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**Research Report**

## The Turkish economy: A winner of the Euro crisis?

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# The Turkish Economy: A Winner of the Euro Crisis?

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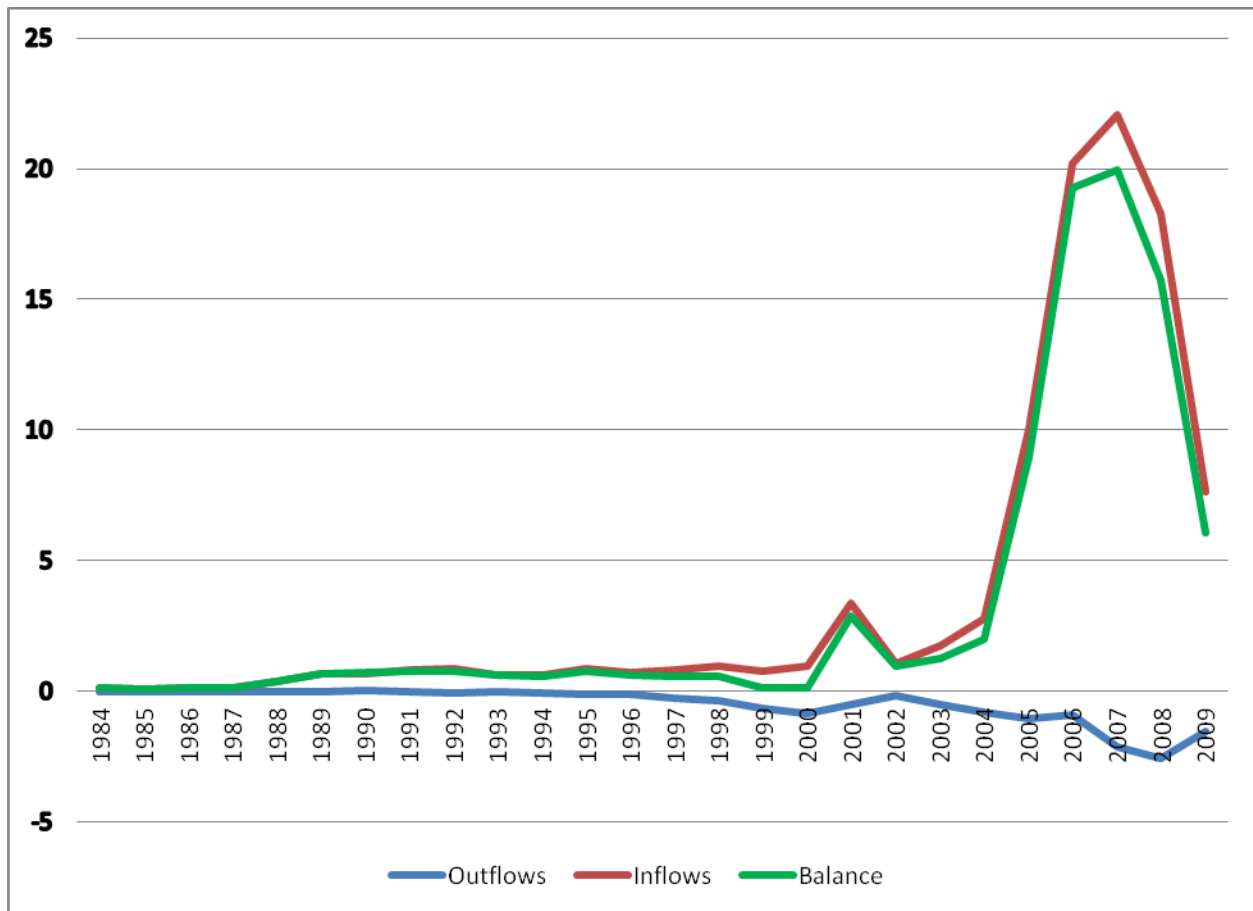
Besides trade on goods and services, and migration, investments coming from and going abroad are another aspect of international activities. Foreign direct investments (FDI) play an important role for many reasons. Firstly, they are a means for compensating a current account deficit (one of the most important challenge for the Turkish economy). Secondly, they are a source of additional investments that are a pre-necessity for economic growth. Thirdly, they are also a source for the import of knowledge and sometimes technologies because they are mostly related with investments of multinational firms establishing new plants. Fourthly, there might be spillovers from FDI to other (local) firms in the area supporting their economic development and improvement of efficiency.

## 1. Very low Foreign Direct Investments to Turkey

While Turkey has opened up for trade, and export orientation has been seen as an important tool for development, foreign direct investments (FDI) have lagged behind. Turkey has not attracted a lot of FDI. Less than one billion US-\$ FDI came to Turkey per year before 2000 (see Figure 1).

In the last decade, FDI to Turkey has risen sharply to a peak of about 22 billion US-\$ in 2007 but with a significant decrease since (as a consequence of the worldwide international financial crisis).

Figure 1: Foreign Direct Investments (FDI) inflows to Turkey in billion current US-\$, 2000-2009



Data Source: Central Bank of the Republic of Turkey, Electronic Data Delivery System (EDDS) available at: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

As it is shown in Figure 1, the total (aggregated) volume of FDI to Turkey remained at 19 billion US \$ over the period 1980- 2003. Throughout these 23 years, Turkey received FDI in two forms, namely as debt payments or portfolio investments. Yet, the year 2003 was a turning point in the historical trend of FDI flows to Turkey. Between 2003 and 2006, the average volume of the FDI flows to Turkey was 8.5 billion US \$ per year. This unexpected pattern continued until the beginning of the global crisis in 2008. The sharp increase in

FDI flows in the post-2003 period can be explained by the full candidate status of Turkey to the EU. The source of post-2003 FDI flows were mostly Europe oriented which indicates a dramatic change of European investors' perception of Turkey. Under the full candidacy, foreign investors perceive Turkey as a potential partner in the European market since investing in Turkey is going to be less risky under the EU regulations.

The increasing importance of Turkey as a receiver of FDI is also reflected in an international comparison. Turkey has climbed to rank 20 in 2008 up from rank 51 in 2000. More and more multinationals (Microsoft, BASF, Coca Cola) use Istanbul as a base for their regional operations in the Middle East, North Africa and Central Asia.

*Table 1: The Most Important Countries for FDI Inward Flows*

Rank in 2008	Rank in 2000	ECONOMY	2008
			in Bio US\$
1	1	United States	316
2	7	France	118
3	8	China	108
4	3	United Kingdom	97
5	38	Russian Federation	70
6	9	Spain	66
7	6	China, Hong Kong SAR	63
8	---	Belgium	60
9	15	Australia	47
10	10	Brazil	45
11	4	Canada	45
12	12	Sweden	44
13	35	India	42
14	92	Saudi Arabia	38
15	2	Germany	25
16	32	Japan	24
17	15	Singapore	23
18	14	Mexico	22
19	43	Nigeria	20
20	51	Turkey	18

The Data have to be taken with caution, due to the fact that often huge single FDI issues have a big impact on the statistics (like the take over of Mannesmann by Vodafone).

Data Source: Unctad: <http://stats.unctad.org/FDI/TableViewer/tableView.aspx>.

According to Table 1, both in 2000 and in 2008, USA was the top ranking country in terms of attracting FDI with an inflow of 316 billion US \$. France followed as the second and China as the third ranked country attracting most FDI in 2008. FDI inflows to UK somewhat slowed down while they remained the same in Brazil and in Sweden. Asian countries reinforced their attractiveness; China, Hong Kong and Singapore being the main receiving countries. An upward trend occurred in the volume of FDI in Russia, India, Saudi Arabia, Japan, Australia, Spain and Nigeria while flows to Canada, Germany and Mexico slowed down slightly.

## 2. Where do the Foreign Direct Investments to Turkey come from?

With regard to the geographical distribution of the FDI flows to Turkey, Table 2 reveals that the EU is the most dominant source by far. About three quarter of all FDI to Turkey came from the EU 27 in the period 2004 to 2009, most of it from the Netherlands (22%), remarkably little from Germany (5%). Almost no FDI has come from the nearby Non-European Turkish neighborhood.<sup>1</sup>

*Table 2: International Direct Investment Inflow of Turkey by Regions and Country, Average 2004-2009 (in % of total FDI)*

Area	Average 2004-09	Ger	Fra	NL	UK	Ita	other EU
EU (27)	75	5	8	22	6	3	30
Non EU Europe	5						
Africa	0						
		US	Can	LA			
America	9	7	1	1			
		ME	Other Asian				
Asian	12	10	2				
Total	100						

Ger = Germany; Fra = France; NL = Netherlands; UK = United Kingdom; Ita = Italy; Can = Canada; ME = Middle East; LA = Latin America (Central-South America and Caribbean);

Data Source: Central Bank of the Republic of Turkey, Electronic Data Delivery System (EDDS) available at: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

<sup>1</sup> Sometimes the top ranking is the consequence of on single big deal. Examples include the Vodafone – Telsim, DexiaBank-Denizbank, the NBG-Finansbank and the OMV-Petrol Ofisi deal. Other notable action include the acquisition of Oyakbank by ING Bank, the Turk Telekom privatization (for the UAE) or the privatization of Turkish airports or the Russian take over of Turkcell (see YASED (International Investors Association of Turkey), *Foreign Direct Investments Report*, for further details).

Table 2 shows that FDI to and from Turkey overwhelmingly comes from Europe or the US. Turkish FDI from and into the neighborhood are low. However, seen from a neighborhood perspective, these low Turkish FDI levels look high. Turkey is among the top ten foreign investors in Iraq, building roads, bridges and other infrastructure projects, especially electricity supplies and oil or gas exploitation. By 2009, about 500 Turkish companies have invested in Iraq among them are Anadolu Group's bottling facility in Arbil, Genel Enerji's subsidiary which invests in the Taq Taq field, and Pet Oil's A&T Petroleum, which drills for oil.<sup>2</sup>

However, on a mesoeconomic level for Turkish border areas and for the lower developed Turkish neighbors, that are lacking even more on capital than Turkey does, Turkey has become an important source of financing local investments. This is especially true for the part of the region having an increasing share of daily cross-border activities. Again the frontier region between Turkey and Syria might be a good example. From both countries there is a strong interest to reestablish a natural economic zone including Gaziantep, Aleppo and Damascus and to reinforce long existing economic, social and family relations.<sup>3</sup>

### **3. What are the Problems to attract more Foreign Direct Investments to Turkey?**

Table 3 shows a country ranking for the ease of doing business in 2008/2009. It becomes clear, that the two main problems in attracting FDI to Turkey have been a) the lack of economic and b) political stability. Turkey has been and is a quite unstable country in terms of its internal politics and macroeconomic stability including price and exchange rate stability. The exchange rate volatility of the Turkish Lira together with the price instability has a negative effect on FDI. Double-digit inflation rates and an inefficient structure of the banking system also play an important role in the investment decision of foreigners. On the one hand, multinational firms are interested in Turkey as a base from which they can offer their supply to Central Asia, Middle East and Europe since Turkey has the potential as a joint venture partner. On the other hand, unpredictability of political and economic atmosphere in Turkey deters its potential for more FDI flows. It should become possible however, to find a balance between these two positions with the accession of Turkey to the EU, which requires structural reforms not only in economics but also in politics.

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<sup>2</sup> See International Crisis Group. *Turkey and the Middle East: Ambitions and Constraints*. Europe Report no 203. Brussels: International Crisis Group, 7 April 2010, esp. page 10.

<sup>3</sup> In February 2010, after investments of 70 million US-\$, the railway line between Turkey, Syria and Iraq was reopened and a fast train service will soon be added between Aleppo in Northern Syria and Gaziantep in Southern Turkey (see International Crisis Group, *Turkey and the Middle East*, p.12).



Table 3: Country Ranking for the ease of doing business 2008/2009

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Singapore	1	4	2	1	16	4	2	5	1	13	2
New Zealand	2	1	5	15	3	4	1	9	26	10	17
Hong Kong, China	3	18	1	6	75	4	3	3	2	3	13
United States	4	8	25	1	12	4	5	61	18	8	15
United Kingdom	5	16	16	35	23	2	10	16	16	23	9
Denmark	6	28	10	9	47	15	27	13	6	28	7
Ireland	7	9	30	27	79	15	5	6	21	37	6
Canada	8	2	29	17	35	30	5	28	38	58	4
Australia	9	3	62	1	34	4	57	47	27	16	14
Norway	10	35	65	114	8	43	20	17	9	4	3
Georgia	11	5	7	9	2	30	41	64	30	41	95
Thailand	12	55	13	52	6	71	12	88	12	24	48
Saudi Arabia	13	13	33	73	1	61	16	7	23	140	60
Iceland	14	33	31	56	13	30	73	31	73	2	16
Japan	15	91	45	40	54	15	16	123	17	20	1
Finland	16	30	47	132	27	30	57	71	4	8	5
Mauritius	17	10	42	36	66	87	12	12	19	66	73
Sweden	18	43	19	117	20	71	57	42	7	51	18
Korea, Rep.	19	53	23	150	71	15	73	49	8	5	12
Azerbaijan	38	17	158	33	9	15	20	108	177	26	84
Cyprus	40	25	77	93	64	71	93	37	15	107	21
Armenia	43	21	72	62	5	43	93	153	102	62	49
Bulgaria	44	50	119	53	56	4	41	95	106	87	78
Romania	55	42	91	113	92	15	41	149	46	55	91
Turkey	73	56	133	145	36	71	57	75	67	27	121

Moldova	94	77	161	141	17	87	109	101	140	22	90
Greece	109	140	50	147	107	87	154	76	80	89	43
Russia	120	106	182	109	45	87	93	103	162	19	92
Iran	137	48	141	137	153	113	165	117	134	53	109
Ukraine	142	134	181	83	141	30	109	181	139	43	145
Syria	143	133	131	91	82	181	119	105	118	176	87
Iraq	153	175	96	59	53	167	119	53	180	139	183

Data Source: World Bank: Doing Business Database: <http://www.doingbusiness.org/economyrankings/>

Economies are ranked on their ease of doing business, from 1 – 183, with first place being the best. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business. This index averages the country's percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. The rankings are from the *Doing Business 2010* report, covering the period June 2008 through May 2009.

#### **4. Quality of FDI flows to Turkey**

The quality (composition, form) of FDI is as important as its quantity. The main economic expectations from FDI flows are job creation, expansion of production and technology transfer. However, in the case of developing countries, foreign capital investments are in the form of purchase or merge of existing companies rather than new investments. According to YASED Foreign Direct Investments Report (2007); in the case of Turkey, out of 20.1 billion US \$ of FDI in 2006, 2.9 billion was real estate purchases by foreigners. Top FDI deals accounted for the 13.2 billion US \$ of the remaining 17.2 billion US \$. Mergers and acquisitions amounting to 15.4 billion US \$ constituted an important part of FDI inflows. Thus, FDI flows to Turkey did not expand the economy's fixed capital stock since 'acquisitions and mergers' are classified under the transfer of national property to foreigners, simply changing hand. Real estate (buildings, land) sales in 2007 reached \$ 3 billion. Service sector as a share of total foreign capital flows are about 66%. The share reaches to 80% when one adds the real estate investments.

#### **5. Conclusion**

The influence of the economic debt crisis in Greece upon the rest of Europe and the distortion in the financial balances created increasing uncertainties not only in the EU but also in the rest of the world. The effect of the current initiative of Angela Merkel in taxing and regulating the speculative financial transfers on the EU stock exchanges and on the Euro Zone is also under discussion.

With the eastern enlargement of the EU, new members had the advantage of attracting FDI flows due to reduction in risk and adoption of Euro. However, the Euro crisis brought additional costs to the new members and to the rest of the EU and became a disadvantage in terms of attracting FDI.

On the contrary, Euro-crisis might be in the advantage of Turkey since it is out of the Euro-zone and not directly affected by the crisis. The indirect effects will be limited and relatively small in comparison to EU countries. FDI flows, which would prefer the PIIGS countries (Portugal, Italy, Ireland, Greece, Spain) under normal circumstances, might change their route towards Turkey.

Turkey's exports are going to take its toll from the current developments in Euro-zone to a large extent since most of its trade is in Euro and to the Euro zone. In the long run, the Euro crisis will affect the competitiveness of Turkish exports in a negative way. However, the contraction in foreign demand and bottlenecks in exports can be financed via the foreign exchange which would be delivered through FDI. Considering the high levels of ROI (return on investment) offered by Turkey (6.50%), it carries high potential to attract FDI more than the European countries do. Being out of Euro zone and offering high ROIs could make Turkey a winner of Euro-crisis in the long run.

## Annex

Table A1: International Direct Investment Inflow of Turkey by Country, 2004-2009 (in % of total FDI)

Countries	2004	2005	2006	2007	2008	2009	Avg
							2004-09
European Countries (27)	86	59	82	66	75	80	75
Germany	6	5	2	5	8	7	5
France	3	25	2	2	5	10	8
Netherlands	48	4	29	28	9	16	22
United Kingdom	11	2	4	4	9	6	6
Italy	1	8	1	0	2	5	3
Other EU Countries	18	15	44	26	42	35	30
Non EU European Countries	1	19	0	2	2	5	5
Africa	0	0	0	0	1	0	0
U.S.A.	3	1	5	22	6	4	7
Canada	5	0	1	0	0	1	1
Central-South America And Caribbean	0	0	0	3	0	0	1
Asian	5	21	11	7	16	10	12
<i>Near And Middle Eastern Countries</i>	5	20	11	3	15	5	10
<i>Gulf Arabian Countries</i>	4	20	10	2	13	3	8
<i>Other Near And Middle Eastern Countries</i>	1	0	0	1	1	1	1
Other Asian Countries	1	1	0	4	1	5	2
Other Countries		0	1	0	0	0	0
Total	100	100	100	100	100	100	100

Source: Own calculations with data from: Central Bank of the Republic of Turkey, Electronic Data Delivery System (EDDS) available under: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

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