world-wide inflation, rapid technological progress and steady erosion in the relative value of the Turkish lira, that led to significant increases in the lira prices of new equipment, the Ministry of Finance insisted that old equipment be replaced at the old foreign book-value prices and at the old foreign exchange rates, which was clearly an impossible task to accomplish. DFI firms argued that this restriction, if it were to be effectively implemented, would surely run them into the ground. All-Turkish firms did not face this restriction and were, therefore, at a distinct advantage vis-à-vis their rivals with foreign equity participation.
- (3) DFI firms found it more difficult to get loans from Turkish banks than did all-Turkish firms because the government frowned on banks that financed DFI firms. This was claimed to be yet another instance of discrimination against DFI firms, in violation of Law 6224.

Altogether there seemed to be sufficient evidence that the several official obstacles DFI firms encountered in their efforts to expand, to grow with their markets, more than just eroded their international economic edge over their all-Turkish rivals. They were so detrimental that several DFI firms, especially after the mid-1970's, had been forced on this account, to rid themselves of their "foreigner" liability, their "hunchback" as one firm put it. Most of them had chosen to go all-Turkish by having the local partners buy out the foreign partners, but maintain close technological and business ties between them. The others had set up all-Turkish firms as extensions (and competitors!) of themselves in order to take unfettered advantage of the market growth, especially in the production of newer products with

higher profit margins which a DFI firm would not be easily allowed to produce. Such all-Turkish extensions of DFI firms had usually the same access to the foreign parents' knowhow, which they paid for often by means of concealed transactions. These transactions had usually involved sufficiently high mark-ups on intermediate inputs imported directly or indirectly from the foreign parents. This practice of spinning off all-Turkish extensions was being considered by a number of DFI firms that were pessimistic about their short- and medium-term growth prospects but wished to maintain their presence in Turkey, hoping for possible long-term improvements in the DFI climate.

These complaints of DFI firms were discussed by the author with several government officials who were asked to state their views on the matter. Their responses follow.

The State Planning Organization (SPO) denied that it was against the growth of DFI firms, especially since most of them were actually so small by international standards and unable to exploit fully the available economies of scale in production. In fact, it had itself forced some of them to increase their capacities to meet its minimum scale requirements.

Concerning this complaint, the SPO officials made the following remarks:

- (1) Any DFI firm that wished to increase its capacity of production had also to increase its nominal capital. And, to increase its nominal capital it had to obtain a new decree from the Council of Ministers. That was the law, i.e. Law 6224. The SPO had to implement the law and the firms had to obey it, unless and until the law could be revised to drop the decree requirement for expansion projects.

- (2) The SPO had to keep track of sectoral capacity levels in order to plan the growth of Turkish manufacturing sector by sector. Keeping track of sectoral capacity levels required information on individual firms' capacities. Although the SPO was not authorized by law to decide and control the capacities of private all-Turkish firms directly, it could do this for DFI firms. It regarded this as an important instrument of planning and was unwilling to give it up so that DFI firms could expand at will without its permission. But, the SPO emphasized, in reality, instead of standing in the way of DFI firms that wanted to expand their production, it often had to demand that DFI firms increase their capacities above certain minimum levels. Frequently, firms were reluctant to comply with its demand in order not to reduce their excessive profits and resorted to all sorts of delaying tactics that were frustrating to the SPO and harmful to the national interest.
- (3) Although the SPO had no general opposition to expansion of DFI firms, it reserved judgment on the desirability of expansion for particular projects of individual DFI firms. The net benefits Turkey could derive from the presence of a given DFI firm changed over time. In other words, the social profitability of an on-going enterprise, as estimated by the SPO, might not be as significant later in its life as in its earlier years. Therefore, its continuous expansion might become for Turkey less and less desirable and eventually not desirable at all. The SPO would keep close watch on every DFI firm and allow it to continue its expansion in a given direction until its social profitability was exhausted.

Furthermore, the SPO believed that whenever, in a given sector, increased production could be provided by the expansion of all-Turkish firms, they should be given priority over their DFI competitors. The social profitability of such an expansion was

higher than that of DFI firms, the SPO claimed. When the SPO was asked whether this did not violate the no-discrimination (between all-Turkish and DFI firms) provision of Law 6224, it replied in the negative. It argued that since according to Law 6224 (Article 1 - Clause a) any DFI firm could be allowed to expand as long as such an expansion tended "to promote the economic development of the country", it was authorized to stop that firm's expansion whenever the country's economic development could be better served by the expansion of all-Turkish firms. This entailed no discrimination for its own sake, the SPO asserted, and there could be no question that the country always benefited more from the expansion of all-Turkish firms than that of DFI firms.

Neither the Ministry of Commerce nor the Ministry of Finance admitted to being opposed in general to the expansion of DFI firms. The DFI Divisions of both ministries argued, as did that of the SPO, that each individual case had to be and was judged separately and strictly on its own merits. No generalization could or should be made.

The Ministry of Commerce was against unilateral revision of old decrees (and did not approve of the SPO's occasional attempts at that) but believed that it was perfectly reasonable for the Turkish government to ask for such revision and then bargain for it with a DFI firm that had applied for an expansion decree. That was the only legal way open to the government to make up for its past bargaining weaknesses and mistakes with that firm. Besides, over time economic and political conditions of the country changed and necessitated a re-evaluation of each on-going DFI enterprise. Even if initially Turkey had bargained effectively with the foreign investors and received the best possible terms from them for that time, later no new terms might be needed to justify their continued presence in the country. If they did not wish to accept Turkey's new terms as a condition for their expanded activities, they were

free to withdraw their expansion applications or even pull out of Turkey completely.

DFI officials of the SPO, the Ministries of Commerce and Finance all rejected the allegation that they did not approve of and harassed highly profitable DFI firms. They claimed that such firms themselves often asked for trouble by becoming unruly. Feeling overconfident, these firms resisted making the changes stipulated in their decrees, e.g. decreasing the equity share of the foreign partners, in a manner satisfactory to the government.¹ Then the government was forced to press them hard to get its demands satisfied. But, these officials argued, they did not pick on a firm just because it was a highly profitable one.

They also noted that a DFI decree by itself could not entitle a firm to any of the industrial investment incentives administered by the Ministry of Industry and Technology.² The SPO officials rejected that ministry's offer to get involved in DFI decisions in the pre-decree stage as a solution, and instead, wished to regain the SPO's authority from that ministry to administer the investment incentives themselves. The Ministry of Finance officials thought that DFI firms would be the losers from getting yet another

¹ E.g., they insisted on selling part of their foreign equity not to those Turkish interests, such as a State Economic Enterprise, acceptable to the government, but to certain Turkish investors whom the government did not approve of.

² Interestingly, the chief architect and administrator of the industrial investment incentives scheme in the Ministry of Industry and Technology, believed that a DFI decree should entitle a firm to receive such incentives and that his ministry, too, should be involved in DFI decision-making of the government to remedy this deficiency.

government agency, i.e. the Ministry of Industry and Technology, involved in (pre-decree) DFI decisions, because that would only increase the inter-agency squabbling and slow down further the processing of DFI applications. DFI firms were relatively better off facing the uncertainty whether they would receive all or any of the investment incentives that they might have assumed in their feasibility studies.

The Ministry of Finance DFI officials stated that their Ministry's Taxation Department was responsible for the ruling on the restricted distribution of investment tax credits to DFI firms.¹ They reasoned that in the absence of the appropriate taxation treaties between Turkey and DFI source-countries, any tax credits Turkey granted to foreign investors might be taxed instead by their source-countries, doing neither Turkey nor the foreign investors themselves any good.²

As regards the complaint about insufficient depreciation allowances, these officials stated that this, too, concerned the Taxation Department. They argued, however, that this justified complaint could be heard from all-Turkish firms as well. The Turkish tax system had to be reformed to enable all firms to use inflation-accounting and thereby take advantage of accelerated depreciation necessitated by ever-increasing inflation. There was claimed to be no discrimination against DFI firms with respect to this serious problem.

¹ It should again be noted that the Ministry of Industry and Technology was critical of this ruling because it was an interference in its administration of the investment incentives and an unjust treatment of DFI firms as well.

² The author was unable to pursue this matter further by interviewing the Taxation Department officials who could not be approached.

Finally, these same officials denied that there had been any systematic attempt on the government's part to restrict domestic bank credits to DFI firms. If there had indeed been any discrimination by domestic banks against DFI firms, its real cause should be sought in the ownership structure of Turkish banking. They speculated that since the larger private commercial banks were controlled by the larger Turkish private industrial conglomerates, the so-called Holdings, they might discriminate against those DFI firms in which they held no equity. This speculation appeared to lack credibility, however, because almost all the important DFI joint-ventures in Turkey had as partners one of those Holdings, each of which controlled one of the larger private commercial banks.

In connection with this issue, it should be noted that according to the research director of the Turkish Industrial Development Bank, itself a DFI firm, a joint-venture with the International Finance Corporation, his bank could finance the investment projects of all-Turkish firms only, as a result of government pressure. Furthermore, the SPO officials were emphatic about the necessity of limiting the access of DFI firms to domestic sources of finance. These officials argued that although these firms had been expected to alleviate the country's savings and foreign-exchange gaps by bringing in foreign credits, which they could get far more easily than all-Turkish firms, they had instead resorted to local borrowing whenever they could, and thereby decreased the availability of domestic funds to all-Turkish firms. DFI firms were claimed to find it easier than their all-Turkish competitors to get local financing from Turkish banks, on the basis of their larger size, higher profitability and international prestige. The SPO believed that contrary to the complaint of DFI firms about discriminatory restrictions on their local borrowing, all-Turkish firms were the ones that were actually discriminated against by the banks. It was this discrimination that the government

objected to and tried to eliminate.¹

Our conclusion on this important issue of capacity expansion is that DFI firms were on the whole discriminated against by the government, which appeared to fear that their increasing sizes might enable them to become too powerful economically and politically. This underlying fear of domination by large foreign business interests on the part of Turkish bureaucracy has been and will continue to be a serious obstacle to greater penetration of Turkish manufacturing by DFI.

16. What Was the Initial Estimate of the Length of Time Necessary to Repatriate the Parent Firm's Original Imported Capital During the First Year of Operation?

Mean = 7.6 years (y)	Standard Deviation = 3.9 y
Standard Error = 0.8 y	
Minimum = 3.0 y	Maximum = 20.0 y
Valid Observations = 25	Missing Observations = 21

Most of the DFI firms who could not response to this question indicated that no such estimate had been made. The above average original foreign capital pay-back period initial estimate of almost 8 years is based on responses of old as well as young firms. Undoubtedly, an individual DFI firm's estimate would have depended on, among other things, the Turkish DFI climate of the time during which it had been established, as well as the sector to which it had belonged.

¹ The serious nature of this issue of local financing might be better understood if it is kept in mind that Turkey had no national money or capital markets to speak of. Almost all local business borrowing, short-, medium- and long-term, was from the banks.

Table 50 - Initial Estimate of Original Imported Foreign Capital Pay-Back Period

<u>Sector</u>	<u>Initial Estimate of Original Imported Foreign Capital Pay-Back Period - Mean (years)</u>
1. Food and Beverages	6.0
2. Rubber	Not available
3. Chemicals	5.5
4. Pharmaceuticals	11.0
5. Transportation Vehicles and Tractors	5.2
6. Non-electrical Machinery and Metal Products	7.0
7. Electrical Cables	10.0
8. Electrical Machinery and Electronics	8.1
9. Building Materials	7.5

We see that sectors 4 and 7 had relatively long pay-back period initial estimates. Now, both these sectors consisted of relatively old DFI firms. Therefore, it would appear rather implausible to attribute their longer than average estimates to worsening of the Turkish DFI climate over time. Instead, their sectoral characteristics would seem to have been influential.

17. Has the Parent Firm's Original Imported Capital Been Already Completely Repatriated?

Table 51 - Is the Original Imported Capital Fully Paid-back?

	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
Yes	21	45.7	48.8	48.8
No	22	47.8	51.2	100.0

Table 52 - Present Estimates of Original Imported Capital
Payback Periods

<u>Sector</u>	<u>Present Estimate of Original Imported Foreign Capital Payback Period - Mean (years)</u>
1. Food and Beverages	Not available
2. Rubber	" "
3. Chemicals	" "
4. Pharmaceuticals	22.7
5. Transportation Vehicles and Tractors	17.0
6. Non-electrical Machinery and Metal Products	9.0
7. Electrical Cables	12.0
8. Electrical Machinery and Electronics	7.6
9. Building Materials	Not available

We observe that in sector 4, the present estimate of the original foreign capital pay-back period is more than double the initial estimate. The author is rather skeptical at this time, however, that the original foreign capital of any pharmaceutical DFI firm had not yet been repatriated when his questionnaire was answered. We hope to investigate this issue later in a separate sectoral study.

In sector 5, the present estimate is more than triple the initial estimate, indicating a rather deep pessimism of the DFI firms producing transportation vehicles and tractors about their future, based on the recent deterioration of the Turkish DFI climate. In sectors 6 and 7, too, the present estimates are longer than the initial estimates, but not so strikingly. In sector 8, however, the present estimate is shorter than the initial estimate, raising the obvious and interesting question, which will be investigated later in a separate sectoral study, as to why.

19. What Has Been the Parent Firm's Rate of Return (Repatriated Earnings as a Percentage of the Parent Firm's Original Imported Capital) during 1970 - 1977?

It should first be mentioned that several DFI firms, especially the relatively old ones that had also grown considerably since their founding, objected to the formulation of this question. They argued that expressing the parent firm's annual rate of return in terms of annual repatriated earnings in current Turkish liras would give a misleading picture of the parent firm's gains. These gains would be grossly exaggerated for two reasons: (1) Inflation in Turkey and elsewhere reduced the real foreign currency value of their current repatriated earnings drastically. Inflation in Turkey occurred at a higher rate than in their parent firm countries, forcing the Turkish lira's periodic depreciations. Furthermore, inflation in their parent firm countries eroded the purchasing power of their earnings after they had been transferred out of Turkey. (2) The current annual repatriated earnings should not be attributed to the original imported capital exclusively because they also included the later contributions of the parent firm to the DFI firm in terms of additional capital imports and/or reinvested earnings.

These DFI firms feared that any exaggeration of the parent firm gains could be easily used against them by anti-DFI forces in Turkey. Consequently, they declined to answer the question as it was formulated in the questionnaire. Nevertheless, some of them answered the question by reformulating it so that the parent firm's annual rate of return expressed the current repatriated earnings as a percentage of the current, i.e. cumulative capital base of the parent in the DFI firm.

Therefore, our figures on the parent firm rates of return should be interpreted cautiously by taking into account the qualifications of our respondents. They can not serve as very reliable indices of the parent firm's gains derived from its DFI in Turkey. Their

Table 53 - Parent Firm Rates of Return

<u>Year</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>Standard Error</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Valid Observations</u>	<u>Missing Observations</u>
1970	23.0	63.1	11.9	0.0	334.0	28	18
1971	28.6	88.1	16.6	0.0	466.0	28	18
1972	24.2	49.7	9.4	0.0	229.0	28	18
1973	23.2	44.9	8.5	0.0	233.8	28	18
1974	20.8	35.7	6.7	0.0	180.4	28	18
1975	22.1	43.6	8.2	0.0	221.8	28	18
1976	24.4	34.7	6.6	0.0	136.0	28	18
1977	19.9	43.4	8.2	0.0	160.2	28	18
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1970-77	23.3	38.3	7.2	0.0	146.8	28	18
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Table - 54 Sectoral Parent Firm Rates of Return (Repatriated Earnings
As a Percentage of the Parent Firm's Original Imported Capital) - Mean (1970-77)

<u>Year</u>	<u>Sector</u> [*]								
	1	2	3	4	5	6	7	8	9
1970	22.3	10.6 —	8.1	111.3	4.7	70.9	9.3	10.3	0.0
1971	27.7	10.5	12.9	155.3	0.0	88.9	8.2	8.6	0.0
1972	30.3	11.3	13.0	76.3	1.9	142.2	8.2	13.7	8.0
1973	32.7	12.3	15.2	20.3	3.7	233.8	9.1	16.0	11.0
1974	35.0	9.6	16.9	16.7	0.0	180.4	14.9	15.1	8.0
1975	49.0	9.6	12.8	0.0	0.0	221.8	11.8	17.2	24.0
1976	67.0	12.3	24.9	0.0	0.9	106.6	15.5	23.9	24.0
1977	4.3	12.3	35.9	0.0	0.0	129.7	0.0	29.9	0.0
1970-77	33.5	11.1	17.5	47.5	1.4	146.8	9.6	16.8	9.4

* 1. Food and Beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals
5. Transportation vehicles and tractors 6. Non-electrical machinery and metal products
7. Electrical cables 8. Electrical machinery and electronics 9. Building materials

unreliability is not, however, only a result of their tendency to exaggerate parent firm gains for the two reasons stated earlier. They also fail to account for the fact that not all parent firms gains were derived from official repatriated earnings proper. In fact, several DFI firms reported that they had repatriated officially no earnings whatsoever during 1970-77 or for even longer periods. As will be discussed later, many DFI firms relied instead on sufficiently high mark-ups on the intermediate input imports from their parent firm profits. In other words, transfer pricing was their either preferred or feasible means of enabling their parents to share in their profits. They did not, of course, use explicitly the term "transfer pricing", with its well-known anti-multinational corporation connotation, to describe their practice. They referred instead to the satisfaction of their parents with being able to find a market in Turkey for products that were imported as their intermediate inputs from their parents.

With the above reservations in mind, we now turn to the examination of our estimates on parent firm average rates of return. The annual mean rates of return appear to have been rather steady during 1970-77, averaging about 23 per cent for this eight-year period. This figure implies a less than five-year pay-back period for parent firm's original imported capital, which is shorter than both the initial and present pay-back period estimates of about 8 years and 14 years, respectively, that were presented earlier. Then the conclusion is that on the whole our respondents exaggerated significantly their estimates of the pay-back period.

There was considerable variation around the mean rates of return, between a minimum of 0 and a maximum of more than 100 per cent, for each year during 1970-77 and for the eight-year period as a whole. In order to inquire into at least some of the reasons for such variation, it might be useful to look at the sectoral average parent firm rates of return which are presented below.

There are, indeed, very sharp differences among the nine sectors in their average parent firm rates of return. Sector 6 stands out very clearly as the one with by far the highest rate of return, which exceeded 100 per cent every year during 1972-77 and also for the period 1970-77 as a whole. On the other extreme, sector 5 had by far the lowest rate of return among all sectors every year as well as for the period 1970-77 as a whole. Our hypothesis, which we hope to test in a later paper after processing the questionnaire data on imports of DFI firms, is that the above sectoral differences in the parent firm rates of return are correlated with their relative levels of dependence on intermediate inputs imports from parent firms. We would expect sectors with higher levels of such dependence to show lower parent firm rates of return, thanks to a broader scope for transfer-pricing.

A. The Controversy on Transferable Profits

As regards transferable profits, which when actually transferred would form the basis of the above estimates of the average parent rates of return, DFI firms expressed the following grievance during the interviews:

Auditors from the Ministry of Finance compared the net value of the fixed assets with the paid-up capital in the balance sheet of a DFI firm. If the former exceeded the latter, they regarded the difference as unauthorized investment. Then the transferable profit of the foreign partner attributable to that difference was blocked at the Central Bank by the Ministry of Finance.

The procedure used by the auditors in their calculations was not revealed to the DFI firms themselves. It seemed to vary from auditor to auditor. Also, the strictness with which the firms were subjected to this type of auditing varied from firm to firm and time to time. The more profitable a firm was, however, the

more likely it was to face such an auditing and to be charged with unauthorized investment.

The majority of the firms covered by this study had faced such an audit at one time or another. Several had had parts of their transferable profits blocked. Some had accepted this result, believing that it would be futile to challenge the Ministry of Finance in Turkish courts. Others, however, had taken their cases to Danistay, the High Turkish Court, which took years to reach a decision. While the case was tried, the blockage remained in effect. A few firms had chosen to deal with this problem illegally, i.e. by bribing the Ministry of Finance auditors for a favorable report. They justified their conduct by arguing that the Turkish government itself resorted to illegal means of restricting their activities and it was hopeless for a DFI firm to protect its interests in Turkey through legal channels only. This was, of course, the same argument that several DFI firms presented in justification of their other types of illegal, or at least questionable conduct.

When questioned by the author, officials of the Ministry of Commerce and the SPO, acknowledging the seriousness of this issue, noted that they had nothing to do with it. Only the Ministry of Finance was said to be involved.

In the Ministry of Finance itself, the Foreign Capital Movements Department (which was responsible for the over-all financial supervision of DFI firms) found the firms justified in their complaint as far as the inconsistency of the auditing procedure was concerned. It was accepted that there had been no explicitly formulated and consistently applied implementation code, although there ought to have been one. The lack of such a code was explained in terms of: (1) the high turnover among the Ministry of Finance auditors and (2) each case being a little special and requiring

an individual treatment that could not be provided by a uniform procedure.

Furthermore, it was pointed out that the Ministry of Finance auditors who went over the books of DFI firms were not from the Foreign Capital Movements Department. They were from the Taxation Department and were thus independent of the Foreign Capital Movements Department which had the over-all financial regulatory responsibility for DFI firms. The Foreign Capital Movements Department argued that it had no authority to request the formulation of a written public code and its consistent application from the auditors of the Taxation Department.

It was believed that these auditors, who were mostly fresh university graduates, approached their task of going over the books of DFI firms with a general anti-DFI attitude acquired during their studies and a desire to show their colleagues and superiors their toughness toward foreign firms. Most of these auditors eventually transferred to other government jobs with promotion or resigned to accept executive positions in the private sector. Their anti-DFI attitudes appeared often to mellow or disappear afterwards. It appeared to us that DFI firms were quite justified in their grievance. Their harassment by Ministry of Finance auditors, whether deliberate or not, increased their reluctance to show official transferable profits subject to possible blockage at the Central Bank. Consequently, they had stronger preference for channelling parent firm gains via transfer-pricing, i.e. sufficiently high mark-ups on imports of intermediate inputs, whenever possible.

Attention turns now to our estimates of rates of return for all, Turkish as well as foreign, investors in DFI firms. These rates of return were expressed in three alternative terms: (1) Earnings before interest and income tax as a percentage of total assets,

(2) earnings before income tax as a percentage of total equity, and (3) earnings after income tax as a percentage of total equity.

20. What Has Been the DFI Firm's Rate of Return in Terms of Earnings before Interest and Income Tax as a Percentage of Total Assets during 1970-77?

The average annual gross rate of return on total assets appears to have increased until 1974 and then declined, with a value of about 20 per cent for the period 1970-77 as a whole. Presently we have no plausible explanation for this trend. The range of this rate, indicated by its minimum and maximum values, was rather wide, for both each year and the eight-year period as a whole. We now look at the sectoral differences in this rate, leaving aside the question of its relative level in comparison with the rate for all, i.e. all-Turkish as well as DFI firms in Turkish manufacturing, which we hope to answer in a later stage of our work.

An interesting pattern of sectoral differences for 1970-77 in the estimated annual gross rates of return on total assets emerges, Sector 2 and 9 show the highest returns, which are about 70 per cent higher than that for all sectors combined. Sectors 1, 3 and 7, too, have above average returns but by a smaller margin. The remaining sectors, i.e. sectors 4, 5, 6, and 8 appear to suffer from similar below average returns by significant margins. The sources of these differences will be investigated in detailed sectoral analyses during a later stage of our work.

Table 55-Gross Rates of Return on Total Assets

<u>Year</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>Standard Error</u>	<u>Minimum</u> *	<u>Maximum</u>	<u>Valid Observations</u>	<u>Missing Observations</u>
1970	13.5	9.9	2.1	-3.0	33.3	23	23
1971	14.5	13.2	2.6	-10.0	39.0	26	20
1972	16.9	14.8	2.8	-14.9	58.2	27	19
1973	21.6	16.5	3.2	1.6	76.1	27	19
1974	23.6	28.7	5.4	-2.2	140.8	28	18
1975	19.1	15.4	2.9	-11.5	64.4	28	18
1976	18.6	22.3	4.2	-8.8	115.5	28	18
1977	18.0	16.6	3.3	-5.0	66.4	25	21
<hr/>							
1970-77	19.8	14.4	3.1	4.9	63.1	21	25
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* Negative rates represent losses.

Table 56 - Sectoral Gross Rates of Return on Total Assets - Mean (1970-77)

Year	<u>Sectors</u> *								
	1	2	3	4	5	6	7	8	9
1970	20.7	16.7	15.9	14.1	2.9	6.5	15.1	7.7	29.0
1971	25.3	19.8	16.3	20.2	10.0	7.1	11.4	5.3	36.0
1972	28.0	34.3	17.5	21.4	16.4	11.0	9.9	6.5	35.0
1973	26.3	41.7	25.5	27.6	17.0	19.8	25.6	9.2	23.0
1974	23.7	45.8	24.2	10.2	11.4	15.9	61.5	12.4	37.0
1975	23.3	14.6	22.0	15.7	11.0	15.5	36.0	12.7	43.0
1976	26.3	62.0	23.1	1.2	9.5	8.5	16.8	14.2	26.0
1977	13.0	36.9	27.0	12.4	10.3	8.4	14.1	14.2	39.0
1970-77	24.6	34.0	21.4	13.4	11.6	11.6	26.9	12.8	33.5

- * 1. Food and beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals
 5. Transportation vehicles and tractors 6. Non-electrical machinery and metal products
 7. Electrical cables 8. Electrical machinery and electronics 9. Building Materials

21. What Has Been the DFI Firm's Rate of Return in Terms of Earnings before Income Tax as a Percentage of Total Equity during 1970-77?

The average annual gross rate of return on total equity appears to have increased until 1973, declined in 1974, and then increased again, with a value of about 29 per cent for the period 1970-77 as a whole. We can offer no plausible reasons for this trend at this time. The range of this rate of return, as in the case of the previously discussed gross rate of return on total assets, was quite wide, for both each year and the eight-year period as a whole. One firm, in pharmaceuticals, had suffered the minimum average annual return (loss) of -51 per cent for 1970-77, in contrast with another, in chemicals, that achieved the maximum average annual return of almost 84 per cent, for the same period. The pharmaceuticals firm was not a newly founded firm whose losses could be explained in terms of a long investment gestation period. It had been in existence for almost 20 years. Actually the chemicals firm was four years younger than the pharmaceuticals firm. We now look at the sectoral differences in our estimates of annual average gross rates of return to see whether they show a definite pattern.

We observe that the average annual gross rates of return for the eight-year period as a whole in sectors 1, 5, 6, 7, 8, and 9 did not diverge very significantly from the rate for all the sectors combined. Sectors 1, 8, and 9 had above average, whereas sectors 5, 6, and 7 had below average returns, relatively to our aggregated sample estimate. The remaining three sectors, namely, sectors 2, 3, and 4, however, tell a different story. Sectors 2 and 3, especially the former, showed returns that exceeded the average by a significant margin. Sector 4, however, had a negative rate of return, with sharp annual fluctuations. Although sectoral patterns in this rate of return, like the others, will be studied more thoroughly in later stages of our work, it should be noted now that the pervasive government price controls on almost all manufactured products were among the

important determinants of DFI firms' earnings. In fact, the pharmaceutical firms told the author during the interviews that whether in any given year they would have negative or positive earnings depended very much on the levels of prices fixed by the government for their products relative to their unit costs that kept rising almost continuously. They complained that although their labor and intermediate input costs kept increasing incessantly, the government allowed them price hikes only after long and arduous lobbying in Ankara, coupled with periodic deliberate production slow-downs to limit their losses. This must have been yet another reason why many DFI firms preferred to remit profits to their parents via transfer-pricing for greater consistency and reliability.

22. What Has Been the DFI Firm's Rate of Return in Terms of Earnings After Income Tax as a Percentage of Total Equity during 1970-77?

Not surprisingly, the average annual net rate of return on total equity shows the time pattern of the gross rate, with a value of about 18 per cent for the period 1970-77 as a whole. And, like the gross rate, it has a rather wide range of variation, for both each year and the entire eight-year period. The minimum (negative) and maximum returns for the period 1970-77 as a whole are accounted by the same pharmaceuticals and chemicals firms, respectively, that were referred to in the last section, concerning the gross rate.

Again we next focus on the sectoral rates of return, whose differences would be expected naturally to reflect the differences in the gross rates on total equity which have been already reviewed in the previous section.

These sectoral differences in the net rates of return on total equity estimates, if indeed based on accurate and representative reporting by the DFI firms in our sample, raise several interesting questions: (1) Are these differences reliable indicators of the

Table 57-Gross Rates of Return on Total Equity

<u>Year</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>Standard Error</u>	<u>Minimum</u> *	<u>Maximum</u>	<u>Valid Observations</u>	<u>Missing Observations</u>
1970	18.0	13.8	2.9	-9.5	41.8	22	24
1971	14.5	44.0	8.6	-143.0	60.0	26	20
1972	32.9	18.4	3.5	-4.2	73.5	27	19
1973	33.0	31.4	6.0	-78.0	91.5	27	19
1974	27.4	63.9	11.9	-257.3	151.4	29	17
1975	29.0	33.9	6.2	-116.6	89.0	30	16
1976	33.6	50.3	9.2	-166.2	161.7	30	16
1977	43.0	39.6	7.6	-8.0	159.0	27	19
<hr/>							
1970-77	29.3	25.8	5.8	-51.0	83.8	20	26

* Negative rates represent losses

Table 58- Sectoral Gross Rates of Return on Total Equity-Mean (1970-77)

Year	<u>Sectors</u> *								
	1	2	3	4	5	6	7	8	9
1970	23.7	20.1	18.5	11.6	5.1	22.3	13.6	20.5	33.0
1971	31.0	31.9	27.9	31.4	-9.8	24.9	11.3	-3.0	38.0
1972	35.0	55.0	38.2	28.0	60.3	27.3	12.9	28.3	17.0
1973	33.3	76.2	48.5	17.9	64.0	55.5	35.0	11.1	25.0
1974	29.7	83.2	50.7	-73.5	17.1	28.4	84.5	29.1	40.0
1975	39.3	32.5	35.0	-28.3	23.4	30.6	42.4	40.1	45.0
1976	36.7	86.1	59.6	-80.4	36.2	12.2	29.5	43.1	27.0
1977	23.5	45.4	65.6	51.5	30.6	13.8	13.3	52.3	40.0
1970-77	31.4	53.8	43.0	-10.9	25.0	26.9	23.8	32.5	33.1

* 1. Food and beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals
 5. Transportation vehicles and tractors 6. Non-electrical machinery and metal products
 7. Electrical cables 8. Electrical machinery and electronics 9. Building Materials

relative productivity of DFI in the different sectors of Turkish manufacturing? (2) If so, should new DFI activity be concentrated in those sectors with relatively higher rates of return? (3) If not, why not? i.e. what other private benefits accrue to investors, not included in the rates of return estimates, that should be taken into account in a complete accounting of DFI productivity? (4) Even after all private benefits to investors have been accounted for, are there quantifiable social (net) benefits that ought to be considered in Turkish DFI policy-making for a better, i.e. socially more productive allocation of new DFI? These and other interesting but admittedly very difficult questions will be addressed in the final stage of our work after all other aspects of DFI activity in Turkish manufacturing have been investigated.

A. The Controversy on Legitimate Field of DFI Activity

In concluding this section, we now take up a very important issue that has affected the profitability of DFI firms, besides being a constant source of friction between many DFI firms and the Turkish government. This issue concerns the legitimate fields of activity for DFI firms. We first summarize the claims and complaints of DFI firms and then present the responses of government officials that were recorded in separate interviews.

According to the DFI firms, there were unreasonable official restrictions on the business activities open to DFI firms, contrary to the spirit of Law 6224. The government frequently accused DFI firms of operating in areas legally closed to them and had their transferable profits attributable to the allegedly illegal activities blocked at the Central Bank.

The government claimed that DFI firms covered by Law 6224 could not engage in commercial activities. They had to limit themselves to manufacturing proper and leave commerce to either all-Turkish

Table 59 - Net Rates of Return on Total Equity

<u>Year</u>	<u>Mean</u>	<u>Standard Deviation</u>	<u>Standard Error</u>	<u>Minimum</u> *	<u>Maximum</u>	<u>Valid Observations</u>	<u>Missing Observations</u>
1970	15.9	14.4	3.1	-9.5	65.0	21	25
1971	4.2	40.4	8.3	-143.0	37.9	24	22
1972	18.8	19.0	3.7	-39.0	51.7	26	20
1973	20.3	24.1	4.6	-78.0	55.8	27	19
1974	14.2	56.0	10.4	-257.3	87.4	29	17
1975	17.8	29.2	5.4	-116.6	64.0	29	17
1976	20.4	42.9	7.8	-166.3	116.4	30	16
1977	27.9	28.4	5.4	-3.8	114.5	28	18
<hr/>							
1970-77	17.9	22.5	5.2	-54.5	67.7	19	27
<hr/>							

* Negative rates represent losses.

Table-60 Sectoral Net Rates of Return on Total Equity-

Year	Mean (1970-77)								
	Sectors [*]								
	1	2	3	4	5	6	7	8	9
1970	14.3	12.7	26.7	11.6	8.8	14.5	8.2	17.7	20.0
1971	19.7	18.7	18.1	14.2	-41.6	16.2	6.7	-11.0	22.0
1972	22.0	32.5	21.5	15.3	44.7	17.7	8.5	10.2	11.0
1973	21.3	46.8	35.5	9.6	40.0	35.4	21.5	4.0	16.0
1974	17.0	47.7	36.2	-78.6	11.0	18.5	50.3	19.5	25.0
1975	25.7	18.8	23.5	-50.1	15.1	19.9	27.2	25.9	27.0
1976	25.7	49.4	41.5	-82.0	27.0	8.0	18.1	27.2	16.0
1977	22.5	25.9	45.9	32.0	18.8	9.0	6.8	32.5	23.0
1970-77	22.1	31.6	31.1	-10.9	8.6	17.4	13.5	23.9	20.0

- * 1. Food and beverages 2. Rubber 3. Chemicals 4. Pharmaceuticals
 5. Transportation vehicles and tractors 6. Non-electrical machinery and metal products
 7. Electrical cables 8. Electrical machinery and electronics 9. Building materials

firms or those DFI firms covered by Decree 17 of Law 1567 (for the Protection of the Value of Turkish Currency). The Law 6224 - DFI firms objected first to the government's arbitrary and discriminatory interpretation of Law 6224 as not permitting them to engage in commerce, and second to its too broad classification of their manufacturing - related activities under commerce.

Law 6224, claimed the DFI firms that it covered, contained no provision, explicit or implicit, on commerce being off limits to them. Any field open to Turkish private investors was to be open to foreign investors, too, according to Article 1 - Clause b of the law. Commerce was surely one such field.

DFI firms argued that they had been unfairly restricted by the government to the production-end only when they had been allowed to invest in Turkey. The sales-end had been closed to them. Consequently, their profits could come only from production, i.e. from ex-factory sales, usually at government-controlled prices and/or profit margins that deprived them of the lucrative profits available at the sales-end. Often the sales-end was in the hands of an all-Turkish firm that was founded and owned by the Turkish partners of the DFI firms. This sales or distribution firm purchased the manufactured goods from the DFI firm at prices that deliberately depressed profits at the production-end and inflated them at the sales-end.

This arrangement naturally created a conflict of interest between the foreign and local partners of a DFI firm. The local partners preferred to take their profits at the sales-end, not having to share them with the foreign partners. This arrangement also suited government's objective of minimizing the profits of the foreign partners for nationalistic and foreign-exchange saving reasons. In the long run, however, the production-end was starved of profits that were needed for increasing capacity and/or productivity

via self-financing. In other words, both the government and local partners were short-sighted and anti-production-oriented in depressing profits at the production-end in order to minimize the returns to foreigners.

Interestingly, however, the foreign partners were able to protect their own interests in spite of the official attempts to limit their returns, by resorting to transfer-pricing. They argued that they were left with no choice but transfer-pricing, although many did not refer to it as "transfer-pricing" explicitly. They simply applied sufficiently high mark-ups to the prices of the imported raw materials and other intermediate inputs to make up for the deficiency in their legal transferable profits. In most cases, these imports were directly purchased from the parent firms.

The foreign partners had three basic reasons for resorting to transfer-pricing for remitting some or most of their profits abroad:

- (1) As already mentioned above, the government depressed their legal transferable profits by restricting them to the production-end only and also controlling their product prices and/or profit margins.
- (2) The government was suspicious of and unfriendly toward highly profitable DFI firms. Any DFI firm that earned high legal profits on which it, of course, paid taxes to the Turkish government, would be accused of exploiting Turkey, and subsequently subjected to harassment. The government would try to invent grounds on which it could block at the Central Bank, what it regarded as "excess" profits. It would also seek ways to limit the growth of such a firm, decrease the foreign equity share, make other unreasonable and unfavorable changes in the firm's decrees, and ultimately prevent the firm being "too" profitable.

- (3) It was easier to remit profits abroad by transfer-pricing than by having them transferred by the Central Bank as legal DFI profits. The government, faced by an almost continuous foreign-exchange shortage, gave priority to foreign-exchange allocations for imports of intermediate inputs over those for DFI profit remittances. Of course, the government's Import Price Control Committee was supposed to regulate the prices charged for such imports, but it was simply not capable of doing an effective job. One automotive DFI firm's foreign chief executive referred to the Committee's regulatory function as a "farce", and claimed that its officials were either too incompetent or too dishonest to perform their tasks effectively.

Several of the DFI firms interviewed pointed out that they had stopped some years ago transferring abroad any profits via the Central Bank, and that they wished to continue relying on transfer-pricing exclusively. They thought that the government seemed to prefer that arrangement, for it had never questioned them as to how they could justify their continued existence in Turkey to their parent firms year after year, without remitting any profits via the Central Bank.

The Turkish partners of most DFI firms were well aware of the wide spread practice of transfer-pricing through which their foreign partners remitted profits abroad. They seemed to accept this as inevitable, given the official restrictions discussed earlier. Without it, they noted, their foreign partners would definitely pull out of Turkey.

Besides prohibiting the Law 6224 DFI firms from investing in commerce proper, the Turkish government often tried to keep these firms out of what it claimed to be essentially commercial activities, but which were, in fact, directly related to the

firms' manufacturing activities. It had the transferable profits of the firms that it accused of engaging in essentially commercial activities blocked at the Central Bank. Then the firms had either to give in to the government and cease those activities or challenge it in Danistay if they believed that the High Turkish Court might somehow rule in their favor.

What were these activities that the government claimed to be essentially commercial?

- (1) Selling of land, buildings, transportation vehicles, and other such fixed assets owned and previously used by the DFI firms in their manufacturing activities. The government claimed that the DFI firms, unlike their all-Turkish rivals, could not sell such used fixed assets without its permission. Even when they were permitted to do so, their transferable profits resulting from the difference between the buying and selling prices of such assets would be blocked at the Central Bank. The government had imposed such restrictions in order to prevent DFI firms from speculating in real estate and capital goods. But, first, it ignored that these discriminatory restrictions did not apply to all-Turkish firms, and, second, it wrongly assumed that all selling of real estate and capital goods by DFI firms had to be speculative. In many cases, such selling involved fixed assets that the DFI firms had for many years owned and used directly in their manufacturing activities. After the sale of such assets, the firms often had to replace them with others at higher prices than they had originally paid. The government seemed not to realize that replacement costs exceeded the historical book values.

- (2) Providing systems engineering, installment, and repair services to accompany and follow the sales of manufactured products, especially capital goods, by the DFI firms. The

government refused to accept that such services were directly related to manufacturing and that often they could be provided by only the DFI firms themselves that had produced the goods. It claimed that such services were commercial in nature, and therefore, off limits to the Law 6224 DFI firms. It blocked at the Central Bank the transferable profits derived from these services.

Several DFI firms confessed that the government's unreasonable restrictions on their service activities forced them to receive concealed payments. They added, whenever they could, the costs of such services to the prices of the manufactured goods. Occasionally, they received off-the-record payments, either without any invoicing or with invoicing that understated the actual payments.¹ This was yet another instance in which DFI firms blamed the government's unfair discriminatory restrictions, on the basis of which, they claimed, they could not operate legally, for their illegal ways of doing business in Turkey.

- (3) Selling of scrap and other secondary - or by-products. The government claimed that a DFI firm could sell only its primary product(s) that it was explicitly authorized, by its decree(s), to produce. If the firm sold any other products, even if it was produced by the same process used to produce the primary product, its transferable profits were blocked by the government. This, too, was a discriminatory restriction on the activities of DFI firms that all-Turkish firms did not face.

¹ No invoicing and under-invoicing were prevalent in the Turkish economy among all firms, especially small all-Turkish ones. The main reason was, of course, tax evasion. Many DFI firms complained that often they were forced into these practices by their local industrial suppliers who evaded taxes routinely.

Several DFI firms admitted that they avoided this restriction by either not invoicing or under-invoicing the sales of the products they were not supposed to sell. Thereby they either showed no profits that could be blocked, and, of course, taxed, or let the government have some profits to block when such sales were too conspicuous to conceal completely. These firms claimed that the government had forced them, with its unfair and unreasonable restrictions, to resort to off-the-record transactions.¹ The local partners, too, benefited from such concealed transactions by having their tax liabilities reduced.

DFI officials of both the State Planning Organization and the Ministry of Commerce were categorical in their assertion that Law 6224 did not allow DFI in commerce. According to the SPO, Turkey needed DFI only in production, not in distribution. Turks could themselves distribute whatever was produced. Did foreigners distribute directly imported products in Turkey? Why should then they be allowed to distribute locally manufactured products? Turkey had no need of foreign know-how in distribution or sales for the domestic market. Why did DFI firms not concentrate their sales skills on foreign markets instead and help Turkish manufacturing become export-oriented?

The SPO claimed that most foreign investors in Turkish manufacturing deliberately de-emphasized exports. They did not wish to spoil their foreign markets, already supplied from their non-Turkish sources of production, with Turkish exports. Furthermore, because

¹ It should be noted that whenever a DFI firm was accused of operating in an unauthorized area, the government's punitive action of blocking the relevant transferable profits at the Central Bank was directed at the foreign partner(s) only. The profits of the local partner(s) were let alone. In other words, the government punished the foreign investor(s) directly, rather than the DFI firm itself.

of the high mark-ups they applied to their imported intermediate inputs, which enabled them to smuggle their excess profits out of Turkey, their units production costs in Turkey were too high for world markets.

The Ministry of Commerce argued that it was pointless for DFI firms to criticize their exclusion from commercial activities, since they had decided to invest in Turkey with full knowledge of that exclusion. It did not matter for Turkey that some other developing countries permitted DFI firms to extend their activities into distribution. Turkey preferred to restrict them to the production-end only and that was that. If that restriction was too disadvantageous for them, they would not invest in Turkey. On the other hand, if they preferred to invest in commerce rather than in production (but, of course, not in both), then Decree 17 of Law 1567 would govern their activities in Turkey.¹

Now, Law 6224 did not, in our opinion, contain any explicit restriction on DFI in commerce proper. But then, it also did not mention commerce explicitly as a field of activity open to DFI. This was just another feature of its vagueness that more than compensated for its liberalism.

If we examine the predecessor of Law 6224, namely Law 5821, we see that it had explicitly excluded commerce, together with agriculture, from fields open to DFI. Law 6224, however, dropped that explicit exclusion and declared that DFI would be permitted in all sectors of the economy, provided it:

¹ Decree 17 DFI firms' transferable profits could be entirely and legally blocked at the Central Bank, whereas Law 6224 DFI firms had, at least on paper, the right to transfer all their (foreign-equity) profits free of any restrictions. The former could remit their blocked profits only at the pleasure of the government.

- (a) aided the country's economic development (not specified as to how this was to be determined);
- (b) was active in a field that was open to private Turkish enterprises;
- (c) did not possess any monopoly or special privileges.

The DFI firms covered by Law 6224 invoked (b) to support their claim that by law they should be allowed to extend their activities into commerce and distribution. The government, on the other hand, invoked (a) to reject their claim. It argued that DFI in domestic commercial activities was not needed for the country's economic development.

Clearly, the vagueness or the flexibility of Law 6224 worked in favor of the government. Furthermore, the government had consistently stuck to its position, since the enactment of Law 6224, to exclude DFI firms from commerce when they were founded.¹ Therefore, Turkey's policy of excluding DFI firms from commerce, whether motivated by economic or political considerations, was well-established and known.² Of course, it was altogether a different matter whether such an exclusion had indeed been in Turkey's own interest.

¹ A few smaller DFI firms, covered by Law 6224, actually had, sometime after their establishment, extended their activities into domestic distribution by taking over their all-Turkish distribution firms. The government had permitted this when these DFI firms had made it clear that they would otherwise pull out of Turkey due to inadequate returns.

² The evolution of this policy might be better understood if it is kept in mind that during the Ottoman Empire almost all domestic as well as foreign commerce of Turkey was dominated by the so-called minorities, namely the Armenians, Greeks, and Jews. After the Republic was founded in 1923, the government put great emphasis on the turkizing of the nation's commercial life through various means. The expulsion of the minorities earlier, and the Wealth Tax of World War II later, were the most effective ones.

It should also be pointed out that as a result of Turkey's highly protectionist strategy of industrialization, almost all sectors in which DFI had been permitted faced sellers' markets. Anything produced could be sold locally to buyers who could not, at least legally, take advantage of competitive imports. Marketing, either wholesale or retail selling, as a tool of distributing a firm's products was far less important than it would be in an open and developed economy. All-Turkish distribution firms were able to market domestically the products of DFI firms without difficulty, without the use of modern marketing methods in which the foreign investors would have had a comparative, and even absolute, advantage. In this sense at least, the government was correct in arguing that Turkey needed no DFI in commerce. Had Turkey pursued a less protectionist industrialization (or were to in the future), however, DFI in commerce might have been (or might become) almost a necessity.

Related to the above consideration is the observation that there was a wide-spread misconception among government officials and Turkish businessmen concerning inflow of foreign technology and technical know-how. It was believed that only tangible technologies, i.e. those embodied in machines to produce physical goods, were worth paying for. Anything intangible, such as marketing know-how, was not worth paying for via either DFI projects or licensing agreements. This sharp distinction between "hard" and "soft" technologies, which paralleled the common belief that production was a socially useful activity but distribution was not, might also be a reason for Turkey's preference to keep DFI out of commerce.¹

¹ In fact, there seemed to be a growing tendency among Turkish bureaucrats and leftist political parties, including the Republican People's Party, to reduce the role of even all-Turkish private firms in commerce by strengthening the position of State firms. This tendency was a reflection of the belief that commerce, when performed by private interests, was a socially parasitic activity.

Concerning the complaint of DFI firms that the government, specifically the Ministry of Finance, unreasonably classified some of their activities as essentially commercial, the official reactions varied among the SPO, the Ministry of Commerce, and the Ministry of Finance. Surprisingly, the SPO's DFI officials were most sympathetic. They stated that, except for speculative land sales, the activities classified by the Ministry of Finance as essentially commercial should not be restricted. They believed that that ministry had been over-zealous in its regulation of DFI firms.

The DFI officials of the Ministry of Commerce agreed with the Ministry of Finance, except for the restriction on scrap sales. They were adamant in opposing the provision of any kind of service by DFI firms to their customers, unless that was explicitly mentioned in their decrees. And, in principle, only all-Turkish firms should be permitted to provide such services. If necessary, DFI firms should aid the establishment and development of such firms.

The DFI officials of the Ministry of Finance, however, took refuge behind the explanation that this complaint, too, had nothing to do with them. The responsible agency was the Department of Taxation which sent its auditors to breathe fire down the necks of DFI firms. These officials actually sympathized with the firms. They suggested that all DFI decrees should be made very specific to spell out in detail the activities that the firms could carry out without any harassment from their ministry's auditors.

Now, it remains to point out that there were several DFI firms, covered by Law 6224, in the service sector, including tourism, banking, consulting, and communications. Obviously, there had been no outright exclusion of all DFI from services per se, contrary to what might have been assumed on the basis of the foregoing discussion. But these service-sector-DFI firms were not also

active in manufacturing. Therefore, we can conclude that rather than opposing DFI in services in itself, the government had objected to a DFI firm's being active in both manufacturing and services.

For which reasons? The only possible reason worth mentioning is that the government might have wished to prevent any given DFI firm from becoming too big and powerful by integrating vertically its manufacturing and servicing activities. Such a reason appears plausible in light of Turkey's historical as well as ideological fear of falling under the economic and political domination of DFI firms and the foreign interests they represented.

The reaction of all DFI government officials to the argument of DFI firms that their transfer-pricing resulted from the unfair and unreasonable restrictions imposed on them was uniformly hostile. The officials rebutted that argument by claiming that transfer-pricing was practised world-wide by multinational companies, regardless of the differences in the DFI policies of their individual host-countries. They believed that Turkey could, on its own, reduce the scope of that widespread practice, not by becoming more liberal in its DFI policies, but by regulating its DFI firms more thoroughly and effectively.

Their reaction to other shady practices of DFI firms, such as no-invoicing and under-invoicing, was the same. The only way to cope with them was to create more regulations and to apply the existing ones more effectively. They viewed the firms as their natural adversaries and argued that the firms would always cheat if not watched closely.

23. How Did the Climate for DFI in Turkey Compare with the Average Climate in Other Less Developed Countries When It Was Decided to Invest in This Project?

Table 61 - Initial Relative DFI Climate

<u>Initial Relative DFI Climate*</u>	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
1.	8	17.4	21.6	21.6
2.	12	26.1	32.4	54.1
3.	12	26.1	32.4	86.5
4.	5	10.9	13.5	100.0
5.	0	0.0	0.0	100.0
No answer	3	6.5	Missing	100.0
Not available	6	13.0	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

* 1. Substantially better 2. Slightly better 3. About the same
4. Slightly worse 5. Substantially worse

Mean = 2.378 Standard Deviation = 0.982
Standard Error = 0.161 Mode = 2.

More than 50 per cent of the respondents rated Turkey's initial relative DFI climate as "better", and only about 14 per cent as (only "slightly") "worse". The mean, 2.378, of this ordinal rating gave Turkey an initial edge over most other less developed countries (LDCs) in attractiveness to DFI.

How did the different sectors rate the initial DFI climate in terms of their means, based on the ordinal scale between 1 and 5?

Table 62 - Initial Relative DFI Climate by Sector

<u>Sector</u>	<u>Initial Relative DFI Climate - Mean</u>
1. Food and Beverages	2.500
2. Rubber	2.000
3. Chemicals	2.667
4. Pharmaceuticals	1.800
5. Transportation Vehicles and Tractors	3.000
6. Non-electrical Machinery and Metal Products	2.000
7. Electrical Cables	2.500
8. Electrical Machinery and Electronics	2.444
9. Building Materials	2.000

It is not at all surprising that sector 4 came up with the relatively best rating since its penetration by DFI took place in the 1950s when Turkey appeared to pursue basically an open-door DFI policy. Since then, however, Turkey's DFI policies have become progressively more demanding of DFI firms. Concurrently, the country had become relatively less stable in its economic, political and social conditions, confronting DFI firms with greater uncertainty and apprehension about their future.

Interestingly, however, none of the sectors rated Turkey initially as "worse" than most other LDCs in its DFI climate. It might be said, of course, that it would have been rather unusual for foreign investors to admit seeing Turkey as a "worse" place to invest at the time they had actually decided to enter Turkey. Presumably, they could and would have gone somewhere else "better", if Turkey had been a "worse" place. It should also be noted, however, that no sector rated Turkey initially being close to a "substantially better" place to invest.

24. How Does the Climate for DFI in Turkey Compare Now with the Average Climate in Other Less Developed Countries?

Table 63 - Present Relative DFI Climate

<u>Present Relative DFI Climate*</u>	<u>Absolute Frequency</u>	<u>Relative Frequency</u> (%)	<u>Adjusted Frequency</u> (%)	<u>Cumulative Frequency</u> (%)
1.	3	6.5	7.7	7.7
2.	1	2.2	2.6	10.3
3.	5	10.9	12.8	23.1
4.	11	23.9	28.2	51.3
5.	19	41.3	48.7	100.0
No answer	5	10.9	Missing	100.0
Not available	2	4.3	Missing	100.0
<hr/>				
Total	46	100.0	100.0	

* Same as above

Mean = 4.077	Standard Deviation = 1.201
Standard Error = 0.192	Mode = 5

Almost 77 per cent of the respondents rated Turkey's present relative DFI climate as "worse" and only about 10 per cent as "better". The mean, 4.077, of this ordinal rating indicates that on the average Turkey was a "slightly worse" place to invest in. But, the question might be asked, if indeed DFI firms viewed Turkey in this light when they participated in the present study, why did they also complain about the government's restrictions on their expansion? The answer is that those restrictions themselves contributed to the firms' negative rating of Turkey's current DFI climate. Furthermore, as was noted earlier, many of the respondents viewed their difficulties as being

temporary and hoped to ride them out in the near future. In other words, they were pessimistic about the short-run but optimistic about the long-run. Those foreign investors who were pessimistic about both the short- and the long-run either had already pulled out of Turkey or were about to. In fact, during the two-year period this research project was carried out only a very few new DFI firms were established but several old ones were taken over by Turkish nationals, reducing the total number of active Law 6224 DFI firms in manufacturing.

How did the different sectors rate the current DFI environment? Was there a significant uniformity among them as in their rating of the initial DFI climate?

Table 64 - Present Relative DFI Climate by Sector

<u>Sector</u>	<u>Present Relative DFI Climate - Mean</u>
1. Food and Beverages	5.000
2. Rubber	3.667
3. Chemicals	4.500
4. Pharmaceuticals	4.600
5. Transportation Vehicles and Tractors	3.833
6. Non-electrical Machinery and Metal Products	2.500
7. Electrical Cables	3.500
8. Electrical Machinery and Electronics	4.444
9. Building Materials	4.000

We see that there was relatively less uniformity among the sectors. Sector 6, for example, even gave Turkey an almost "slightly better" rating which we cannot explain in terms of our other findings so far. We hope to shed some light on this and several other issues not adequately understood and explained within the limited framework of this initial research report, in our forthcoming reports, especially those focusing on individual sectors in more detail.

VI. Closing Remarks

This working paper, first in a series of working papers that will contain the findings of a two-year study on the role DFI in Turkish manufacturing development, focused on the DFI process itself.

In our empirical analysis of this process, several interesting conclusions seemed to emerge. These conclusions, although of particular interest in themselves, raised many questions that could not yet be answered without systematic and detailed analyses of all relevant aspects of DFI activities in Turkish manufacturing, especially on a sectoral level. In fact, it might be said that this initial paper has formulated or at least suggested more (yet unanswered) questions than it has itself answered.

The task of the forthcoming papers is to tackle these unanswered questions and also deal with other questions too specific to have been raised in the present paper. And, most importantly, the final purpose of our later work is to integrate the various different but related aspects of the role of DFI in the development of Turkish manufacturing, to be considered separately in individual papers. It is only then can we say to have achieved our ultimate goal in studying DFI in Turkish manufacturing. And, also only then can we confidently make some policy suggestions for the consideration of Turkish DFI policy-makers.

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