T.R.
MARMARA UNIVERSITY
EUROPEAN COMMUNITY INSTITUTE
EUROPEAN UNION ECONOMICS

TURKEY'S PERFORMANCE IN ATTRACTING EU-ORIENTED FDI COMPARING WITH THE CZECH REPUBLIC, HUNGARY & POLAND

MSc Thesis

T.C. YÜKSEKÖĞRETİM KURULU
DOKÜMANTASYON MERKEZİ

İVGEN NAYMAN

İstanbul 2003

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ABSTRACT

In developing countries and transition economies FDI is seen as a source of economic development and modernization, income growth and employment. To speed up economic developments, governments are taking actions aimed at winning the increased share of the investment inflow, expecting to bring new technologies, know-how and thus contribute to increasing productivity and competitiveness of domestic industries. In the past decades Turkey has attracted barely $1 billion a year of FDI at a time when global flows have multiplied, especially by regional standards and given Turkey's economic size, advantageous location and the fact that it is a dynamic, outward-looking country, the figures are quite poor. For all the candidate countries the EU has always been potentially both the largest trading partner and the most important source of capital and technology. The Czech Republic, Hungary and Poland sighted as the main competitors of Turkey, in terms of receiving the EU oriented FDI. The competition between the countries, increased the standards for attracting foreign investments, consequently making it more difficult for Turkey to compete for EU oriented FDI. The purpose of this study is to analyze Turkey's performance in attracting EU-oriented FDI over time and relative to competitive countries and to identify the role of the EU in achieving the foreign investment

ÖZ

Gelişmekte olan ülkelerde ve değişim ekonomilerinde doğrudan yabancı sermaye, ekonomik gelişme, modernizasyon, gelir ve istihdam artırıcı kaynak olarak görülmektedir. Ekonomik gelişmelere ivme kazandırmak amacıyla hükümetler yeni teknoloji, know-how getireceği ve bu sayede üretimdeki verimliliği ve iç pazardaki rekabeti hızlandıracağını düşündükleri yabancı sermaye girişini artıracak faaliyetlerde bulunmaktadırlar. Dünyadaki sermaye akışının arttığı son yıllarda Türkiye yıllık olarak ortalama 1 milyon dolar doğrudan yabancı sermaye girdisi sağlanmıştır. Türkiye'nin içinde bulunduğu coğrafi bölge, ekonomik büyüklüğü, avantajlı konumu, dinamik ve dışa dönük yapısıyla bu oranlar küçümsenmeyecek kadar azdır. Tüm aday ülkeler için Avrupa Birliği her zaman en büyük ticaret ortağı, sermaye ve teknolojinin kaynağı olmuştur, Çek Cumhuriyeti, Macaristan ve Polonya Türkiye'nin AB kaynaklı yabancı sermaye girişinde belli başlı rakipleri olarak görülmüşlerdir. Ülkeler arasındaki bu rekabet Avrupa Birliği merkezli yabancı sermaye çekmedeki standartları arttırmakta, sonuç olarak Türkiye'nin rekabet gücünü azalmaktadır. Bu çalışmanın genel amacı Türkiye'nin Avrupa Birliği'nden gelen yabancı sermaye akışını zaman içerindeki gelişimini ve rakip ülkeler olarak değerlendirilen Çek Cumhuriyeti, Macaristan ve Polonya'ya kıyasla performansının değerlendirmesi ve Avrupa Birliği'nin yabancı yatırım üzerinde oynadığı rolü belirlemektir.

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LIST OF ABBREVIATIONS

CEEc	Central ad Eastern Europe Countries CEEc
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
GATT	General Agreements on Trade and Tariffs
GDFI	General Directorate of Foreign Investment of Turkey
GDP	Gross Domestic Products
ICO	Istanbul Chamber of Commerce
IMD	International Institute for Management Development
IMF	International Monetary Fund
ITDH	Hungarian Investment and Trade Development Agency
ISO	Istanbul Chamber Office
MAI	Multinational Agreement on Investment
M&As	Mergers and acquisitions
MFN	Most Favored Nation Treatment
MIA	Multilateral Investment Agency
MIGA	Multilateral Investment Agency
MNCs	Multinational Companies
MNEs	Multinational Enterprises
OECD	Organization of Economic Corporation and Developments
PAIZ	Polish Agency of Investment
UN	United Nations
UNCTAD	UN Conference on Trade and Development
VAT	Value Added Tax
WTO	World Trade Organization
YASED	Foreign Investor Association of Turkey

INTRODUCTION

Throughout the consequences of globalization and with the help of the technological improvements in communications, information processing and liberalization movements helped to increase the foreign capital circulation in the world. "Information" and "Money" can freely travel across national borders without government restrictions. The industrial countries recognize the increasing importance of international business and the need for domestic firms to be competitive in the international economy. With the significant effects of the globalization as national companies are turning into multinational corporations, they become closer to the customers by making foreign investments both in the case of production and distribution. This situation helps the companies to derive profit from cost advantages in different countries. Generally this enables corporations to become internationally more competitive in their countries. A large and growing number of firms now view overseas expansion through direct investment as a necessity rather than as a luxury reserved only for the largest firms. Thus many industrial countries are looking with increased favor on foreign direct investment including investment in developing countries. Increasing tendency towards attracting the FDI leads the decision making process more difficult than before.

Until the last two decades, many countries had reservations as regards FDI and excluded or restricted its inflow, today, every single country seeks to attract FDI, in many cases not only at the national level but also, at various sub-national levels. Developing countries and transition economies have come increasingly to see FDI as a source of economic development and modernization, income growth and employment. To speed up economic developments, governments are taking actions aimed at winning the increased share of the investment inflow, expecting to bring new technologies, know-how and thus contribute to increasing productivity and competitiveness of domestic industries. Therefore they have

changed their attitude on foreign direct investment, instead of fearing, limiting or even banning foreign investment; these countries have not only permitted it but indeed are competing to attract it. As it is seen the primary vehicles for international economic integration, great attention given to the foreign direct investment is not surprising.

Since the supply of FDI has increased and become more diversified, with the increasing numbers of demand, the proportion taken from the total foreign capital inflows is getting smaller. On the contrary to this accelerating demand, there is an increasing tendency to make short term investment which leads foreign investment pie to get smaller. Investors tend to favor the free flow of capital across national borders because it allows capital to seek out the highest rate of return. The volume of “hot money” unattached capital slashing around the world looking for higher rate of returns, has reached extremely high levels in the recent years. The free entry and exist mechanism of global mobility of capital, with causes of the financial fluctuations can create undesirable outcomes by creating instability and financial crises in the home country such as experienced in Mexico, Argentina, Brazil and Turkey. Unlike short term capital investment FDI can not leave easily at the first sign of trouble so that mostly preferred by the countries.

Yet the governments want to use foreign direct investment as part of achieving a development objective will therefore have to think of policies towards attracting foreign investment, upgrading the direct investment and encouraging linkages between foreign multinationals and local firms. Some governments want foreign direct investment more than others and may try harder accordingly. However, while some countries attracted large foreign direct investment flows, others were less successful, even though they had liberalized FDI regimes.

In Turkey, developments in foreign investments accelerated since January 1980, when there were dramatic changes in the economic and social structure of the country. As a result of the changes in the Foreign Investment legislation, Turkey

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has been pursuing liberal and outward-oriented economic policies and the investment climate was made more efficient and suitable for potential investors, starting with the 1980s. Like the other developing countries, the Turkish governments view foreign direct investment as vital to the country's economic development and prosperity.

Turkey is well positioned in terms of location and market access to serve the European market and other neighboring regions in Central Asia and the Middle East. In addition to being in the EU Customs Union since 1996, Turkey has recently won the status of full candidate for membership of the European Union. The Custom Union has brought Turkey closer to the larger Western European economies. Despite the apparent strength in some domestic industries, it seems that the broader benefits of globalization in Turkey, as measured by increases in FDI have been limiting. In the past decades the country has attracted barely $1 billion a year of FDI at a time when global flows have multiplied, especially by regional standards and given Turkey's economic size, advantageous location and the fact that it is a dynamic, outward-looking country, the figures are quite poor. Turkey represents a paradox with the gap among potential and actual investment flows and the failure to attract foreign investment is a major impediment to Turkey's growth potential.

For all the candidate countries the EU has always been potentially both the largest trading partner and the most important source of capital and technology. EU membership is expected to provide Turkey with the chance of becoming a major recipient of FDI, rivaling Ireland and Spain. Since the collapse of the Eastern bloc, the states of Central and Eastern Europe have become a new important destination of FDI. The Czech Republic, Hungary and Poland sighted as the main competitors of Turkey, in terms of receiving the FDI. The competition between the countries, increased the standards for attracting foreign investments, consequently making it more difficult for Turkey to compete for EU oriented FDI. Unfortunately, those countries receiving from five to ten times as much as Turkey in relation to their economic size and Turkey is missing the opportunities of

attracting foreign investments. The ratios show that while inward capital flows to Turkey have represented 0.5% of GDP into Hungary and the Czech Republic have averaged 4% of GDP and 2% in Poland. EU candidacy was a benefit for attracting the foreign direct investment to the countries whereas not so many differences occurred in the case of Turkey.

Building on the prior literatures the focus of this thesis is to analyze Turkey's performance in attracting FDI over time and relative to other three candidate countries; Czech Republic, Hungary and Poland which are sighted as the main competitors of Turkey in terms of FDI attracting. As European Union is the major trading and investment partner of the countries, study will be focus on the EU-oriented foreign direct investment flows. The purpose of this study is to identify Turkey's position in attracting EU-oriented FDI and by comparing with other three candidate countries, to see the role of the EU in achieving the foreign investment. The study is divided into four parts; to touch on the subject of foreign direct investment in the first part some complementary information is provided.

To understand the reasons of competition between the countries to attract the foreign investment, the general perspective of FDI in the world will be overviewed. According to the conceptual framework of the FDI, general definition of foreign direct investment and its costs and benefits for the host country is tried to analyze and to find an answer of why countries are so keen on to open their economies to foreign investors. It is found necessary to evaluate the historical developments of FDI in the world to draw a general perspective to the subject. The existing literature reviewed to identify the factors determining investment location in the developing countries.

In the second part of the study a general picture of the FDI in Turkey will be drawn, by summarizing the historical evolution and by analyzing the investment environment in the country. It is also tried to find out the facts that are blocking the foreign investors. What are the main strengthens and weakness of Turkey in

attracting foreign investments inflows to the country? What are the major problems that foreign investors faced with?

In the third part of the study European Union's role in attracting the foreign direct investment into the candidate countries will try to be explained. The main concern of this part is both to establish a connection of the EU policies in the FDI inflows of the countries and to guide the reader with presenting the profiles of the countries. How EU is supporting the countries in pre-accession period? Why there are differences among the candidate countries in terms of supporting the firms for making investment into this region? To guide the reader the country profiles of Czech Republic, Hungary and Poland will be presented by evaluating the foreign capital's developments during the transition period.

Due to the objective of the study and the availability of the data, comparison between Turkey and the other three countries among the main indicators, is considered to be the main focus of the last part. There is tried to find out the facts of the under performance of attracting FDI inflows to Turkey, by examining the position compare to the selected countries. In this context, the research reflects the most important factors that affected the foreign investment. Main concerns here are to shown the differences and similarities of the countries with Turkey.

I. FOREIGN DIRECT INVESTMENT IN THE WORLD

1.1 CONCEPTUAL FRAMEWORK

The International Monetary Fund (IMF) defines foreign direct investment is "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise". According to the IMF when the investor holds 10 percent or more of the equity of an enterprise it should be counted as foreign investment, this is amount usually enough to give the investor a say in the management of the enterprise. Sometimes an investor with a smaller share plays an active role, or a larger investor may remain passive.[1]

According to the OECD definition of foreign direct investment, FDI consists the following items;

- The share of the foreign investor in the profits, which are not distributed but adopted and reinvested.
- Foreign investor's purchase of stock and debt securities (short or long term) by cash or capital in kind.
- The credits that are provided to the company by foreign investors
- The take-over of non-cash machinery and production rights by the foreign investor.
- The commercial and other type credits that the foreign investor provides to firm.

Turkey's traditional FDI definition is much narrower than that of some countries and international institutions. For instance, unlike the OECD definition, Turkey records short and long term credits from foreign partners as foreign investments only if the foreign partners' receivables are added to company's capital; otherwise it is not recorded as an increase in foreign investment but

[1] Foreign Direct Investment Report Washington DC World Bank 1997 p:9

rather as an increase in external debt. The situation leads to the under valuation of foreign investments coming to Turkey. However, for the first time in 2001, due to a particularly large long-term foreign credit and in response to international discussions on the matter, it was decided to classify it as an FDI in conformity with international norms.

According to the Undersecratariat of Treasury definition of Foreign Investment represent the capital cash in the form of convertible foreign currency that is bought and sold by the Central Bank of the Republic of Turkey.

- Transfer of net profits, dividends, sales, liquidation, and compensation values that correspond to stocks of foreign real and legal corporate bodies; license, know-how, technical support, management, and costs of arranging franchising contracts; foreign credit capital and interest payments or transferable values are considered as foreign investment.
- The amounts that are accepted as share of capital emerging from the existing assets and receivables that are born within the confines of foreign exchange regulations, pertaining to foreign settled persons and institutions.
- The amounts from intellectual rights such as patent and trade-mark that are accepted by the Undersecretaries of Treasury.[2]

A simpler and more commonly used definition is as follows: "FDI means a fixed investment made in real sector with the aim of setting up a physical establishment and creating employment. Typical example would be a factory set up with foreign capital in the manufacturing sector or the establishment of a new, wholly owned subsidiary of a foreign firm in the services sector" [3]

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[2] Foreign Investment in Turkey Report 2001 GDFI Ankara 2001 p:11

[3] S.T. Ok "Main Problems that Foreign Investors in Turkey encounter and possible solutions recommended for these problems from their viewpoint" Marmara Üniversitesi Doktora Tezi Istanbul 1999

Foreign direct investment is an integral part of an open and effective international economic system and a major catalyst to development. Yet, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities, foreign direct investment has strong influence on domestic employment through types of job created, regional distribution of new employment, wage levels, income distribution and skill transfer. These direct effects are complemented by the indirect effects or spillover effects. Indirect effects take place through the increase of employment in domestic subcontractors.

According to the OECD; given the appropriate host-country policies and a basic level of development, most of the studies shows that FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. All of these contribute to higher economic growth, which is the most potent tool for alleviating poverty in developing countries[4]. FDI is not only a mechanism to link the markets; it is also a mechanism to link the production systems of countries internationally. The integration of FDI into a local economy results often in a deep social change. Movements of labor and links with domestic subcontractors enable transmission of business culture, which include corporate values, organizational structures and management practice.

Moreover, beyond the strictly economic benefits, FDI has the potential to bring social and environmental benefits to host economies through, transferring "cleaner" technologies and leading to more socially responsible corporate policies by the dissemination of good practices. Economic literature identifies technology transfers as perhaps the most important channel through which foreign corporate presence may produce positive externalities in the host developing economy. Multinational Enterprises (MNEs) are the developed world's most important source of corporate research and development activity, and they generally

[4] Foreign Direct Investment for Development Maximising Benefits, Minimising Costs OECD 2002

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possess a higher level of technology than is available in developing countries, so they have the potential to generate considerable technological spillovers. [5]

However, whether and to what extent MNEs facilitate such spillovers varies according to context and sectors and how exactly the transmission of technology occurs is not yet fully understood, making international technology transfer is an active area of research. A major question of interest is that once a technology has been introduced into a country, does it subsequently diffuse throughout the rest of the economy, which is not the scope of this paper, but should be analyzed in the framework of cost and benefits of foreign direct investment. The technologies that are transferred to developing countries in connection with foreign direct investment tend to be more modern, and environmentally "cleaner", than what is locally available in order to reap its benefits to the host country.

Although the direct environmental impact of FDI is generally positive, at least where host-country environmental policies are adequate, there are examples to the contrary, specially in particular industries and sectors. During the MAI (Multilateral Agreement on Investment)[6] negotiations one of the suspicions about the liberalization of FDI was, possibility of implying a danger that capital flows would be diverted to places where costly environmental protection regulations and/or workers' rights to protection, which are perceived as restrictive, are lowest. There are abundant believers emphasize that corporations move operations freely around the world, escaping tough pollution control laws, labor standards, and even the taxes that pay for social and environmental needs.

The possibility that pollution-intensive multinational firms relocate to developing countries with less stringent environmental standards has been labeled as "pollution haven" hypothesis. Consider that there are two countries country A and country B, host country A may have less stringent environmental

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[5] Saggi K; "Trade, Foreign Direct Investment, and International Technology Transfer" Southern Methodist University 2001

[6] In the next chapter, there will be exclusive information about MAI

protection than country B, which might make country A more attractive than country B to foreign direct investment, particularly from the "dirty" industries[7]. If it costs money to conform to more stringent environmental requirements in developed countries, profit-maximizing firms would want to relocate their production activities. Unfortunately developing countries don't give enough importance to environmental regulations in order to attract foreign capital; they are disregarding the fact that in the future the cost of environmental pollution will be much higher than the benefits of the foreign capital move to the country because of the lack of environmental regulations.

Moreover there are some arguments about foreign investment that it may lead to undesirable outcomes such as rising inequality between (groups of) individuals or regions, direct or indirect crowding-out of local capabilities or an erosion of the tax base or labor and environmental standards. There are many other subjects relating to who and what gains from FDI within societies. Does the environment gain or lose from the presence of FDI, do poor people benefit as much as the rich, men as much as women, rural areas as much as urban, small firms as much as large firms etc. these are many important issues, related with costs and benefits of FDI.

Apparently, developing countries need to reach certain level of development in education, technology, infrastructure and health before being able to benefit from foreign presence in their markets. Imperfect and underdeveloped financial markets may also prevent a country from reaping the full benefits of FDI. Governments first need to ensure that FDI fits within their development strategy and could employ other instruments to mitigate negative effects.

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[7] Smarzynska B; " Pollution Havens and Foreign Direct Investment: Dirty Secret or Popular Myth?" September 2001

1.2 EVOLUTION OF FOREIGN DIRECT INVESTMENT

1.2.1 Historical Developments of Foreign Direct Investment

First foreign investment movements started with the colonization period, during the 19th century, Western countries, a consequence of industrial revolution, looked for a profit maximization opportunity with the excess capital in their hand. In the first half of the 1800s, the need of raw materials, especially oil and some specific minerals, were the basic reasons of capital movements towards colonized countries. During the First World War, America was the leader country in the foreign direct investment, in 1929-1930; developed countries stopped investing in non-developed countries during this recession period. Before the First World War, international investment was generally in portfolio type, but with the 1950s, it changed direction to direct investment which is mainly the reason of the changes in the dimensions of the world economy. Many developing countries also have been ambivalent about encouraging inflows of foreign direct investment and particularly during the 1970s, required other ways to obtain private foreign capital, technology, and management skills. Some developing countries, in fact, put up significant barrier to direct investments.[8]

In 1980s, foreign investment flows were at a very low level, because of the debt crisis experienced in the world. Especially in Latin American and Asia many countries which, had acquired loans, could not even return the interest of these to the creditor countries. Therefore international finance organizations decide to encourage FDI into those countries. Following this resolution a rapid growth had been experience right from the beginning of 90's. As result of political adopted following the debt crisis, the share of the developing countries from these investments have increased continuously.

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[8] Karluk R. "Turkiye'de Yabanci Sermaye Yatırımlarının Ekonomik Büyümeye Katkısı' T.C Merkez Bankası Ekonomik İstikrar Büyüme ve Yabancı Sermaye Seminerleri Ankara 2001

Table 1.1

Historical Evolution of FDI

YEARS	SECTORS
1800-1890	Natural &Agricultural Resources Petroleum, minerals, fruit production
1891-1940	Chemical items, Pharmaceuticals
1941-1945	Transportation, army equipments
1946-1960	Financial services, communication, truism Machinery, engineering
1961-1971	Electronic equipment, research, traveling & entertainment services
1972-1985	Education services, food industry, cleaning production
1985-2000	Tourism, information, automation, telecommunication, nuclear items

Source: Carikci E. Ekonomik Gelismeler ve Türkiye AB Ilişkileri

Although at the end of the 80's the share of the developing countries within the total investment was around 20% and the rest 80% was traveling between the developed and already investment exporting countries, towards the middle of the 90's, the share of the developing countries in total FDI reached one third peaked to 43.3% in 1997. Moreover the Far East Asian crisis, which did not affect the total FDI values adversely, affected the investment inflow towards the developing or underdeveloped countries.[9]

Developing countries had shown much more stability in FDI inflows compared with developed countries, where volatile mergers and acquisitions activity had a significant effect. According to the studies of Fontagné the dramatic increase in FDI over the last decade has had at least three sources. First, technological improvements in communications, information processing and transportation, coupled with new organizational structures, have enabled firms to

[9] Ariman A. "Foreign Investment in Turkey" TMMOB Globalization and Industrialization Congress December 2001 Istanbul

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become more effective in existing firms. Second, the changing framework of international competition has led to the liberalization of capital flows among developed countries. According to the UNCTAD records between 1991 and 1998, there were 750 changes in legislation relating to FDI worldwide, over 700 of which represented liberalization. Liberalization of investment regimes had often been combined with privatization and sales of State assets to foreigners and had constituted a main vehicle for market access by foreign investors in the 1990s.[10] Third, developing countries are increasingly liberalizing their regimes for inward foreign investment. At present, one-third of the world's FDI stock is located in developing countries, although it remains heavily concentrated in a few of them.[11]

Table 1.2

FDI inflows in the World (USD billions)

	1990- 1995	1999	2000	2001
WESTERN EUROPE	87	507	832	336
NORTH AMERICA	47	308	367	152
ASIA PASIFIC	48	103	134	102
LATIN AMERICA	12	38	39	45
CENTRAL&EAST EUROPE	6	25	26	27
AFRICA	4	13	9	17

Source: UNCTAD World Investment Report 2002

A matter of concern is that the FDI gap among developing countries widened further, with the top five countries receiving 55 % of all the developing-country inflows in 1990s and the 48 least developed countries receiving less than one per cent. Yet another disconcerting feature is that the 10 largest countries in terms of hosting inward FDI flows account for well over two-thirds of overall FDI. Global FDI inflows exceeded the one trillion dollar mark in 1999, reaching $1.1

[10] Thomensen S; "Investment Patterns in Longer term Perspective" Working Papers on International Investment Number 2000/2

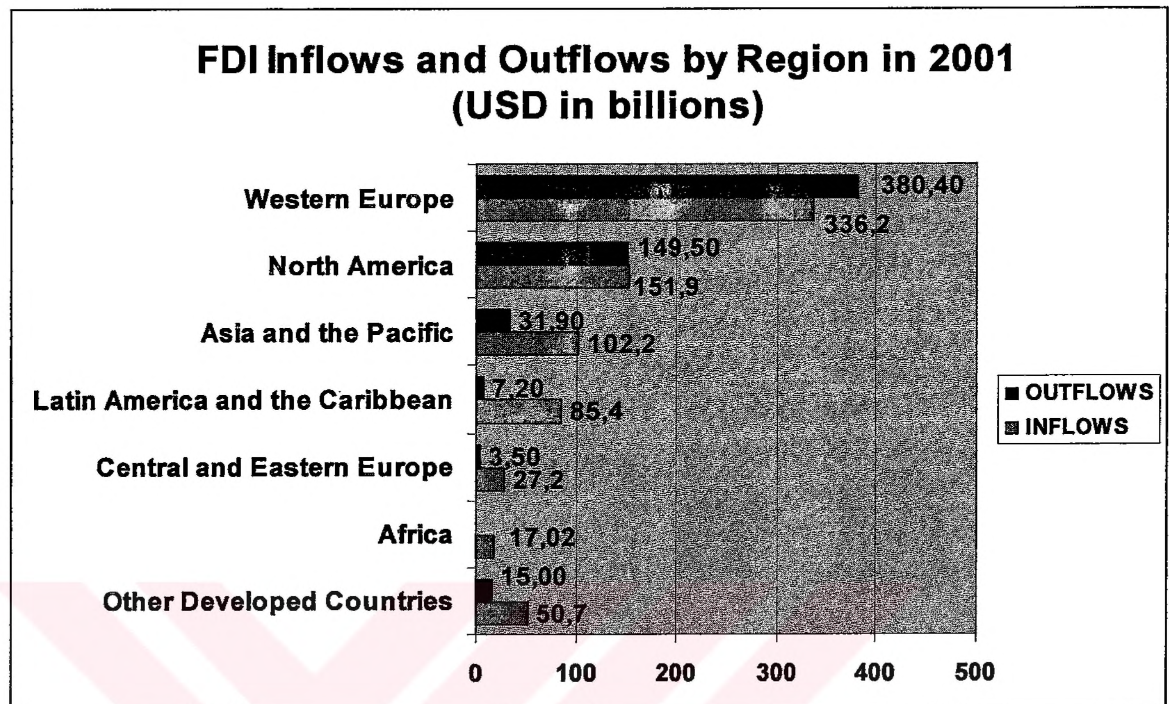
[11] Lionel Fontagné "Foreign Direct Investment and International Trade: Complements or Substitute?"

trillion increase of 55 per cent over 1998. In 2000 global FDI inflows increased by 18 % over 1999 levels to 1/3 trillion. Although the pursuit of FDI become very sophisticated and highly competitive on a global level more than US$ 1 trillion of the $1.3 trillion of FDI inflows in 2000 went to developed countries. Despite increases in the levels of FDI received by developing countries overall, the majority of FDI has gone to developed countries. According to UNCTAD, the FDI dropped by 40% to around US$ 760 billion in 2001. A general assessment of the countries where FDI was made reveals that the biggest fall was registered in the developing countries whereby it dropped by 49% and that this amount which was US$ 1.3 trillion in 2000, went down to around US$ 510 billion in 2001.

According to the World Investment Report 2002 the *Triad* (Japan, the European Union and the United States) has long accounted for the bulk of international production, providing and receiving most of the global FDI. During 1998-2000, the Triad accounted for the three quarters of global FDI inflows and 85 per cent of outward FDI stocks. In terms of both the origin a destination of international investment capital, the European Union is the most important region for FDI. There is a virtual balance between capital inflows and outflows. Since the collapse of the Eastern bloc, the states of Central and Eastern Europe have become a new important destination for FDI. The states of Africa continent, on the other hand, continue to play a minor role. Latin America and the Caribbean, where FDI flows had tripled during the second half of the 1990s, registered a 22 percent decline to $ 85 billion in 2001. In the Annex I, it is listed the several countries FDI inflows between the years of 1990 to 2001. According to the Table 1.3, it is seen that developed countries approximately same amount of both inward and outwards FDI, but on the other hand developing regions have higher FDI inflows to outflows.

Table 1.3

FDI Inflows and Outflows by Region in 2001

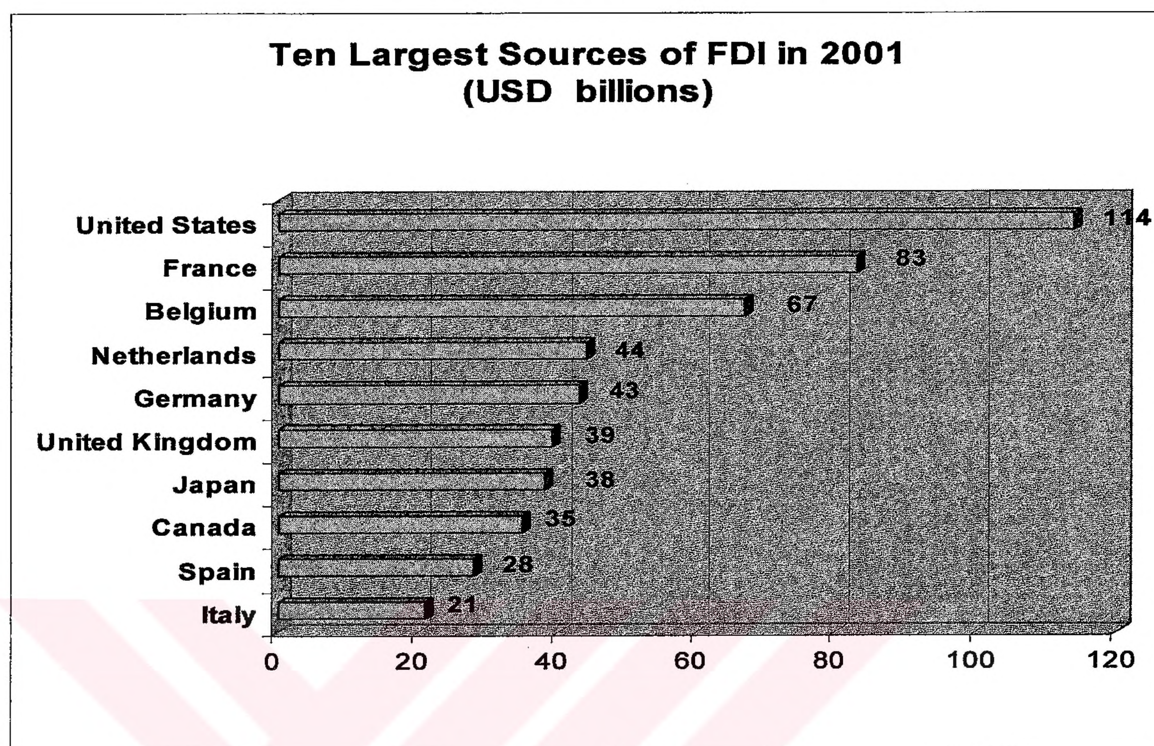


Source: UCTAD World Investment Report 2002

Within Western Europe, the European Union (EU) accounts for more than 90 per cent of both inward and outward FDI flows. While record inflows into the EU were stimulated by progress in regional integration, extra EU flows were dominated by the United States. Rising FDI flows between EU and European Free Trade Association were the main stimulus for FDI into other Western European countries, reflecting also closer relationships on other levels of international relations. As it is seen from the Table 1.4 among the 10 countries 7 of them are EU member states. Within, the France was the largest outward investor in 2001 and the largest investor worldwide for a second consecutive year, mainly due to major cross-border and Germany become the most important FDI receipt in the region. For all the candidate countries the EU has always been potentially both the largest trading partner and the most important source of capital and technology.

Table 1.4

Ten Largest Sources of FDI in 2001



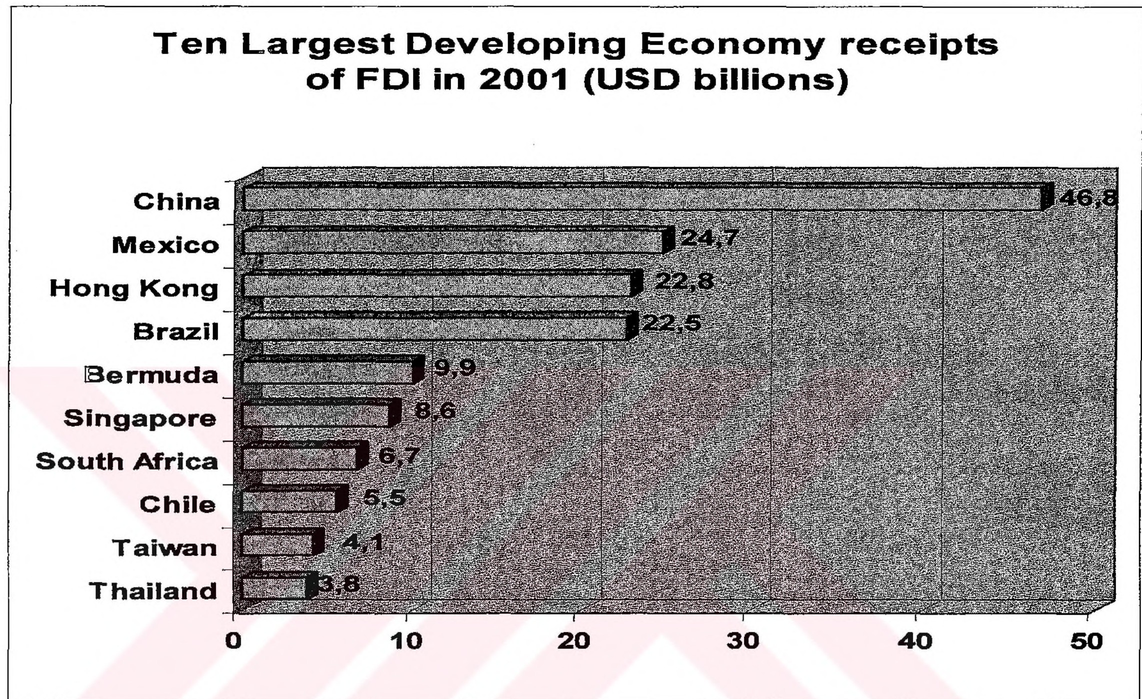
Source: UNCTAD World Investment Report 2002

When it is looked through the European Union's history foreign capital movements have often been greatest during periods of rapid integration. The longest record of direct investment into Europe is by US firms, beginning in the nineteenth century but growing most quickly over the past four decades. The three periods of rapid growth in the European share of total direct investment coincide with the three phases of most intensive integration among European economies: 1960-66 after the signing of the Treaty of Rome and subsequent tariff reductions among Common Market members; 1973-80 when the United Kingdom, Ireland and Denmark all joined the Community; and 1985-90 following the launch of the Single Market Program in the middle of 1980s. The introduction of the euro at the beginning of 1999 also focused attention on the impact of ever-greater European economic integration on patterns and levels of FDI in Europe. European integration over four decades had played an important role in FDI trends in Europe, encouraging investment by firms from outside of the region,

promoting consolidation of European industry and helping to shape the geographical pattern of production by both European and non-European firms in Europe.[12]

Table 1.5

Ten Largest Developing Economy Receipts of FDI in 2001



Source: UNCTAD World Investment Report 2002

Among the ten largest developing economy receipts of FDI are observed from Far East Asia and Latin America. FDI flows to the developing countries of Asia were at record levels in 2000 as the region recovered from the crisis of the late 1990s. Inflows to the region rose 44 per cent to $143 billion, while outflows increased 140 per cent to $85 billion. The bulk of the inflows were to Hong Kong, rising by 160 per cent to $64.4 billion, and China, $46.8 billion. The main reason why Hong Kong SAR overtook China as the single largest recipient of inflows in Asia, according to the report, was that FDI flows entered Hong Kong for the purpose of being invested in China. In 2001 China took the highest amount of capital inflow into the country with $ 46.8 billion and Hong Kong had a decrease

[12] Ibid from Thomensen "Investment Patterns in Longer Term Perspectives"

to $22.2 billion but still the 4th largest recipients from the developing countries. The report notes that other large recipients of FDI in Asia were Singapore, $8.6 billion; Taiwan, $4.1 billion; and Thailand $3.8 billion.

1.2.2 Liberalization Movements for Foreign Direct Investment

The establishment of a liberal framework for FDI involves the reduction of barriers to entry and operations by foreign investors; the strengthening of standards for their treatment by host countries; and the strengthening of mechanisms that ensure the proper functioning of markets. The unilateral national efforts at liberalization are complemented by facilitation and protection efforts at the bilateral level, where the principal instruments are double-taxation treaties and bilateral investment treaties. At the regional level, governments seek to improve the framework for FDI flows, especially in the context of the European Union, NAFTA, the Lome Convention, APEC, and ASEAN has taken steps in this direction. In fact today's regional agreements are no longer only free-trade agreements but more and more free investment agreement as well.

Since the end of the 1940s, international trade in goods, and since 1995, trade in services, have been covered by as system of multilateral rules (the GATT and the GATS respectively), a multinational set of rules for international direct investment has been largely lacking. The scope of multinational production expanded as GATT's Uruguay Round and various regional integration agreements had reduced the barriers to international trade and investment at the same time as important technical innovations in telecommunications and information technology facilitated the condition of international production network. The globalization of the economy, together with the successful conclusion of the Uruguay Round and the establishment of the World Trade Organization, brought about a steady decline in barriers to international business transactions.

Difficulties of establishment of multilateral agreement and lack of global investment agreement lead to sign bilateral investment agreements within the several countries. In order to solve the needs of an agreement on liberalization of global investment environment, Multilateral Agreement on Investment (MAI) came into a surface but after long negotiations suspended to the future time. In 1995, negotiations on Multilateral Agreement on Investment were launched in the framework of the OECD. The main aim of the MAI was to oblige to its members to apply National Treatment Rule as well as a Most Favored Nation Treatment (MFN) Rule to investors and their investments.

The multilateral agreement on investment is for the first time establish a binding multilateral framework for international investment, including direct investment, loans, rights granted by law or under contracts, licenses, authorizations and intellectual property but excluding artistic or literacy property. Two principles underline the agreement: non discrimination between national and foreign investors on the basis of the principles of national treatment and most favored nation status, and the principle of transparency, which is to be translated into an obligation to publish all rules and court decisions which affect the implementation of the agreement.[13]

Investment with the meaning of the MAI will be an extremely far reaching and extensive notion. Not only it will recover FDI but every kind of asset owned or controlled, directly or indirectly by an investor including enterprises, shares, bonds, rights under contracts, claims to money, claims to performance, intellectual property rights, rights conferred pursuant to law or contract, all forms of property and related rights. By all, the MAI would fundamentally alter the climate for international investment by preventing governments from providing more favorable conditions for their citizens and domestic companies than for other investors. Among the major provisions are the following.[14]

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[13] 'Küreselleşen Sermayenin Anayasası: MAI' İktisat Dergisi Ağustos 1998 sayı:381 İstanbul
[14] European Parliament Session Documents 26 February 1998

- Countries would be required to treat foreign investors no less favorably than domestic ones. For instance, they could not maintain economic assistance programs that benefit only domestic companies or place restrictions on what foreign companies own.
- Limits would be placed upon performance requirements, which are laws that require investors to meet certain conditions (minimum levels of domestic employment, requirements to purchase goods in that country or to hire a given level of local personnel, restrictions on exports, etc.)
- Restrictions on the repatriation of profits or the movement of capital would be banned.
- Private investors and corporations would be allowed to sue national governments in an international tribunal, rather than in that country's domestic courts, through governments would be able to sue the investors before the same international tribunal.
- National governments are able to lodge reservations specifying that particular articles of the MAI do not apply to certain industries or economic sectors.

Nongovernmental organizations criticized MAI, which were considering the interests of multinational companies instead of investors'; consisted of regulations restricted the independences of nations during the application of the environment and labor law. Another critic to MAI is to give the rights to foreign investors and corporations to sue national governments according to their losses in the host country. Although MAI gave many rights to the multinationals, their obligations are constrained. MAI, with its radical decisions aims to ease international capital investments, was scaled back in the face of global reaction.

It is important to have common regulations for foreign capital movements so to eliminate discriminations between the countries, MAI as an idea brought a liberal view to the world trade but on the other hand with its critics still the issue of many discussions and researches which are beyond the scope of this paper. Although MAI couldn't come into force, a liberalization movements on investment

is very important, with the globalization need of the arrangements of capital movements seem to be in the world agenda for many years.

1.3 THE DETERMINANTS OF ATTRACTING FDI TO THE DEVELOPING COUNTRIES

Given the potential role FDI can play in accelerating growth and economic transformation, developing countries are strongly interested in attracting it. Governments want to use FDI as part of achieving a development objective will therefore have to think of policies towards attracting and upgrading FDI and encouraging linkages between foreign multinationals and local firms. They are taking steps to improve the principal determinants influencing the locational choices of foreign direct investors. Countries are almost forced to be more open towards foreign investment; the emerging environment implies that it is difficult to build up an industrial capacity behind closed doors, even if countries have an effective government. So that developing countries have begun liberalizing their national policies to establish a hospitable regulatory framework for FDI by relaxing rules regarding market entry and foreign ownership, improving the standards of treatment accorded to foreign firms, and improving the functioning of markets.

Simply opening an economy is often no longer enough to attract sustained inflows of FDI an upgrade its quality. Governments need to take a more active and targeted approach, especially if they seek with the mobile competitive advantages of firms, with a view towards upgrading the former. Therefore many countries go beyond national treatment of multinationals by offering foreign companies, through subsidies and tax holidays, more favorable conditions than those granted to domestic firms. As the economic rationale for this special treatment, policy makers cite positive externalities generated by FDI through productivity spillovers to domestic

To look through the facts that effect the investment decisions of foreign companies it should be understood the needs of invest abroad. Firms invest abroad for many reasons, but in general they are prompted to do so by market

saturation at home and by faster growth prospects abroad. For some firms, faster growing foreign markets could be supplied through exports. A local presence is seen as a way of enhancing the investor's share of the local market. As Thomensen stated that it allows for closer interaction between buyers and sellers, promotes greater brand recognition and overcomes many of the obstacles associated with foreignness. Firms invest abroad not only in search of new markets but also sometimes to seek out more efficient locations in which to produce a given good or service. In some cases, the output might be intended for the parent company in its own downstream production, but it is commonly assumed that the affiliate will supply the global market. In this way, FDI is seen to promote a more efficient distribution of economic activities worldwide to the benefit of all.[15]

According to Tatoglu and Erdal; the fact that any firm, transnational or national, can decide to locate any part of its value –added chain where it is best for it to convert global inputs into outputs for global markets, means that FDI and trade flows are increasingly being determined simultaneously. They are both immediate consequences of the same location decision. So more specific question is where to invest to locate, it becomes an FDI decision if a foreign location is chosen and it follows the decision of the target markets host country or the region surrounded of that country.[16]

Through the decision making process, there are several influences that have been and always will be, important to FDI inflows. The most basic ones are political and economic stability and a welcoming environment for foreign capital. According to the Velde; the most significant determinants for the location of FDI are economic considerations, which come into full play once an enabling FDI policy framework is in place. They may be divided into three groups: the availability of location-bound resources or assets; the size of markets for goods and services; and the cost advantages in production. Although many of the

[15] Ibid from Thomsen S; "Investment Patterns in Longer term Perspective"
[16] Tatoglu E; Erdal F; "Locational Determinants of FDI an Emerging Market Economy: Evidence from Turkey" *Multinational Business Review*, Detroit Spring 2002

factors that attract investment to particular locations, such as abundant natural resources; large host country markets; or low-cost, flexible labor, remain important, their relative importance is changing as transnational corporations, within the context of a globalizing and liberalizing world economy increasingly pursue new strategies to enhance their competitiveness.[17]

Multilateral Investment Guarantee Agency (MIGA) with the assistance of Deilotte & Touche, conducted FDI Survey, responded by 13 largest Multinational Companies (MNCs) and 100 transnational businesses. As part of the study, companies were asked to rank the top five location factors influencing new site selection, the factor cited most often market access (ranked in the top five by 77% of respondent), followed by stable social and political environment (64%), ease of doing business (54%), reliability and quality of infrastructure and utilities (50%) and ability to have technical professionals (39%).[18]

According to the OECD the broader enabling environment for FDI is generally identical with best practices for creating a dynamic and competitive domestic business environment. Ease of entry and exit, appropriate standards of treatment and dispute settlement, the principles of transparency and nondiscrimination are instrumental in attracting foreign enterprises and in benefiting from their presence in the domestic economy. FDI is unlikely unless investors have a reasonable understanding of the environment in which they will be operating. Moreover, a lack of transparency may lead to illicit and other unethical practices, which generally weaken the host country's business environment.

FDI policy frameworks are only one determinant of the location of investment among host countries. Countries must also pay attention to other factors that influence investors' locational decisions. For example, they are

[17] Velde William D. "Policies Towards Foreign Direct Investment in Developing Countries: Emerging Best Practices and Outstanding Issues" Overseas Development Institute London March 2001
[18] "Foreign Direct Investment Report 2002" MIGA and Deilotte& Touche January 2002

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emphasizing coherence between the various policies that can affect FDI in particular, between core FDI policies and trade policies. Equally important, with FDI policy frameworks becoming more similar, countries interested in encouraging investment inflows are focusing on measures that facilitate business. These include investment promotion, investment incentives, after-investment services, improvements in amenities.[19]

According to the World investment report 2001 the new driver skills are technological capabilities, supply networks, good logistics and strong support institutions to attract FDI. It is also indicated in the report that the development of these items becomes key to attracting international production. In the report it is briefly generalized into three categories of the new determinants of location which are policy liberalization, rapid technological progress, and new management and organizational techniques.

Policy liberalization alters many parameters of international location. Trade liberalization reduces the need for FDI to jump tariff barriers and intensifies competition in existing activities. It also increases the size of accessible markets, including for export activities. The liberalization of FDI regimes and strengthening of international standards for the treatment of foreign investors allow firms greater freedom in making international location decisions and in choosing the mode for serving each market and meeting functional needs. Between 1991 and 2000, a total of 1185 regulatory changes were introduced in national FDI regimes, of which 1121 were in the direction of creating a more favorable environment for FDI. During 2000 alone, a total of 150 regulatory changes were made by 69 countries.[20]

FDI can be influenced by the specific policy regime with respect to foreign investment, and particularly by preferential treatment offered to foreign firms. Multinational firms clearly respond to positive incentives, and react against

[19] Fontagne L; "Foreign Direct Investment and International Trade: Complements or Substitute?" STI Working Paper 1999/3 OECD
[20] World Competitiveness Report 2001

restriction and disincentives, especially when the economic environment is relatively stable. The investment policy environment is determined by a combination of all macroeconomic and commercial policies, but those that are of particular interest to foreign investors are entry requirements, incentives, foreign exchange and funding policies, access to visas and work permits, land ownership laws, access and availability of physical infrastructure and repatriation and expropriation rights.[21] Most foreign investors prefer open and unrestricted policies, so governments are moving to more simple, transparent and automatic investment policies. Governments offer special financial and fiscal incentives to governments through offering discretionary grants to multinationals and tax holidays or special tax rates on business profits in host countries and on dividends payment to home countries.[22]

Number of studies fined that technical changes affect the geography of FDI in many ways; the dynamics of international production today largely reflect the nature, speed and occurrence of technical progress. Rapid innovation provides the advantages that propel firms into international production; thus innovation intensive industries especially tend to be increasingly transnational and have to be more innovative to maintain their competitiveness. New transport, communication and information technologies intensify competition while allowing firms to spread and manage international operations more efficiently. The rising cost of innovation leads firms to internalize their technological advantages rather than sell them, raising the role of FDI in technology transfer. Location decisions have to be based on the ability of the host countries to provide the complementary skills, infrastructure, suppliers and institutions to operate technologies efficiently and flexibly. Technological progress, forces firms involved in international production increasingly to differentiate between the haves and

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[21] Guidelines for Investment Promotion Agencies UNIDO August 1994

[22] Number of studies fined that taxation significantly influences FDI, corporate borrowing, transfer pricing, dividend and royalty payments, Research & Development activity, exports, bribe payments and location choices. The external reasons are often complex in practice due to the complexity of multinational activity and the variation in home country taxation. Experience shows that incentives are most often effective export oriented investment in countries or regions that are similar to neighboring countries or regions in places where other aspects of the business climate are already favorable.

have-nots in new FDI complementing factors when deciding where to undertake different activities.[23]

The competition atmosphere enhanced, with increasing numbers of multinational companies, the demand of the new products and production techniques, which can be managed by educated and talented labor force. Increasing the costs of the highly qualified managers in western countries, cause a shift of foreign investments into developing countries that where the educated and good managerial skilled labor force is high and cheap. Managerial and organizational factors strengthen the new locational determinants of FDI. New organizational techniques stimulate a more efficient management of global operations, encouraging a greater relocation of functions.

As it is mentioned in many researches; the attractiveness of the regime also increasingly, depends on the effectiveness of FDI promotion. With rising competition for FDI and more discriminating investors, host countries and regions recognized the need undertake proactive investment promotion efforts. Support by industrial country governments for promotion programs has sometimes been ambiguous; in fact many governments in the beginning have faced serious opposition to these programs from domestic interest groups that fear foreign investment will export jobs and technology and thus weaken the home economy. Because of these fears investment promotion programs have received less political support than export promoting programs. These attitudes are now changing with the willingness of developing countries to attract foreign capital.

Bilateral and multilateral investment promotion programs supported by industrial countries are designed to help potential investors from those countries learn about investment opportunities in developing countries, find host country partners, and develop projects after opportunities have been identified. To

[23] Buckely P; Claggs J; Forsans N: "Increasing the size of the "country": Regional economic integration and foreign direct investment in a globallized world economy" Management International Review; Wiesbaden; Third quarter 2001

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facilitate project identification and development, these programs provide investors with information, subsidize some part of their own costs to obtain information, and help to cover project development costs.[24] An investment promotion strategy involves the organized use of a range of promotional activities to increase the level of investment in a country. Most strategies use three different but interrelated sets of activities: activities to enhance the image of a country *(image building)*[25], those to generate an increased flow of investors (*investment generation*)[26] and those to help investors (*investor servicing*).[27]

An investment promotion strategy should combine these techniques in a way that suits the requirements and resources of an individual country The importance attached to an activity varies by country and over time, but at any given time most strategies include elements of all three activities.[28] There is no doubt that no unique implementation of the all possible policies or a single best practice FDI strategy for the countries. The UNCTAD report on global FDI in 2001 stresses that FDI promotion should focus not only on the quantity of FDI but also on the quality, including linkages between public and private sectors. UNCTAD also recommends an active dialogue, requiring among others the "dissemination of best practices based on companies programs and actions and experiences of government practices and measures in different countries".

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[24] Belot T. "Programs in Industrial Countries to Promote FDI in developing Countries" World Bank Washington D.C 1991

[25] Image-building activities include producing and distributing fact sheets, videos, brochures and newsletters, holding briefings and engaging in media relations, public relations and advertising. Image-building techniques must be accompanied by investment-generation and investor-servicing activities, as on their own they are invariably wasteful. Some of these techniques, particularly advertising and media and public relations, are best implemented by professionals.

[26] Investment generation involves the use of mail and telephone campaigns, investment seminars and missions and direct marketing to individual investors. These techniques can and should be applied to audiences within the host country as well as to audiences overseas. They are applied differently for joint-venture projects and for direct investments, and the strategy needs to reflect these differences.

[27] Investor servicing involves pre-approval services, approval services and post-approval services. These services can be provided in a proactive manner or in a reactive one. They can be comprehensive, providing "airport to airport" servicing, or selective, concentrating, for example, on ensuring that all permits and clearances are provided with the minimum of delay and bureaucracy.

[28] Guidelines for Investment Promotion Agencies UNIDO August 1994

As the international investment flows have trebled over the past decade and are playing an increasingly important role in the investment plans of many developed and developing countries. To speed up economic developments, more and more governments are taking actions aimed at winning an increased share of this investment. As the benefits of foreign direct investment seem more than its costs, the competition for attracting it, will be more by each passing day. As it is given basically the main points of how to attract the foreign capital, each factor can be a subject of a new thesis. At the Table 1.6, it is summarized the determinants which effect foreign capital in the developing countries which are mainly discussed in here, table divided into sections according to the different fields related to the attracting of foreign direct investment.

Table 1.6

Host Country Determinants of Foreign Direct Investment

ECONOMIC DETERMINANTS	POLITICAL AND STRUCTURAL
* Liberal Economy	* Political system
* Economic Performance (GDP Growth, Inflation, domestic and foreign debts)	* Government policies towards FDI
* Existence of FDI	* Harmony with FDI and trade policy
* Long Run Strategy (stabilization, export, domestic market)	* Privatization Policy
* Trade policy, export promotion and infrastructure	* Agreements related to Foreign Trade
* Taxation	* Juridical System
* Competition Policy	* Red Tape, Bureaucracy
* Privatization opportunities	
TARGET MARKET	**APPLICATION TOWARDS FDI**
* Market Size	* Presentation of FDI (marketing)
* Ability of entrance global and regional markets	* Investment Subsidies
* Growth of Sectors	* FDI Promotions
* Market Structure (competitiveness, purchasing power)	* After investment services
* Improvement of domestic Trade	* Social and Cultural factors
* Preferences of Domestic Customers	
PRODUCTIVITY	**OTHER FACTORS AND POLICIES**
* Cost of the resources and Equity	* International, regional and bilateral treaties
* Raw Materials, land acquisition	* Global economic integration
* Low Labor Cost	* Insurance and political risk rating
* Qualified Labor Force	* Number of university and research institute
* Technology, technical abilities	* Research and Development
* Number of university graduated labor force	* Absence of corruption

Sources: Derived from World Investment Report 1998 Trends and Determinants Table IV.1 page91, FIAS Report, UNCTAD Report on Investment

II. FOREIGN DIRECT INVESTMENT IN TURKEY

2.1 HISTORY AND EVOLUTION OF FDI

Since its foundation in 1923, after the collapse of the Ottoman Empire, the Turkish Republic has exerted every effort to turn the economically underdeveloped country, with a largely nonexistent infrastructure, into a modern nation state. The shared vision of the founders was "the creation of a modern society" based on secular human values that would earn Turkey a place of equity in contemporary world civilization Turkey set her sights towards the West. After the building basic infrastructure, with process that started in the 1950's and accelerated during the following decades, private sector replaced the state sector to a large extent.

The Turkish society has been transformed, within a period of 50 years, from a sparsely populated rural agricultural country into a densely populated urban industrial society. Turkey had only 13.6 million people according to the first census undertaken by the Turkish Republic in 1927 and urban population was only 3.3 million, which was less than 25% of total population. Following fifty years of migration from village to towns, Turkey has become a densely population had gone up to 69 million, of which 49 million were living in cities, which is approximately 70% of the total population. In the country, industrialization process started off in 1950 directly as a result of the introduction of mechanized agriculture.

The foreign capital inflows in Turkey were only $300 million in 1971, and up until 1980 the average annual inflow of FDI was only $10 million. According to the OECD reports; while the cumulative foreign capital approvals between 1954 and 1980 were 325 million US dollars. The numbers shows so far that it wasn't so less than other comparable countries. Although considered as substantial investments for Turkey, these investments were limited to a few automotive

investments, including two passengers car plants, investments realized by three petrol corporations, investments of some pharmaceutical companies, some investments realized in the food sector and the two Public Participation concerns.[29] Investments beyond these were very small investments on private company scale. The primary reason of attracting a very low limited amount of foreign investment is the fact that Turkish economy was dominantly a closed economy that despite the incentive law was enacted in 1954; the investments were not supported in implementation.[30]

In January 1980, the government introduced a comprehensive policy package to correct the worsening economic situation. The immediate goals of the reforms were the reduction of inflation and balance of payments deficit. The policy makers further aimed art making the economy responsive to market forces in the long run, and in turn more dynamic and efficient. Consequent of these developments in foreign investments accelerated since January 1980, when there were dramatic changes in the economic and social structure of Turkey. The deregulation of interest rates, establishment of organized financial markets for money, foreign exchange stocks and securities, and reforms in the banking sector are just some of the major economic policy changes during this period.[31]

As a result of the changes in the Foreign Investment legislation, the investment climate was made more efficient and suitable for potential investors. The results of the liberalization policies and promotion measures adopted have appeared as increased direct foreign investment flows into the country. In the year 1980 alone, the newly created Foreign Investment Department approved foreign investments to value of 97 million dollars and the actual investment inflow was 35 million dollars. The following year almost all the subsidiaries of foreign firms in Turkey applied for approval for capital increases and investment extensions, and in some cases for carryings out new projects and in that year

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[29] Finans Dünyası 'Yabancı Sermaye Neden Artık Yabancı Değil' Ağustos 1991

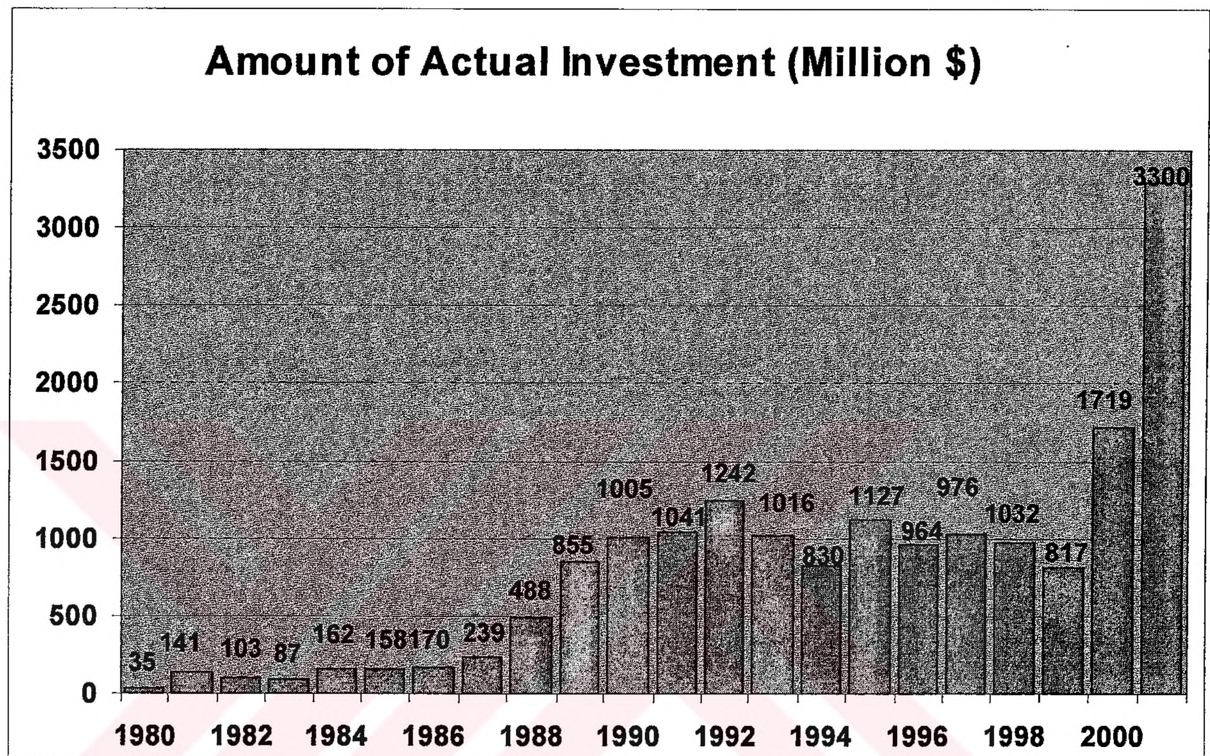
[30] Law Concerning the Encouragement of Foreign Capital Law No : 6224 Date : 18 Jan 1954 Date of Official Gazette : 24 Jan 1954

[31] Togan S. "Foreign Trade Regime and Trade Liberalization in Turkey During the 1980s" Averbury 1994 p:5

approved foreign investment reached the number of 338 million dollars but the actual investment was around 141 million dollars.[32]

Table 2.1

FDI Flows in Turkey between 1980 and 2001



Source: GDFI, Foreign Investment Report 2001

Annual FDI inflows grew rapidly from the middle of 1989s, as the recent liberal foreign investment and privatization policies began to show their results. Annual FDI flows reached to 1 billion dollars in 1990, however could not increase for decades since 2001. Generally, during the 1990s when global FDI flows accelerated FDI in Turkey remained static. While the total world's FDI was increasing and the investments realized in China, Brazil, Poland and various Eastern Asia, Latin America and Eastern European countries were growing in the period following 1990, Turkey couldn't exceed the 1 billion dollars level achieved in 1990. On the other hand, despite the implementation in January 1996 of a

[32] "Foreign Investment in Turkey Changing Conditions Under New Economic Programme" OECD Paris 1983

custom union with EU, foreign direct investment in the country remained low and the expectation of the bulk of foreign capital inflow was a frustration for Turkey.

As it is given in the Annex II, the cumulative investment between 1980 and 2001 was realized as 17,251 billion dollars, taking into consideration the period between 1954 and 1980, where 325 million dollars foreign capital inflow was registered, the total foreign invested added up to 17,576 billion dollars. According to the data of General Directorate of Foreign Investment (GDFI), foreign direct investment had 110% increases in 2000 compare to the previous year with 1.7 billion foreign investment. Total FDI into Turkey in 2001 was $ 3.3 billion, highest since the records began. Most of this came from the Is-Tim consortium (a joint venture of Telecom Italia and Isbank) for the infrastructure required for the third GSM mobile license. Total FDI into Turkey has been quite low so far, on average it is below $ 1 billion a year.

On a cumulative basis over the 1980-2001 periods, the countries with the largest share of foreign investment permits, the Netherlands, France, the United Kingdom, USA and Germany have traditionally led the way in terms of investment in Turkey. France and Germany are the major investors in Turkey in terms of approved investment. In Annex III, European Union's investment in Turkey is listed, EU make investment with 65.53 per cent has the highest share in the total FDI. By the end of 2001, the number of foreign companies operating in Turkey reached to 5841[33], EU companies have the largest share, and the leading country is Germany 1013 firms followed by Netherlands 419, United Kingdom 366, and France with 264 firms. As a total there exist 2756 EU firms in Turkey by the end of 2001.

[33] **JAPAN**: Toyota, Mitsubishi, Honda, Bridgestone, Sumitomo, Kagameco, Mitsui, Marubeni. **USA**: Goodyear, Citibank, Ford, GM, Lockheed, General Electrics, Philip Morris, Reynolds, Hilton, Mercure, DuPont, Levi's, McDonalds, Mobil, Baskin Robins, Procter&Gamble, **FRANCE:** Alsthom, Ciment Francaise, Renault, Carrefour, Elf Union Oceane, Axa, Danone, Alcatel. **GERMANY:** Siemens, AEG, Mercedes, Hoechst, MAN, Metro, Mannesmann, Robert Bosch, Bayer. **UK:** Unilever, Philiphs, New Netherlands, Northern telecom of Netherlands, BP, ICI, Glaxo, British Gas, Costrol. **ITALY**: Pirelli, Fiat, Benetton, Merloni. **SWITZERLAND**: Nestle, Roche, Borak. **SOUTH KOREA**: Hyundai, Kia.

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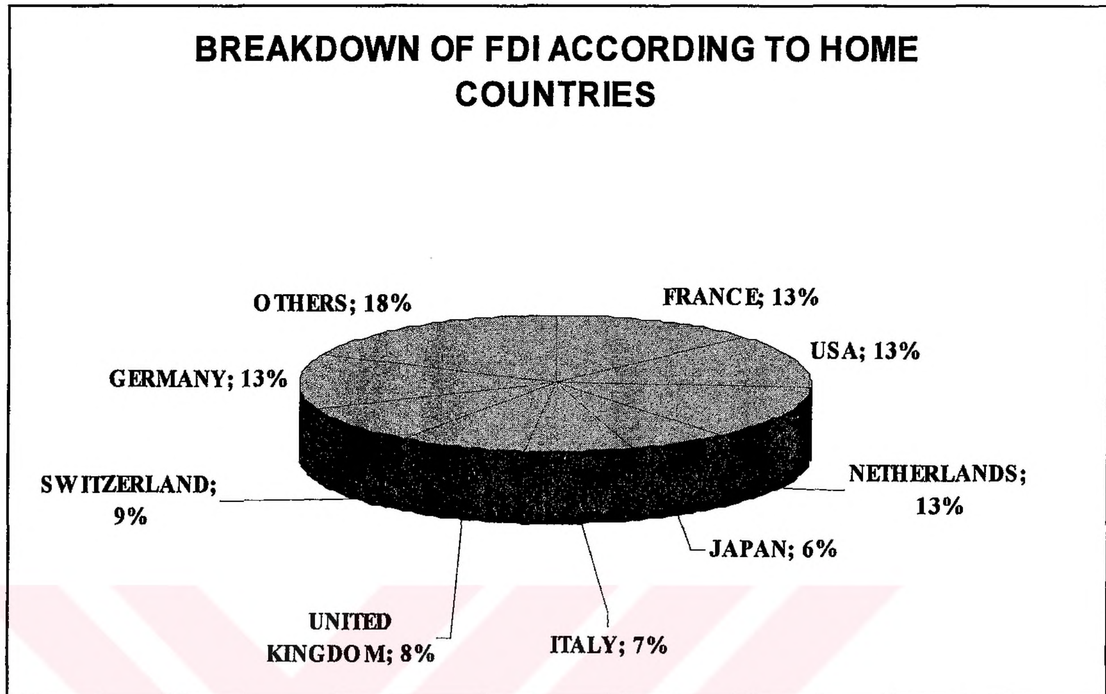
Table 2.2

FDI Inflows According to the Countries in 2001



Source: GDFI "Foreign Investment Report 2002"

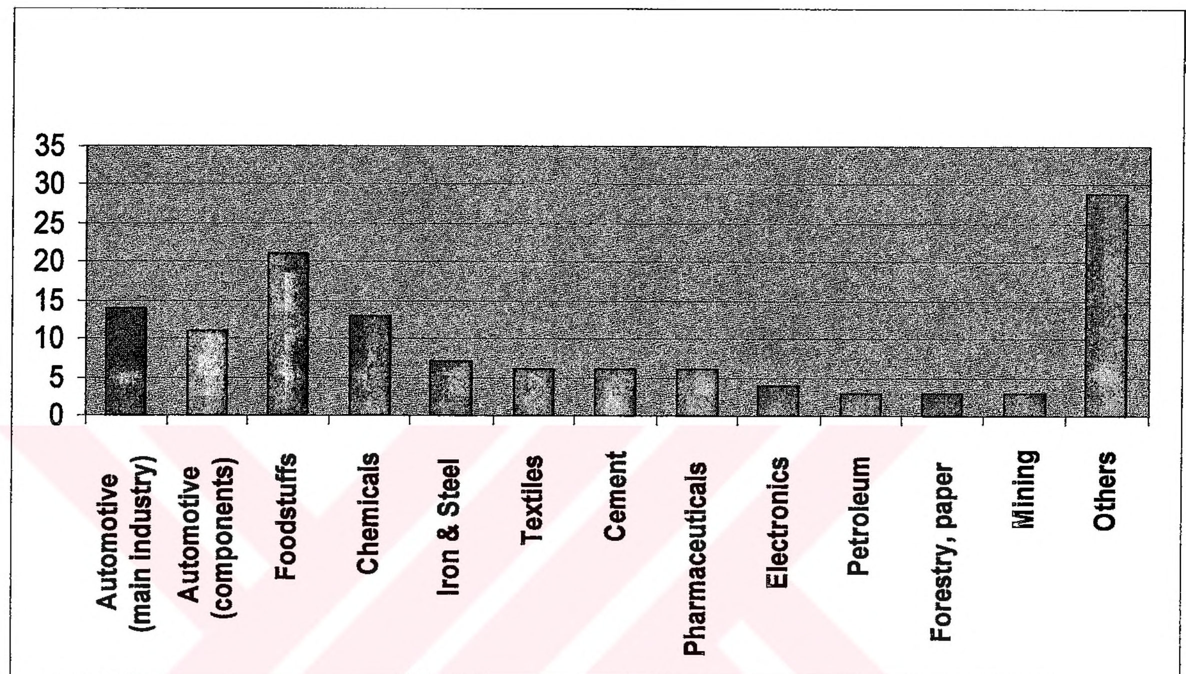
In terms of the number of foreign equity companies, Germany is by far the most important source of FDI - accounting for almost 18% of all projects in Turkey. Total British investments into Turkey have reached $2.5 billion so far, making the UK the fifth largest foreign investor. Significant British investments announced recently include those by British American Tobacco in a new plant near Izmir, the purchase of Demirbank by HSBC and a purchase of equity by Cadbury Schweppes in Kent, a leading confectionery company.

On the country basis it can be summarized as follow: German investors prefer to invest in automotive and components, chemicals, pharmaceuticals, foodstuffs sectors. The US companies invest in foodstuffs, tobaccos, chemicals, automotive and components sectors. Italy make investment in the field of automotive and components, tires, cables, ceramics sectors. France, another important foreign investors profile in Turkey, prefers to invest in automotive and

components, cements and cable sectors. Japan is generally focusing on the automotive industry in Turkey.[34]

Table 2.3

FDI by Sectors in Top 500 companies in Turkey



Source: Istanbul Chamber of Commerce "Turkey Your Business Partner" 2001

The automotive and automotive components sector is mostly preferred by foreign investors with 24 companies. This capital intensive sector is followed by foodstuffs sector, with 21 companies, then comes chemical sectors with 12 companies and other sectors followed by around 5-7 companies such as cement, iron and steel, textiles, pharmaceuticals, durable goods and the electronics sectors. Looking into details of the top 100 industrial companies gives similar results. Out of 100 top industrial companies of Turkey according to direst sales are the dominant sectors in the list, followed by electric electronics, foodstuffs (including tobacco products) iron and steel, telecommunications and

[34] On the basis of information gather from GDFI

pharmaceuticals.[35] At the table 2.3 it is given the top 500 industrial companies by sectors in 2001.

Table 2.4

FDI Permits by Years

	1999	2000	2001	1980-2001
AGRICULTURE	17.15	59.74	134.68	577
MINING	6.76	6.32	29.90	303
MANUFACTURE	1,123.22	1,115.20	1,255.88	17,061
SERVICES	553.40	1,878.64	1,318.12	13,410
TOTAL	1,700.53	3,059.90	2,738.58	31,349

Source: GDFI, Foreign Investment Report 2001

Manufacturing and services sectors had a leading position in the sectoral distribution of foreign investment permits in the last three years, in line with similar patterns over previous years. While the manufacturing sector was the leader in 1999, this situation changed in the favor of the services sector in the following years. In 2001 the services sector had the highest share with 48% of total permits in comparison with 46% for the manufacturing sector. There has been a modest improvement in mining and agriculture sectors with respect to foreign investment permits.[36] When the sectoral distribution of total foreign investment permits allocated over the 1980-2001 period is considered, manufacturing is in the first place with the share of 54.4%, followed by the services sector with a share of 42.8%, the agriculture sector with 1.5% and the mining sector with 0.8%.

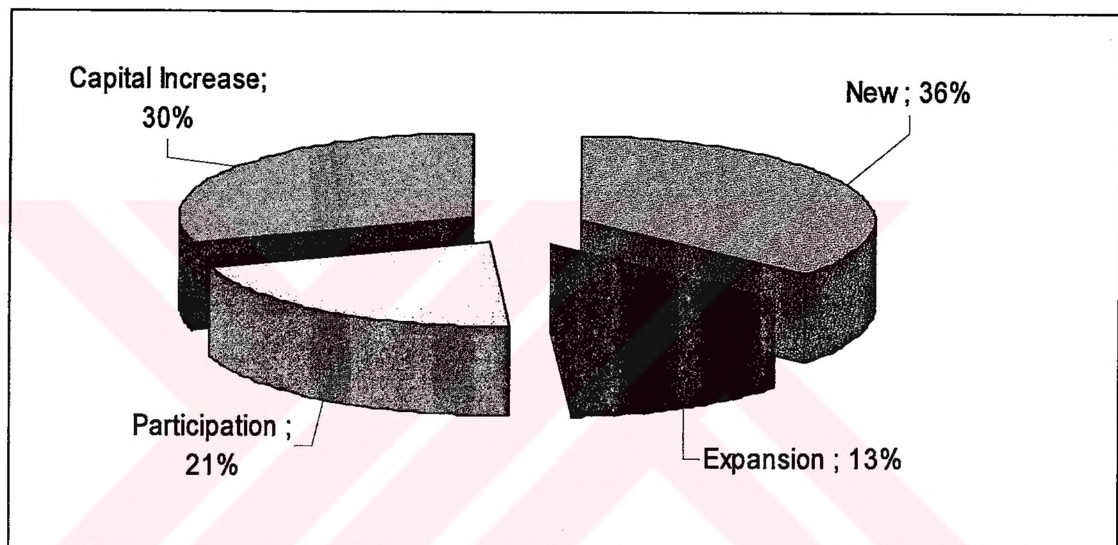
[35] Turkey Your Business Partner Istanbul Chamber Office 2001

[36] Yabancı Sermaye Raporu 2001 Yabacı Sermaye Genel Müdürlüğü Ankara Şubat 2002

As it is seen from the Table 2.4 on a cumulative basis over the 1980-2001 period "new" investments permits the highest which shows that during the period new foreign companies entered into the country, followed by "increase in capital proves" that firms with 30% and "participation" and "expansion" type permits were the other factors. It is clearly seen that when a foreign investors entered to Turkey decided to sustain their investment decisions[37].

Table 2.5

FDI Permits by Type of Investment 1980-2001



Source: GDFI, Foreign Investment Report 2001

According to the studies of Foreign Investors Association of Turkey (YASED) show that almost half (30-50%) of the FDI realized in Turkey until 1993 were developing as new investments. Yet this figure dropped to 11% in 1994, to 6% in 1995 and excluding the GSM investment in 2000, new investments sustained this level since then. This corresponds to a new investment amount of

[37] According to the GDFI definition; new investments constitute the investment for machinery and equipment, land and construction costs in an investment location where there is no facility for the same type of service and goods production. By means of statistical evaluations, the new investment definition expresses the approved amount of foreign direct investments.
Expansion implies the form of investments towards increasing the capacity to produce the existing commodity and service within the same company, that produces a corporation by forming a co-ownership with the preexisting establishment after the expansion which does not carry the nature of new investment.
Participation defines the approved foreign capital to provide the participation of a foreign real or legal person each investing no less than $ 50, 000 to a foreign owned company.

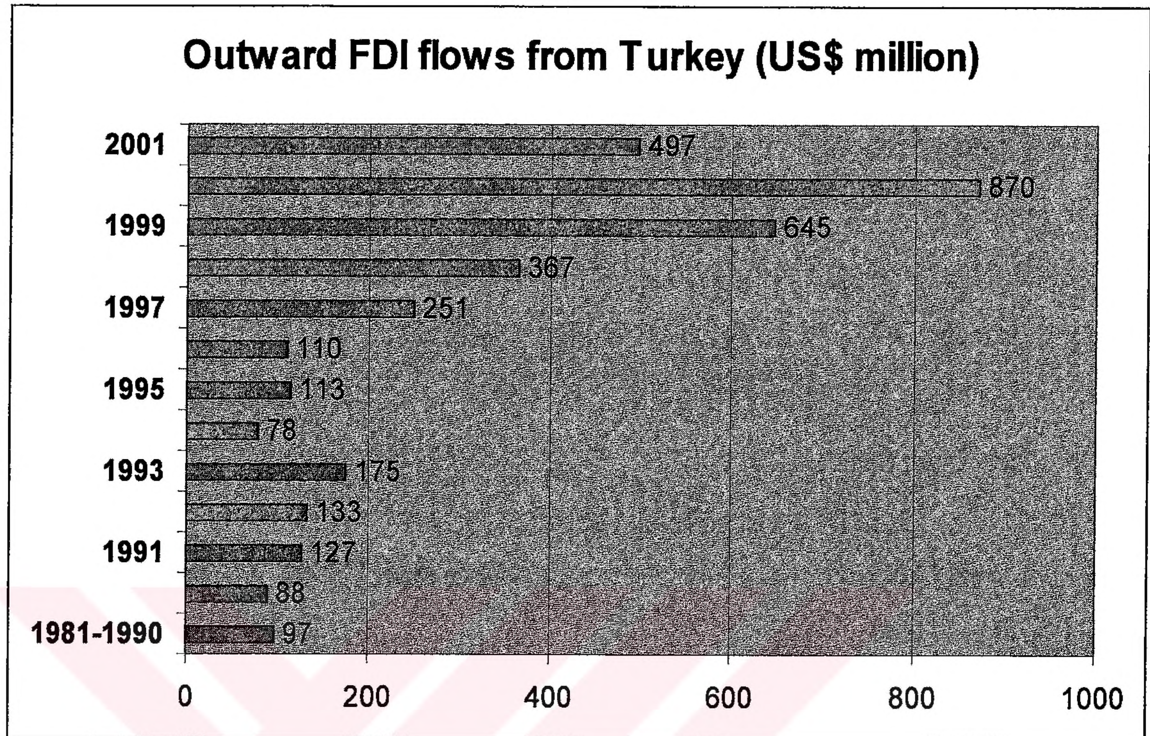
USD 50-100 million annually. The new investments other than Honda, Hyundai and Ford, relatively big investments with a cumulative value of USD 15-20 million are being realized by 400 companies, as indicated by the average increase in number of companies each year.

While Turkey tries to attract foreign capital into her country, she has seen even her own companies choose to invest abroad instead of at home at an increasing rate over the past decade. According to the Foreign Investment Advisory Services (FIAS) Report on FDI, in Turkey foreign direct investment outflows in the 1980s averaged less than US$ 50 million per year, while they increased to just over US$ 120 million per year between 1990 and 1995 and nearly US$ 375 million during 1995-1999. In 2000 Turkish companies invested approximately one billion US dollars in foreign countries.[38] Khosrow Zamani the director of IFC's Southern Europe and Central Asia Department states that "Turkey is a source of FDI to other countries, only in the 2001, about the same amount that foreigners brought into Turkey went out. Turkey offers very dynamic, creative, hardworking entrepreneurial class. They can live in a very tough environments, not only the vision is there by entrepreneurs who have formulated the investment, but Turkey also have very good managers". Actually the reasons of Turkish firms to invest abroad is coincide with the facts that why foreign firms do not take decisions to invest in Turkey, which will be discussed further in the next section.

[38] See for more information "Diagnostic of FDI in Turkey" FIAS March 2001

Table 2.6

Outward FDI flows from Turkey between 1981 and 2001



Source: World Investment Report 2002

Although Turkey used to rank around 20's during the early 1990, yet it failed to hold on to this volume of FDI inflows and started downgrading in the world rankings to 40's and in 2000s unfortunately fall to the 70's.[39] Turkey couldn't benefit from its advantageous position she had obtained at the beginning of 90s and during the recent years, annual inflows of FDI remained below 0.5% of GDP, which is significantly below her potential. Whereas Turkey has attracted a total FDI of around USD 17 billion in the last 50 years, some countries attract 4-5 fold of this amount annually. Based on international ranking, Turkey is the country whose gap between actual and potential FDI inflows in the largest. Countries like Romania, Bolivia, Columbia, Nigeria, Egypt, the republic of Dominique and Malta ranked higher than Turkey; that gives a general idea of Turkey's position in FDI inflow.[40]

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[39] Economic Report Istanbul Chamber of Commerce Publication No:2001/45 February 2002 Istanbul

[40] World Investment Report 2001

3.2 INVESTMENT ENVIROMENT IN TURKEY: OPPORTUNITIES AND OBTACLES

The Turkish Government considers foreign capital as an essential factor in its efforts to rank among the top economic powers of the world in the 21st century. Flexible foreign investment policies have been introduced as a part of the liberalization of Turkish economy. The foreign investment legislation provide a secure environment for foreign capital via support from several bilateral and multilateral agreements and organizations, granting such as capital the same rights and obligations as local capital, while guaranteeing the transfer of profits, fees and royalties, and the repatriation of capital.[41]

Turkey has one of the most liberal foreign capital laws in the world, supported the "Multilateral Investment Agreement" and signed "Mutual Promotion and Protection of Investment" agreements with 57 countries and "Prevention of Double Taxing Agreement" with 42 countries since 2000. In addition, as a member of the WTO and the OECD, Turkey is allied to the Multilateral Investment Agency (MIA), and the "International Centre for the Resolution of Investment Disputes". The "Foreign Direct Investment Draft Law" which is currently being drafted aims to achieve the equalization of foreign and local investors.[42]

Furthermore Turkey's incentive regime is also one of the most attractive on paper in the world; in 1995 the government announced an incentive package designed to attract investors to 20 industrial belts across the country. The package includes grants of up to 70% of total fixed investment, custom duties and fund exemptions, value added tax (VAT) refunds and subsidized credits up to 40%[43]. Turkey also has 17 free zones offering very generous incentives.[44]

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[41] See Annex IV for further information about the "Foreign Investment Legislation of Turkey"
[42] Dartan M; "Turkey EU Relations with Particular Reference to the Custom Union" *The European Union Enlargement Process and Turkey* Marmara University Publication no: 691 2002, p298
[43] See for details www.treasury.gov.tr/english/ybsweb/incentives.html and www.treasury.gov.tr/english/ysbweb/freezones.html

Although having one of the world's most liberal foreign investment law and attractive incentive regimes, the enabling environment for privatization and infrastructure related foreign investors have been very weak. Foreign investors decide to invest abroad based on the commercial strategy of the investor, the host country's economic environment and the risk affecting the projected rate of return on the proposed investment as it is mentioned in the previous sections.

According to Institutional Americas (2000), Turkey represents a paradox with her gap among potential and actual investment flows. Turkey's advantages listed as follows; the country offers foreign investors: a domestic market of around 68 million people, proximity to the huge markets of Europe, the Commonwealth of Independent States, the Middle East and North Africa, low labor costs, a well-educated managerial class, telecommunications networks, and modern infrastructure. Foreign investors can freely move capital goods, capital profits, and dividends in and out of the country, and have the same rights, exemptions, and privileges as Turkish investors.

According to the regular report on Turkey's progress towards accession, high economic volatility, political uncertainty and complicated and opaque bureaucratic procedures are stated as the main reasons for the low inflow of FDI. According to the report there is a common view that Turkey's low level of research and development activities, the lack of foreign know-how is particularly disadvantageous. The failure to attract foreign investment is a major impediment to Turkey's growth potential, as it represents a missed opportunity to modernize the Turkish capital stock and to improve market access.[45]

According to Abdurrahman Arıman General Secretary of Foreign Investors Association of Turkey (YASED) basic reasons of Turkey's failure in attracting foreign capital after the acceleration in 90s become disappointment are; Turkey is

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[44] The main incentive tools granted to investors by the current legislation are; exemption from customs duties and fund levies, investment allowance, VAT exemption for imported and locally purchased machinery and equipment and exemption from taxes, duties and fees.
[45] "2002 Regular Report on Turkey's Progress Towards Accession" *Commission of the European Communities* 10/2002

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not establishing its investment environment for investments in general and for foreign investment particularly from the beginning, except for the second half of the 80's; never ending creation of problems during implementation; excessive paper work; and in addition to these, the country being poorly administered under continuous political instability and undergoing one of the world's highest inflation rates for a long term; the lack of legal environment and the recent encouragement of opposition against foreigners. "*By not taking advantage of FDI, Turkey has missed opportunities to create more jobs, improve productivity and competitiveness, and raise living standards, this has also contributed to the country's heavy external debt burden and problems with macroeconomic instability* " said Johannes Linn, vice president, Europe and Central Asia region at the World Bank. Linn added that Turkey has not been able to take full advantage of its customs union with the European Union.[46]

As in Table 2.7, driven by the General Directorate of Foreign Investment (GDFI), it is summarized the advantages and weakness in attracting foreign capital into Turkey. General criticisms about the obstacles on foreign investment are political and economic instability, cumbersome legislation and bureaucratic deterrents generally administrative barriers. In the event that Turkey announces the trust atmosphere necessitated by FDI to enter a country, in a political consensus to the world and initiates to restore the deficiencies marked out in the World Bank experts' reports which obstruct competition with other countries, the country most likely will start to advance rapidly to realize its annual USD 35 billion FDI potential. Based on UNCTAD ranking, Turkey is the country whose gap between actual and potential FDI inflows in the largest. Countries like Romania, Bolivia, Columbia, Nigeria, Egypt and the republic of Dominique ranked higher than Turkey.[47] To attract the foreign capital Turkey should see her weakness and eliminate all sorts of barriers that are impediments. Derived from the several criticisms, which are also accepted by the governments, economic and political instability and administrative barriers are seen the most important obstacles in front of the foreign investors.

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[46] Parsons N. "Turkey Seek Partner for the Long Term" Global Finance New York June 2002
[47] UNCTAD World Investment Report 2001

Table 2.7

Turkey's Advantages and Disadvantages in Attracting FDI

WEAKNESSES	STRENGTHS
Political and economic instability	Unique geographical location
Uncertainties in the relations with EU	Population of 67 million
High inflation and real interest rates	Qualified, efficient, young, educated and cost competitive work force
Administrative barriers	A liberal foreign capital legislation
Existence of an unrecorded economy	A dynamic and globally integrated economy
Frequently changing legislation	An improved business environment
Lack of promotional activities	The existence of prominent transnational companies in the world
Delays in the privatization program	A huge energy expansion program
	GAP project; one of the world's biggest development project[48]

Source: Treasury, GDFI

[48] The Southeastern Anatolian Project GAP, is the largest development project underway in Turkey and one of the largest in the world.

3.2.1 Economic and Political Instability

As most of the economic commentators stated the greatest obstacle to foreign investment is macroeconomic uncertainty. Economic stability is the foremost important prerequisite for attracting FDI to Turkey. Businesses want sufficient security that their commitment will pay off. Steady economic growth and exchange rate are the most important determinants of the pay-off. Turkey's recent macroeconomic performance has been characterized by high volatility and a relatively low average growth rate. The main underlying factors for this development are the short term orientation of economic policy by frequently changing coalition governments and accumulated market distortions resulting from political intervention and postponed structural reforms. High public sector deficits created a chronic high inflation environment implementing medium term planning of economic agents.

In 1999 as Turkey was adversely affected by Russia's economic crisis and two major earthquakes. The already-large public sector fiscal deficit widened in 1999 due in large part to the huge burden of interest payments which accounted for 42% of central government spending. Various Turkish businesses suffered a financial weakening due to high real interest rates in 1998-1999-2000 and lately needed a recapitalization. These tend to be among the more risky prospects for an investor. According to the report on "Macroeconomic and Financial Sector Stability Developments in Candidate Countries" the main source of instability depends on strong shifts in investment responding to volatile financial market conditions and a pro-cyclical expenditure behavior of public sector. Volatile growth in a depreciating currency is negatives in terms of attracting investment and macroeconomic instability with two important crises in 2001 is a deterrent to both direct and portfolio investment.[49]

[49] "Report on Macroeconomic and Financial Sector Stability Developments in Candidate Countries" by Directorate General for Economic and Financial Affairs Number:8 April 2002

Kemal Dervis former economy minister stated in his speech at the YASED meeting of Turkey's performance attracting the FDI:[50]

"Turkey has three crises in the 90s: 1994, 1999 and 2001. People were reasonably optimistic, and there are many opportunities, but there was always this fear of a macroeconomic crisis and that has been perhaps the single most important reason why foreign direst investment could not achieve the performance. International studies show that macroeconomic stability is probably the number one determinant of the amount of foreign direct investment. One of the major reasons for this macroeconomic instability has been high inflation rate. When the inflation rate that varies between 60 and 100%, the degree of uncertainty is just too high real interest rates lead to follow instability, and therefore bringing down the inflation rate clearly is a key factor for foreign investors."

Between 1990 and 2000, annual average inflation was 76% reaching 105% in 1994 and coming down to 54% in 2001.A recent perspective on investment conditions in Turkey is provided by the World Business Environment Survey[51]; investors suggested that inflation and political instability and uncertainty are leading constraints. One of the most difficult aspects of the presence of inflation in Turkey is the lack of adjustment accounting, especially for tax payments purposes. Investors have singled out the complex and confusing tax and incentive regime and uneven enforcement of the regime as important obstacles.

The bulk of investor problems regarding taxation in Turkey are not only in the procedures, but they have roots in policy, legislation, and administration. The administration of the taxation and investment incentives system is carried out by several executing government agencies with different, overlapping legislations and mandates. Another problem for investors is frequent changes in tax rules,

[50] Insight YASED Volume: 4 Issue 1 July 2002 p:6
[51] This survey of 150 foreign investors in Turkey was conducted under World Bank oversight as part of a larger study that covered 80 countries worldwide.

rates and procedures. Not only the do such changes introduce uncertainty for business plans and forecasting, they also create an environment of confusion, as investors often can not keep abreast of all changes and end up paying heavy penalties for non-compliance.[52]

Although the existing uncertainties, foreign investors in the country enjoy the benefits of making investment decision in Turkey. According to Arnold Hornfeld, General Directorate of Turk Siemens factory implied that from outside, taken merely on the axis of prudence and risk, investment decisions of foreign capital might display hesitant behavior. Foreign companies might stop on the doorstep of Turkey without even knocking and head for alternative emerging markets. He stated that Siemens-Turkey has been and still is continuing its investments with confidence in the Turkish economy and in the advantages.

This policy may not sound reasonable for the outsiders of foreign companies whose presence in Turkey is new. However, in terms of investment philosophies, this divergence between foreign companies with long and short histories in Turkey is a strong testimony on variables tat simple and cursory economic analysis may not take into account. Hornfeld added that "*We can site these extra-economic variables, which have real economic advantages to those who utilities them. They include young demographics, built-in resilience created by a large second-economy, geographical access and cultural-historical proximity to diverse regions, a large domestic market as well as the dynamic entrepreneurial and flexible national character of its people*". [53]

As it is clearly seen from the statement of Hornfeld, the main problem is to take the investment decision in Turkey, from the data, it is observed that the companies which entered into Turkish market, generally do not repent for their decisions. To improve the functioning of its markets and its competitiveness, Turkey needs to continue the present reform process in order to achieve

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[52] "Türkiye Doğrudan Yabancı Sermaye Yatıtım Ortamı Analizi ve Yatırımın Önündeki Engeller Raporu " FIAS Şubat 2001
[53] "Türkiye'nin Geleceğinde Yabancı Sermayenin Etkileri" Mercek Dergisi Nisan 2001 Sayı: 22 p.8

macroeconomic stability and fiscal sustainability. On the other hand in reality political instability seems more important obstacle in front of Turkey. Political stability is a general factor taken into account in FDI decisions globally. Firms may be prevented from undertaking apparently profitable investments by the treat of political instability, or a volatile or unpredictable political situation.

The lack of a continuous and predictable policy reform process had an eroding effect on investor confidence; an example of uncertain policy reform was demonstrated by high expectations for major privatizations, which were followed by a slow and disappointing program. Because of the division of the votes between many parties, Turkey was continuously ruled by weak coalition governments, lack of political will, populist policies and leader repression in political parties, caused many problems. These factors and the most importantly not really having the ruling power, most of the time caused unable to pass the laws they want through the parliament, caused the political instability in the country.

On the other hand recent developments have occurred during the final period of the preparation of this thesis; Turkey went on an early election in November 2002. The result was a surprise not only for Turkey but also for the rest of the world. Justice and Development Party (AKP) with 38 per cent of the general votes of the country get 365 chairs in the parliament and Republican People's Party (CHP) is only other party represented in the new Turkish Parliament. Turkey was not ruled by a single party government for a long time in this context the reactions from the overseas perspective to the election result was positive. As the actions of the new government is new, there can not be easily make conclusions so far but it seems that ruling by a single party government can bring political stability in some cases especially with having the enough proportion to pass necessary laws through the parliament.

3.2.2 Bureaucracy and Red-tape Inefficiency

Turkish bureaucracy, well known for its complexity, slow action, changing rules, and lack of transparency, creates an uncertain business environment, especially in the areas of taxation, trade and customs, and licensing and inspections. All these factors increase the risk and costs for FDI projects and made it difficult to reach sound investment planning. The importance of administrative barriers are having a dampening effect on competitiveness in Turkey is demonstrated by investors surveyed by the Global Competitiveness Report of the World Economic Forum, which ranked bureaucratic 'red tape' as one of the leading competitive disadvantages of the Turkish business environment.

Turkey ranked lower than many other countries in terms of competitiveness indicators, especially in the areas of administrative and procedural matters where Turkey was frequently ranked at the bottom. The report ranked Turkey 52nd among 59 countries for government bureaucracy and red tape, and 49th for management time spent with government bureaucracy. In the latter category, the Czech Republic ranked 14, Hungary 26, Italy 40 and China 56. In the competitiveness indicator areas of institutional stability and hidden economic activity, Turkey ranked nearly at the bottom with, 55 out of 59 in each category.

According the FIAS report, to get approval for a business currently involves 19 different stages of red tape and the average time to accomplish this is nearly three months, through such a difficult, lengthy process to obtain an investment license. It is also difficult for the domestic investors with 18 steps for a local company and getting approval for land and site development can take up to four years.[54] Acquiring public land and obtaining all permits necessary for the developments of a site are exceptionally lengthy process in Turkey, taking two

[54] Ibid from "Türkiye Doğrudan Yabancı Sermaye Yatıtım Ortamı Analizi ve Yatırımın Önündeki Engeller Raporu FIAS "

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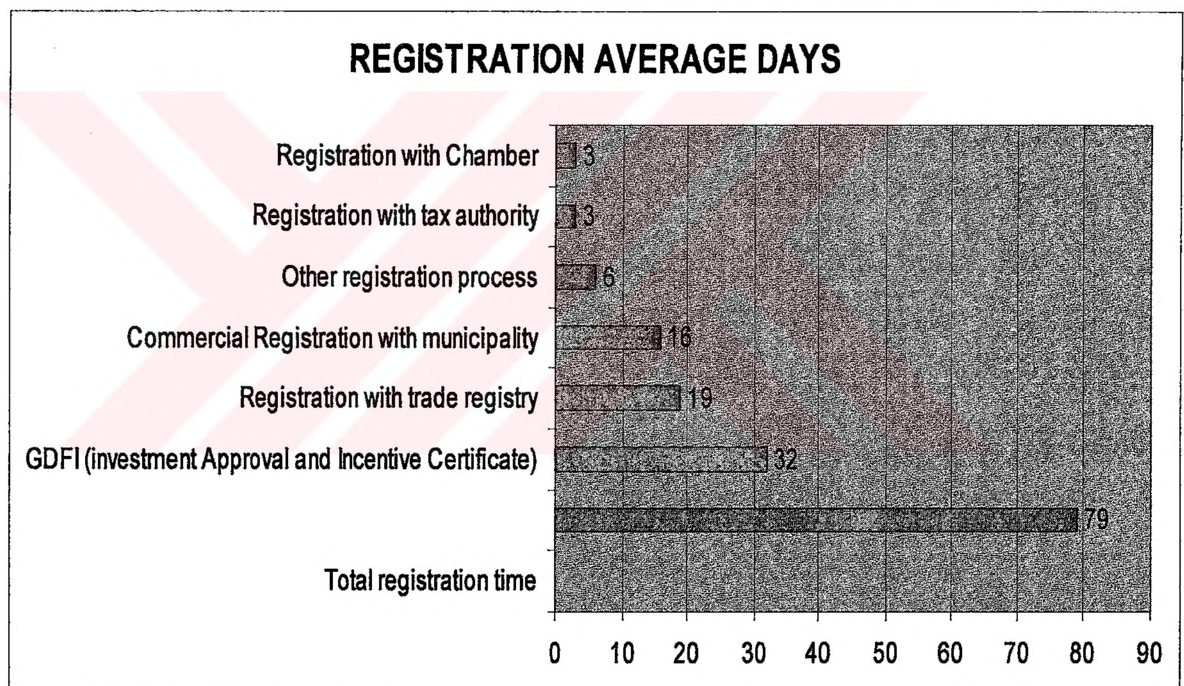
years or more of administrative clearance and approval procedures. Most investors agree that the real problems of establishing operations in Turkey begin at the locating, or land and site development stage. It is also stated in the report that investors about 20 per cent of management time is spent dealing with government regulations and administrative requirements compared to only 8 per cent in Central and Eastern Europe and 4 per cent in Latin America. As it is seen from the table 2.8 that total registration time as an average 79 days which is very high compare to Turkey's competitors.

Table 2.8

Average Registration Days in Different Institutes



Source: FIAS report on Administrative Barriers on Turkey

According to the study conducted by Morriset and Lumenga, it is compared the current practices in a set of 32 developing countries by identifying 26 core administrative procedures that are generally required to set up and operate a business. According to the findings of the research Turkey requires the largest number of steps, up to 125 when the land is purchased from the state. Data on individual countries indicate that the longest delay is found in Turkey

(1106 business days) followed by Mozambique (731), Bulgaria (702 days) and Romania (634) days.

Table 2.9

Establishment Business in Turkey

	ENTRY	LAND\SITE	OPERATION
Number of procedures	22	125	8
The number of business day	121	985	*
Monetary cost	304	*	*

Source: Derived form the research of Morriset and Lumenga

At the research total cost to delays to the investors are also calculated, according to analysis total costs are defined as delays (converted into monetary costs) plus direct costs associated to administrative procedures in each country. Delays was converted into monetary costs assuming that opportunity costs for local investors are equal to the number of days multiplied by the daily GDP per capita in the country. According to this study, in Turkey a total cost per procedure for local investors is around 832$ on the other hand for foreign investors it is around 6480 dollars. [55]

FIAS also conducted an informal foreign investor survey of administrative procedures and costs in Turkey. In the survey, foreign investors asked how different regulatory areas affected their ability to establish and operate in Turkey. As it is seen at the Table 2.10, a large majority ranked complexity and non transparency of regulatory as the number one problem. On the other hand, regulations for labor, health, fire and sanitary issues posed little or no problem to business operations of most investors.

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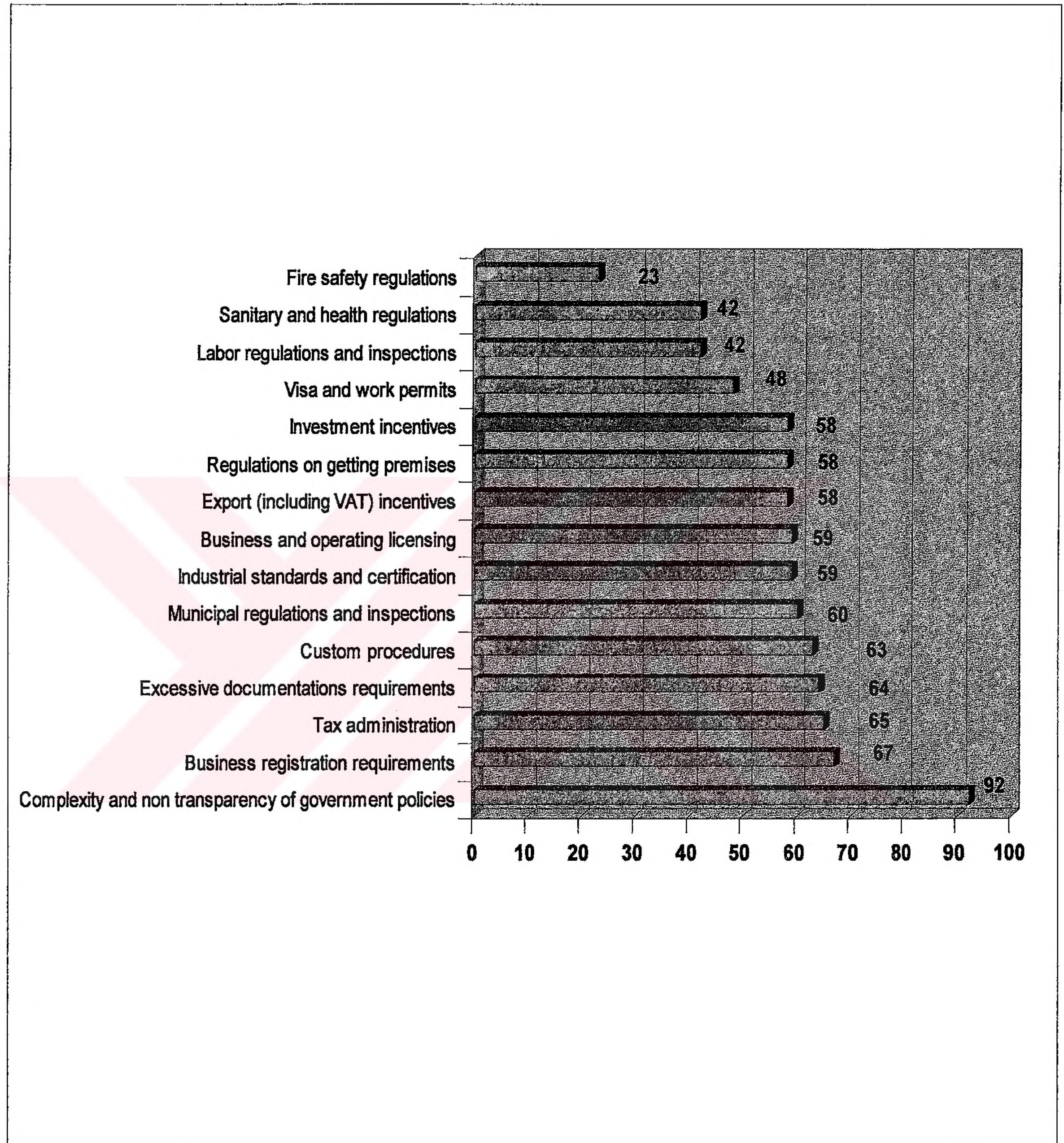
[55] Morriset J. Lumenga O; "Administrative Barriers to Foreign Investment in Developing countries" OECD Working Paper May 2002

To consequence red tape inefficiency is certainly a vital problem, for foreign investors in Turkey. The added costs and related delays of dealing with the bureaucracy make doing business more expensive. The country as a whole suffers from these duplicative procedures and disincentives to invest, which hurts the competitiveness of Turkish producers. Although the governments know the disadvantages of bureaucratic obstacles, and promised in several times to solve the problems by reducing lengthy procedures nothing done to eliminate. Clearly the overall objective needs to be to streamline the current procedure and to eliminate all requirements to a point at which only the really necessary authorities are involved and only the justified documents are requested. This does require serious administrative reform to centralize the system and decrease the number of involved bodies to a minimum keeping one central organization in charge of the main registration process instead of many sequential steps. The European Union has recommended to its Member States several proposals for simplifying the registration aspect of starting a new business in the Annex V, EU's recommendations on company procedures are listed.

Table 2.10

Problems with Different Regulatory Areas

(Percentage of investors who ranked area as a major or moderate problem)



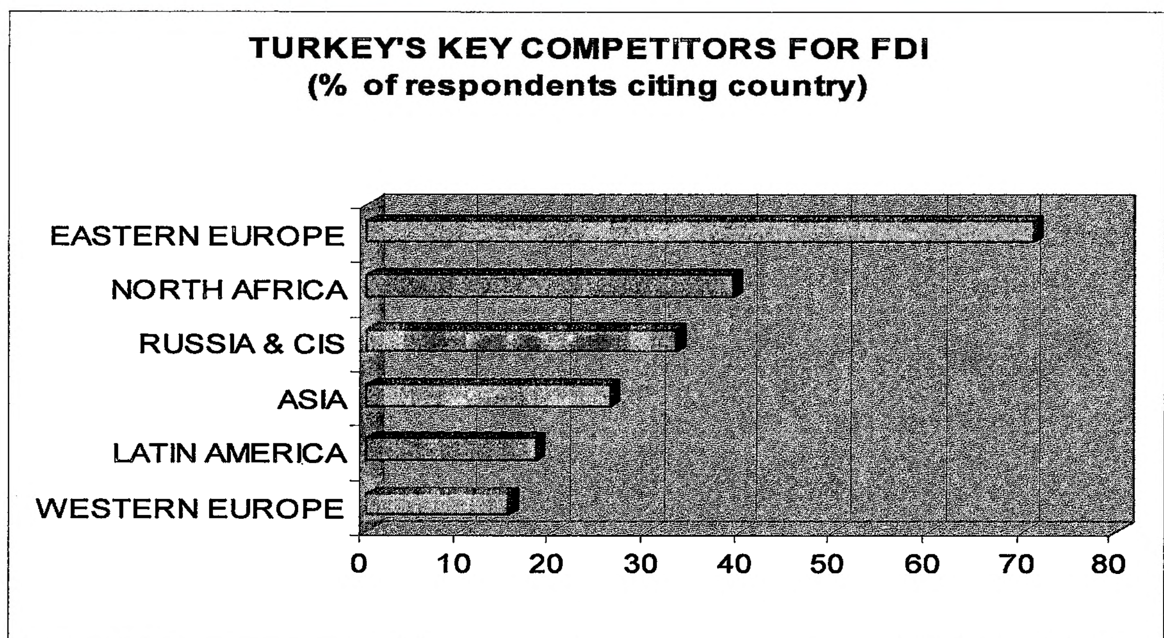
Source: FIAS, Turkey Administrative Barriers to Investment

III. EUROPEAN UNION'S IMPACT ON FDI INFLOWS IN CANDIDATE COUNTRIES AND COUNTRY PROFILES OF THE COMPETITOR COUNTRIES

Hungary, Poland and the Czech Republic sighted as the main competitors of Turkey, not only by receiving far greater inflows in FDI in absolute magnitude, but from five to ten times as much as Turkey in relation to their economic size. Not only have these countries increased the level of the competition for FDI, but they have also effectively raised the standards (from investment climate point of view) for attracting FDI, making it more difficult for Turkey to compete for EU-oriented FDI. According to the studies of FIAS, Eastern European countries sighted as the main competitors of Turkey with 70%, as it is given in the Table 3.1 There is no doubt that Turkey has under performed in attracting the foreign direct investment, to understand the reasons of failures, it should be analyzed that how those countries were successful to take FDI inflow.

Table 3.1

Key Competitors of Turkey



Source: FIAS, Turkey Administrative Barriers to Investment

One of the basic reasons that make those countries to competitor to each other is their future membership to European Union. In terms of both export and FDI sources of the countries, EU has an important effect on their economies. The impact of EU on the FDI inflows should be overviewed and to draw a picture of foreign direct investment's position, brief information about the region and the historical evolution of foreign investment in each, is essential to make comparison with Turkey in the following chapter.

At the beginning of 90's for most Western companies the idea of investing in Central and Eastern Europe was relatively new and the mechanism for gathering and assessing information was need to be developed. It had seemed to take great risk for many reasons to enter into those markets immediately. Theoretically, investors could insure themselves with private institutions against every type of risk, but this was an expensive and troublesome business. In these circumstances, particular significance was assumed by diverse forms of government guarantees, some of them built into international agreements concluded between the countries of origin and East European nations. A large number was signed to date which offer various kinds of investment guarantees, but the process of implementation was long.[56]

EU countries, especially Germany have played a major role in the direction of foreign capital investments to Central and Eastern European countries (CEEc) since the beginning of 1990s. The study of Estrin ad Bevan found that FDI flows form Germany were significantly larger than would be expected on the basis of labor costs, market size, proximity and credit ratings alone. At first glance, the finding that geographical proximity and FDI connection is not surprising, and might be expected from the large flows of German FDI to the neighboring (CEEc) [57]. However, the result was stronger than would have been expected owing to geographical proximity alone. Once study controlled for

[56] Dobosiewicz Z. "Foreign Investment in Eastern Europe" Routledge London 1992 p 110
[57] Including Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia

this "neighborhood effect", Germany was still found to send a disproportionately large amount of FDI to CEEc.[58]

In this context, Dartan noticed the fact that how German governments are succeeded to attract the foreign capital into the region. According to his article German government has been insuring companies, by state banks or public financial institutions especially appointed for this task, that were prepared to invest in countries where German companies are encouraged to invest, for the sake of political and economic interest. Dartan also calls attention the fact that bulk of investments entering to Poland, Hungary, the Czech Republic and the other Eastern European countries are not the main causes of the transition process to the market economy, indeed this interest is reflection of the political will of dominant countries such Germany in EU, which would like to see these countries to enter the Union. As a result of multidirectional support with financial aid, encouragement of investors, these countries will be EU member states in 2004.[59]

No doubt that European Union's efforts and supports to those countries were successful so that bulk of investment flowed into those counties. Inflows of investment of Central and Eastern Europe increased sharply since 1994, when the EU committed itself enlarging. During the transition period EU gave priority to policies that would have an immediate benefit to the applicant countries, by encouraging FDI inflows to them. On the context of the "One Europe or Several" program, it is examined the impact of the public commitment made by the European Union member state to enlarging eastwards at the Essen Council in 1994. Having controlled for all the factors that encourage and discourage FDI, the results suggest that the 1994 Essen Council announcement was associated with a significant increase in the level of FDI received by the front runner countries; Hungary, the Czech Republic and Poland, moreover the results indicate that the

[58] Bevan A. Estrin S; "The Impact on EU Accession Prospects on FDI Inflows to Central and Eastern Europe" Policy Paper 06-01 Sussex European Institute 2001
[59] Dartan M; "Avrupa Birliği'nin Genişleme Sürecinde Türk-Alman İlşkileri Marmara Avrupa Araştırmaları Dergisi Cilt:9 no:1 2001 İstanbul

EU's decision in 1997 to open negotiations with five CEE applicant countries led to an increase in the growth rate of FDI to the leading applicants.[60]

European Association Agreement (EA) increased attractiveness of Central Europe Countries to foreign investors greater than before. The EU shortened transition periods by eliminating tariffs and quotas on industrial imports from CEE countries by 1997, CEEc exporters of manufactures had duty free market access. Thus, investors seeking unfettered access to EU markets would also consider locating production facilities in the area. Investors from outside the EU would find location in CEEc as useful to overcome trade barriers in the EU, whereas EU-based firms might then consider moving the production from the EU without fear of deterioration in the conditions of access to their home markets. They both would take advantage of emerging economies of scale to unfettered access to large markets in the EU. "EU-associate" status has increased attractiveness to preferential access to EU markets and enhanced credibility to stay reform course. With access to EU markets, the size of a domestic market mattered less. In addition, the overwhelming public support in CEEC for accession to the EU has provided reformers with a weapon to persuade investors that liberal reforms are firmly locked-in and to contain vested interest group opposed to economic reforms.

In consequence the impact of the policy induced integration process on foreign capital inflows is twofold. First, by reducing the risk that foreign investor face and improving a country's business climate, they increase the flow of direct and portfolio investment often diverting them from other regions. Combined with additional incentives associated with the improved access to markets of developed countries, the increased inflows may be quite considerable. These can be driven by the desire of firms to overcome trade barriers and take advantage of emerging economies of scale. Second, the EA guaranteed the right of establishment to EU firms guaranteed by the EA as well as commitments to liberalize access to services together with other provisions envisaging an orderly

[60] Ibid from "The Impact on EU Accession Prospects on FDI Inflows to Central and Eastern Europe" p 5

process of interaction between the EU and its associate members have served as a credibility-enhancing mechanism.[61]

After the start of negotiations for membership with EU, bulk of foreign investments entered into the region. Therefore few people expect EU membership to bring substantial changes to the East European candidate countries overnight, largely because the obvious economic benefits, trade and investment, have already been reaped. But most believe that EU membership will boost economic growth, leading to a convergence in income levels – and purchasing power. Economists reckon that accession could bring around 5-9% points of additional real GDP within ten years. Experience in Spain, Portugal, Ireland and Greece suggests that accession will boost growth only if new members pursue stable macroeconomic policies and invest in skills and education.

When Ireland joined in 1973, its GDP per capita was only 60% of the EU average, even taking purchasing power into account. By 1990, it had reached around 75%, but ten years later (as the Single Market was introduced) Ireland's national income had rocketed to 120% of the EU average. Spain and Portugal, which joined in 1986, have also shown solid improvements, and are probably more typical examples for the East European members, since much of Ireland's recent success depended on its becoming the European location of choice for US high-tech companies.[62]

Spain saw strong investment-led growth immediately after accession and increased its GDP per capita from 71% of the EU average on joining to 83% fifteen years later. In the year of 1986, compared to previous year foreign capital inflow increased by 73 per cent. FDI was 716,8 million PTA in 1986 and during 1986-1990 five year period total foreign capital in the country was more than 55

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[61] Kajiminski B; "How Accession to the European Union has Affected external Trade and Foreign Direct Investment in Central European Countries" World Bank Washington DC 2000

[62] Çelik A; 'Yabancı Sermayenin Türkiye Avrupa Birliği Bütünleşme Sürecindeki Rolü İstanbul Üniversitesi Sosyal Bilimler Enstitüsü Doktora Tezi Istanbul 1996

billion dollar. The statistics shows that more than 50 per cent of the foreign investments were coming from the European Union member states, with becoming the member state Spain was getting 50,7 % of FDI from EU in 1986 and this amount increased to 55% in the coming years. Annual inward investment flows average around $20 billion for a country the same size as Poland. Spanish companies shifted from investing virtually nothing abroad, just like the East European candidates, to investing around $30 billion a year.[63]

Portugal, on the other hand, the poorest entrant to date with national income of only 56% of the average in 1986, is now approaching 75%. Over 20% of fixed investment and 4-5% of GDP in Poland, Hungary and the Czech Republic, foreign investment levels are already quite high. EU accession will, however, ensure that foreign interest continues, despite the waning of privatization. Even in Hungary, once the investors' favorite, foreign investment flows slowed markedly after privatization ended. But enlargement creates a new set of motives in favor of investment in Eastern Europe over other global locations. It reduces risk by guaranteeing a certain level of political and macroeconomic stability. It reduces transaction costs by creating a business environment that is similar to other EU countries and removing remaining trade barriers.

It opens up a market of 450 million people, changing the potential of any specific production location. Those changes will encourage companies that only do business in the EU to sit up and take notice. Smaller German, Austrian and Italian companies have already made the move across borders, shifting production to lower cost neighbors or buying up market share. But accession will encourage companies from further field to do the same. In Poland, which is particularly attractive due to its market size, interest is already growing among smaller French and Nordic companies and the trend will increase over the next few years. Indeed, Poland will continue to attract the bulk of investment, much

[63] European Union Acession: Practical Implications for Business in Central *Europe Economist Corporate Network Ernest&Young* April 2002 London

like the large Spanish market had done and accession will, over time, change the quality of investment.[64]

EU membership symbolically marks the end of the candidates' global labor cost advantage. Increasing wages have already pushed outward processing work further east. The improved business environment in the new EU members will encourage more investment in R&D centers and in higher-tech production, as is already the case in Hungary and the Czech Republic, especially if governments focus on improving skills. Raising the six most developed East European countries to just 50 percent of the income level of the EU would have required a $450 billion investment, according to the Institute for International Economics in Washington.

EU has steered clear of the topic in talks with East European officials, according to Olivier Hoedeman, a researcher with Corporate Europe Observatory: "*With EU expansion, Hungary and Poland have more companies moving low-wage operations into Eastern Europe, over Southeast Asia. That's because of cultural reasons, and the logistics of transport between markets. That's why the EU is so focused on building new transport links between East and West,*" explains Hoedeman.[65] Nevertheless, the new members will be the low-cost production centre within the EU for at least the next 20 years. The new members will have a similar window of opportunity to attract investment, especially where skills, infrastructure and proximity are as important as labor costs.

At the studies of Estrin and Beavan, they pointed out the fact that the EU itself will have to consider its role as a development agency after enlargement, as the countries on its periphery are likely to experience widening gaps with their neighbors. The EU will have to consider additional measures to help countries that cannot join for many years, not only Turkey but also Bulgaria and Romania,

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[64] Ibid from "EU Accession Practical Implications for Business in Central Europe"

[65] Wesolowsky Tony " East meets west: European Union Expansion and the Troubled Former Communist Countries" *Multinational Monitor*, Washington; May 2002;

in the longer term, a more comprehensive development policy will be needed if the union is to be effective in encouraging the economic development of all candidate for membership.

The writers also stated that FDI receipts and economic reform may be further affected if announcements of delayed accession lead to a loss of popular support for reform in the applicant countries furthest from membership. FDI inflows look likely to become increasingly concentrated in these three countries, as EU decisions reinforce investors' preferences. According to the writers by contrast Bulgaria and Romania, both of which are likely to be excluded from EU for many years owing to relatively poor progress in meeting the economic conditions, received lower levels of FDI which will turn further limit their accession prospects and undermine support for painful and difficult measures.[66]

Positive announcements about EU enlargement have boosted inflows of FDI to those countries most likely to join quickly. However, there is a widening gap between FDI receipts to the front-runners and back markers among the applicants. This process appears likely to be self-reinforcing, inducing virtuous cycles for the front-runners and potentially trapping the back markers at a low level of economic development. FDI receipts and economic reform more generally may be further deterred if announcements of delayed accession lead to a loss of popular support for reform in the applicant countries.

Economic transition began in 1989 in most of Central Europe as a consequence of the collapse of the communist political hegemony in the region, in the previous decades, economic progress in the socialist bloc had been at best lackluster, and development levels were generally well below those pertaining in most Western Europe. With the opening of Central Eastern economies foreign capital investment has become an important mechanism of their integration into world economy. The first three economies to reform -Hungary, Poland, and Czech Republic- showed success of attracting the bulk of FDI into the region.

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[66] Ibid from "EU Accession Practical Implications for Business in Central Europe"

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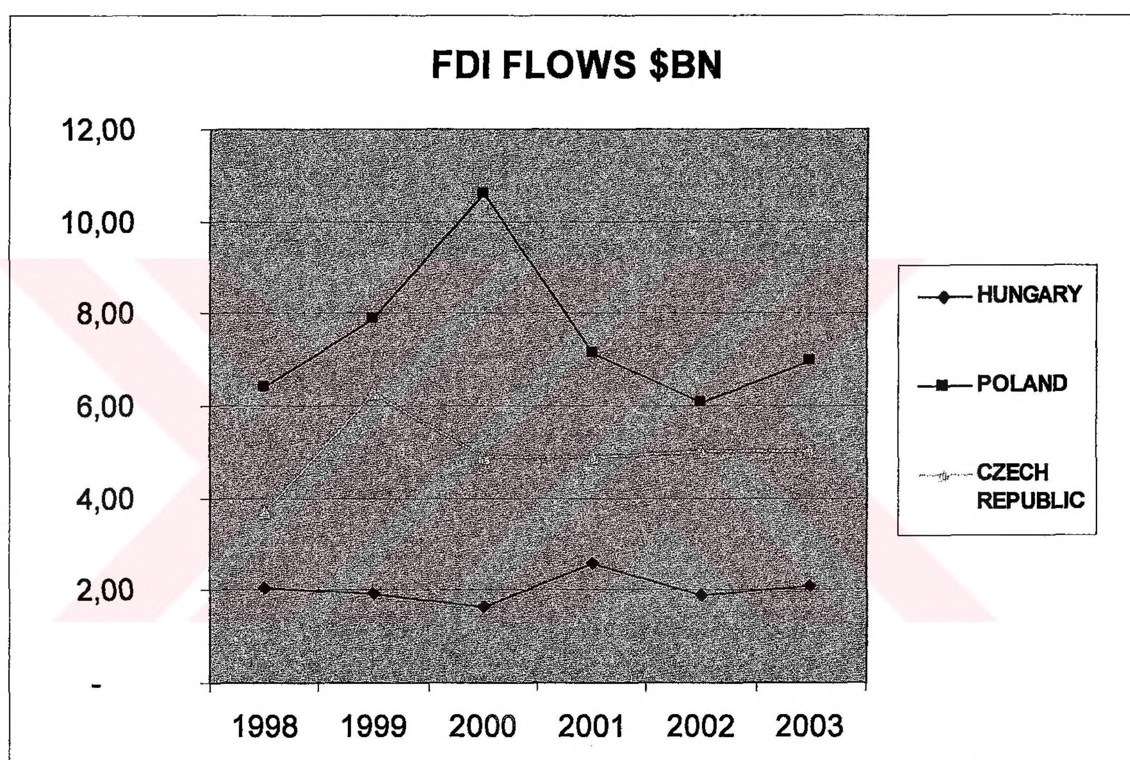
Starting from level of only 2.4 billion dollars in 1990 with 1.5 per cent, representing a very small proportion of total flows for developing countries, there has been considerable improvements especially after 1995. The region now attracts some 21 billion dollars, 10% of FDI to developing countries and 2.5% of the world total.

Table 3.2

FDI inflows to Hungary, Poland and the Czech Republic



Source: EIU, World Investment Prospects 2003 *Forecast

In a special report on FDI prospects in 27 countries in Eastern Europe, the Economist Intelligence Unit predicts that the FDI boom of recent years will strengthen in 2001-05, despite the global economic slowdown in 2001-02. Total FDI inflows into all 27 countries of the region in 2001-05 are projected to reach US$162bn, 36% above the 1996- 2000 total of 119 billion dollars.[67] Most studies suggest that new markets, is the main attraction for foreign investors in the region. Numerous papers and books contained evidence about the pulling power

[67] Special Report of the Economist Intelligence Unit November 2001

of new markets in Central and Eastern Europe for Western multinationals.[68] The Economist listed the reasons of attracting FDI as follows;

- For selected consumer-oriented industries, Eastern Europe provides a product market and also a potential production base
- Changes in legislation have been forced through to encourage Western firms to pursue exploration of oil and gas reserves.[69] These could obviously be great significance to the national economy, but require up-front investment as well as the latest technological methods of succeed
- Services which are seen as overtaking manufacturing in the developed economies of the West are at an appallingly backward stage in Eastern Europe.
- Full membership to European Union

According to the research key areas of investment in the Eastern European countries are consumer good, food production, healthcare, packaging, environmental clean-up, services and tourism. Central and Eastern Europe countries represented a particularly attractive prospect for Western companies not with the absolute size of the region in terms of population and also for consumption levels of many consumer products were low relative to per capita income. Most of these countries had been, for more than a generation, completely insulated from Western goods, especially from consumer goods with a strong brand image[70].

Although labor costs are not as low as in many developing countries, they are low by western European standards, with average Czech wages about one-tenth of German wages. Combined with lower transport and generally lower

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[68] See for more information: National Economic Research Associates 1991, Organization for Economic Cooperation and Development 1995

[69] Oil, gas and precious metals are found predominantly in the former Soviet Union but in the given countries there is an access to relatively cheap intermediate products such as iron, steel, and ferrous metals.

[70] Obvious examples are the markets for hamburgers, cola and pizza. However these specific characteristics of transition economies also represent a challenge for Western multinationals and exports in assessing the most effective combination of quality, variety and price, and in developing advertising strategies for these countries.

logistical costs due to location, the cost advantages of Central and Eastern Europe may be fairly attractive to a number of firms, especially those in labor intensive sectors. Furthermore labor force are relatively high skilled and a high proportion of workers have been employed for many years in sectors such as chemicals, engineering, machine tools, vehicles and aerospace.[71] Apart from the given factors, the reason for investing in Eastern Europe have been examined, recognizing that the individual countries which make up this region are all at different stages of the industrial development and also accord different degrees of welcome to foreign investors.

[71] Estrin S. "FDI in Central and Eastern Europe Multinationals in Transition" Royal Institute of International Affairs 1997

3.1 THE CZECH REPUBLIC

The Czech Republic is one of the economically most advanced countries in Central and Eastern Europe. Left in dereliction for almost half a century by the communist regime, the Czech Republic became a sovereign State on 1 January 1993 following the dissolution of the Czech and Slovak Federal Republic. The government's overriding foreign policy objective is to solidly lock the Czech Republic into Western European economic, political and security structures through membership of the European Union, NATO and the OECD. The Czech Republic joined NATO's Partnership for peace program in the spring of 1995 and took the first places among the former communist countries to join the OECD.

The Europe Agreement with the Czech Republic was signed in October 1993, and entered into force in February 1995; the country's application for membership of the EU was presented in January 1996, followed by the start of accession negotiations in March 1998. The Czech Republic is at the forefront of the enlargement process and will join the Union in the first wave of enlargement in 2004. The EU is the country's leading trade partner, accounting for 69 per cent of exports and 62.3 per cent of imports in January-June 2002[72]. The Czech economy began to grow again during the past years as a result of accelerated economic reforms and increased foreign direct investment inflows. EU accession negotiations are well advanced and the Czech government is strongly committed to them and very keen to accelerate their pace.

The Czech Republic, like Poland and Hungary had many steps coming to its position in the world today it can be said that the legal status of foreign enterprises in Czechoslovakia had been even more strongly affected by political factors than others. Up to the Second World War it was a country with an exceptionally heavy foreign capital involvement. After the outbreak of the war

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[72] Takizawa H; Tzannis D; "Czech Republic Selected Issues and Statistical Appendix" IMF July 2002

majority of enterprises were transferred to German ownership, which facilitated the post-war process of nationalization. In 1950s foreign investment in Czechoslovakia was out of the question. Subsequently a number of agreements were concluded which allowed foreign enterprises to undertake a handful of projects but without ownership rights.

From 1969 to 1989 Czechoslovakia was ruled by the communist put in power as a direct result of the Soviet intervention in 1968. They were more concerned with preserving “ideological purity” than rest of Eastern Europe and for a long time emphatically rejected the idea of attracting foreign direct investment and continued to stand firm even after most other governments had started swinging round to such policy. The door to foreign direct investment was not opened until 1986 when regulations were issued permitting the establishment of joint ventures. [73]

However, the foreign capital stake could not exceed 49 per cent and a majority holding had to be retained by a Czechoslovak enterprise. The operations of these joint ventures were confined to industrial production. The question of profit transfers was regulated by means of permits decided on a case-by-case basis. Foreign investors received no guarantees that the provisions for remittances, taxation, etc. would not be subject to change at some future date. Income tax was set at 50 per cent and there were no additional tax incentives. A levy of 25 per cent was imposed on hard currency remittances. One of the most restrictive clauses was that key management positions had to be filled by Czechoslovak citizens. The net effect of these rules was that foreign investment in Czechoslovakia remained next to negligible until the end of 1989.[74]

The country had maintained a remarkable degree of macro-economic stability since the so called "Velvet Revolution" of November 1989 despite an early program of thorough economic reform, the dismantling of the former central

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[73] Dobosiewicz Z. “Foreign Investment in Eastern Europe” Routledge London 1992

[74] Paliowada S; “Investing in Eastern Europe Capitalizing on Emerging Markets” The Economist Intelligence Unit 1995

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planning regime and movement toward a market oriented reform program, and had been continued by the Czech Republic. Reforms focused on the decontrol of prices, privatization, liberalization of foreign trade and foreign exchange. The government issued a string of declarations proclaiming its interest in attracting foreign direct investment, and a large number of Western businessmen paid to visits to Czechoslovakia.[75] The Czech Republic's economy underwent a dramatic transformation in the early 1990s. An extensive stabilization program was launched in 1991 in line with International Monetary Fund guidelines and included measures such as currency devaluation, price and foreign trade liberalization, a rapid enterprise transformation, a tight monetary policy and privatization of the state owned assets.

A period of recession continued until 1993 followed by a period of economic expansion until 1996. Following the initial successes, macroeconomic performance started to falter in 1996, partly because of a lack of reform in the still state-dominated banking sector. In the spring of 1997, the government implemented stabilization measures in two policy packages aimed at increasing market confidence although the authorities were forced to abandon the fixed exchange rate regime in May 1997. 1998 marked by a period of recession and late in that year Czech authorities began to loosen monetary and fiscal policies and to advance with the restructuring of the banking and corporate sectors. The recession continued into the first half of 1999 when there were signs of a recovery reflected in modest GDP increase.

Following a few years of slowdown, the country's economy started to grow again in 1999, driven by high FDI inflows accounting almost 20 per cent GDP and growing domestic demand reinforced the solid balance of payment position. Because of its high trade integration with the European Union, in particularly Germany, strong inflows of FDI supported strengthening of production capacities. The Czech Republic managed to sustain a gradual economic recovery with GDP

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[75] Dragamir M. "Czech Republic Stealing Central Europe's Thunder" May 2002 Kwonolda

grew by 2.9 per cent in, after the following three years of recession and reached 3.6 per cent in 2001.[76]

Table 3.3

Main Economic Indicators of Czech Republic

	1998	1999	2000	2001
Real GDP Growth	**- 1.2**	**- 0.4**	**2.9**	**3.6**
Unemployment Rate	**5.9**	**8.7**	**8.8**	**8.3**
Inflation rate	**10.7**	**2.1**	**3.9**	**4.7**
Real Exchange Rate (Against Euro)	**9.2**	**-2.5**	**3.1**	**7.0**

Source: Central Bank Czech Republic[77]

According to the Progress Report the financial sector was singled out as one of the biggest remaining problems. Continuing price liberalization, restructuring public finances and improving the legal framework for enterprise activity were listed as other recommended priorities. According to the report the economic transition is nearly complete with almost 80 per cent of the GDP produced by the private sector and the legal structure to govern the economy already in place and being adjusted to EU standards[78]

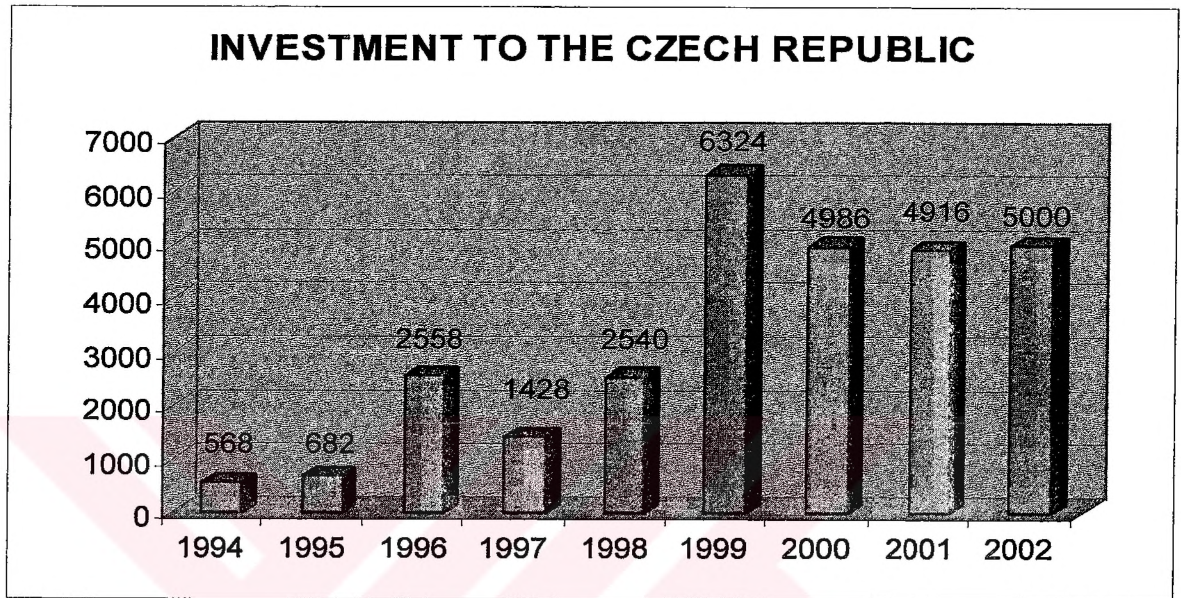
FDI inflows to the country have been variable over the years, depending on the opportunities to acquire shares in large state enterprises. The Czech Republic has attracted almost US$ 20 billion in FDI since 1989, about half of which was invested during the last two years, 1999 and 2000. The most important transactions involved in the sale of stake in Skoda Automobile to Volkswagen and part of these tobacco enterprise to Phillip Morris in the early nineties, an almost 50 per cent share in the petrochemicals sector to Agip\Shell\ Concoco consortium

[76]" Foreign Direct Investment Report 1999-2000" Ceska Narodin Bank Prague 2001
[77] www.cnb.cz/en/index.htlm. Retrieved on 25 January 2003
[78] Evaluation of the 2001 Pre accession Economic Progress of Candidate Countries" European economy Enlargement Paper Directorate General Economic and Financial Affairs Number:7

in 1996. This investment helped to reach the investment flows to US$ 2,558 billion in the same year.

Table 3.4

FDI Inflow to the Czech Republic



Source: CzechInvest[79]

The increase in the FDI flows with beginning in 1998 was attributable to several factors; privatization of state owned enterprises, especially in the financial and telecommunications sector, expansion of foreign supermarket chains and increase in the equity of existing foreign owned companies. Several greenfield investment projects were also undertaken by the new investment incentives.[80] In 1999 with 6.324 billion dollars it reached the highest level and in 2000, the inflows amounted to 4.91 billion dollars or about 9.3% of GDP and 82% of FDI inflows originated from the EU and about 95% from OECD countries. In 2000 there were 37 companies that had been awarded incentives to invest more than US$ 1.5

[79] Derived from the data of CzechInvest www.czechinvest.

[80] A system of investment incentives was introduced by the Czech Government in 1998. Its aim was to encourage both foreign and domestic investment and to enable the Czech Republic to compete favorably for FDI with Poland and Hungary. The 1998 Government provisions on investment incentives were further enhanced in a law adopted in January 2000. For more detailed information about incentives in Czech Republic see "Foreign Direct Investment Report 1999-2000" Ceska Narodin Bank Prague 2001

billion.[81] Although large FDI receipts to date have been in the retail and real estate sectors, there have also been significant investment inflows in the banking sector and in industry, especially in automotive and electronics companies. [82]

Table 3.5

Inflows into the Czech Republic by Country

COUNTRY	1999 bill. $	2000 bill. $	2001bill. $	1993=2001 bill $
Germany	1300	1,322	1,375	6,662
Netherlands	1,131	1,036	817	4,987
Austria	833	738	295	2,806
United States	581	303	240	2,406
France	232	232	1,371	2.378
Belgium	1,378	53	48	1,729
Switzerland	354	228	138	1,666
United Kingdom	104	158	64	1,044
Denmark	43	103	232	436
Sweden	127	148	21	432
Canada	11	155	21	202
Italy	47	36	1	188
Others	179	428	276	1,682
Japan	5	46	19	148
TOTAL	**6,324**	**4,986**	**4,916**	**26,757**

Source: The Czech National Bank

Since 1990 most FDI in the Czech Republic has come from Germany followed by the Netherlands, the United States, the United Kingdom, Austria and France. FDI projects have come through direct privatization sales or through greenfield operations which has been largely concentrated to date in specifically created government aided industrial zones[83]. According to the table 3.5 Germany is the main source of the foreign direct investment into the country

[81] Foreign investors have been particularly attracted by the investment incentives package, and also by the new business zones with enhanced infrastructure provided by the municipalities, which are now also being established in the economically depressed regions.

[82] Hungary Investment Profile 2001 EBRD April 2001

[83] "New Supplier Development and After Care" Program for investors implemented by the Czech Agency for foreign investment, have also significantly enhanced the attractiveness of the Czech Republic as an investment base.

within the period of 1993 and 2001, made an investment of 6.662 billion dollars, followed by Netherlands with 4.987 US$, Austria and France are listed as the other important players in the Czech Republic. EU investment as cumulative reached to 26.757 billion dollars between the same periods.

Philips (Netherlands) started built a US$ 624 million television plant in North Moravia in 2000, the largest greenfield investment in the country's history. An important factor greenfield investment is the presence of suppliers of large multinational firms. The highest share of FDI has been in the telecommunications and the transport sector. Investment in the automotive, transport vehicle and components sectors has grown steadily as has the presence of multinationals in the consumer goods sector. Other large investments have been mode in electronics, petroleum, gas distribution and power generation sectors. In recent years there has been a strong concentration of FDI in the trade and services sector and financial services which accounted to 50 per cent of total inflows in 2000.[84]

According to the EU's report strong FDI inflows are expected to continue in 2003 partly because of renewed privatization efforts by the government including sales of telecommunications and energy companies.[85] The Czech Republic has proved to be an attractive location for greenfield investment, and this advantage seems even to increase in the context of EU accession, FDI inflows are expected to remain on a comparatively high level, though they might develop more erratically. The government has put strong emphasis on attracting foreign investments by creating an attractive investment climate with competitive incentive packages as its main elements.

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[84] OECD Reviews of Foreign Direct Investment Czech Republic 2001
[85] "Report on Macroeconomic and Financial Sector Stability Developments in Candidate Countries" by Directorate General for Economic and Financial Affairs Number:8 April 2002

3.2 HUNGARY

Hungary's government policy towards foreign investors has been one of the most favorable in Central and Eastern Europe. Hungary was very successful in attracting the foreign investors with the beginning of nineties, but their efforts even started before license transfers, creation of joint ventures, regular supplier contacts were developed as early as in the 1970's. Under the communist regime foreign equity couldn't exceed 50%, some multinationals established their presence even early. Subcontracting links with Western firms had been building since 1968, so that managers were accustomed to cooperating with foreigners.[86] As all other Soviet-oriented countries Hungary also had a centrally planned economic system. Socialist enterprises had in fact no right to take independent decisions on their own activity they had to fulfill the orders of the state authorities, the Planning Office and different Ministries, foreign trade and relationships to foreign firms was also centrally controlled.[87]

In 1989, Hungary with the breakup of the Warsaw Pact, shifted to a democratic political system, a market-oriented economic system, and a sharply altered trade regime. Consecutive governments since 1990 pursued an economic and political program aiming to build up an open and liberalized market economy, and a political system based on democratic values. The first freely elected government, led by the centre-right Hungarian Democratic Forum, launched the first reform program liberalizing foreign trade, freeing prices, reducing subsidies and improving the position of the private sector.[88]

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[86] Dobosiewicz Z. "*Foreign Investment in Eastern Europe*" Routledge London 1992

[87] The state control was not pushed completely into the background even in the period of the Hungarian Economic Reform, when Hungary experimented with the partial introduction of market forces in certain areas of the economy. This system proved to be inefficient and inferior to market economy, and was quickly replaced in the process of transition during the 1990s.

[88] Fowler B;"Debating Substate Reform on Hungary's 'Road to Europe" Working Paper 21/2001 Centre for Russian and East europe studies University Birgmingham

Inviting FDI to Hungary, mainly in the form of joint ventures was a major policy aim during the 1990s and a fairly large number of joint ventures were established. Because of the openness of the Hungarian economy, long term cooperation links were also developed rather frequently with major multinationals. After the 1989 "revolutions," the only country that was attractive to international investors was Hungary, which had a good record in its relations with private and multilateral financial institutions. [89]

"Economic transition in Hungary was rather quick and straightforward. There was a nationwide consensus about the important milestones of the process. Everyone hoped that the introduction of fully-fledged market economic system would quickly turn around the economy, and also the economic agents, companies. Though the process lasted perhaps longer, than it was expected, still it was perhaps the quickest in Central and Eastern Europe. *'Today Hungarian transition process is finished with a few exceptions. Transition process provided a lot of opportunities for foreign investors. It was therefore Hungary where foreign capital started to invest first in the region. Hungary received the most foreign investment until 1996 among countries in transition."* [90] says Iouri Adjoubei (Economic Affair officer of Trade and Investment department of UN Economic Commission for Europe) in his article about the FDI in transition economies' today and past."

The new governments were ready to sell flagship companies to primarily foreign investors in order to increase budget revenues. They did a good public relations job of promoting the foreign investment opportunities in Hungary and they were also willing to open up to foreign investors a large part of the industrial and service sectors. Among the main sectors affected were telecom, banking,

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[89] Kaminski B. "Foreign Trade and FDI in Hungary and Slovenia: Different Paths—Different Outcomes" University of Maryland, World Bank 2000

[90] *"Promoting Foreign Direct Investment in Central and Eastern Europe and CIS"* Trade & Investment guides 3 UN Economic Commission for Europe 2000

electricity generation and distribution, gas, tobacco and hotels[91]. Consequently spectacular success of Hungary in attracting FDI in the early 1990s was largely based on FDI preference in privatization policy or either the establishment of joint ventures.[92]

Investment opportunities came more gradually for larger multinational companies, initially through exports, and then progressively through the privatization of the state owned enterprises and greenfield investments. The early stages of the privatization process were strongly driven by western multinationals' interest in consumer goods business with established markets and brands. Investment by Procter and Gamble, Electrolux and General electric are characteristic of this early era and throughout the nineties Hungary privatized a bigger share of its economy than any other OECD country. On the other hand establishment of joint ventures with foreign capital participation was promoted by allowances of corporate income tax. State subsidies were offered for large-scale investments in certain high technology sectors (electronics, automotive, biotechnology, communications, etc.) and in tourism, for investments in depressed regions with a requirement of certain amount of job creation, and for increasing exports. Later the investment subsidies were expanded to domestic companies as well.[93]

Inward investment amounted to about US$ 2 billion on average annually over the period 1990 and 1999 and foreign owned companies now account for more than one third of GDP and 30 per cent of private sector employment in the country. In 1995, the volume of foreign capital inflows in Hungary was exceptionally high, almost four times as much as in 1994 with 4.41 billion dollars comparison to 1,10 billion dollars in 1994. This was due in particular to

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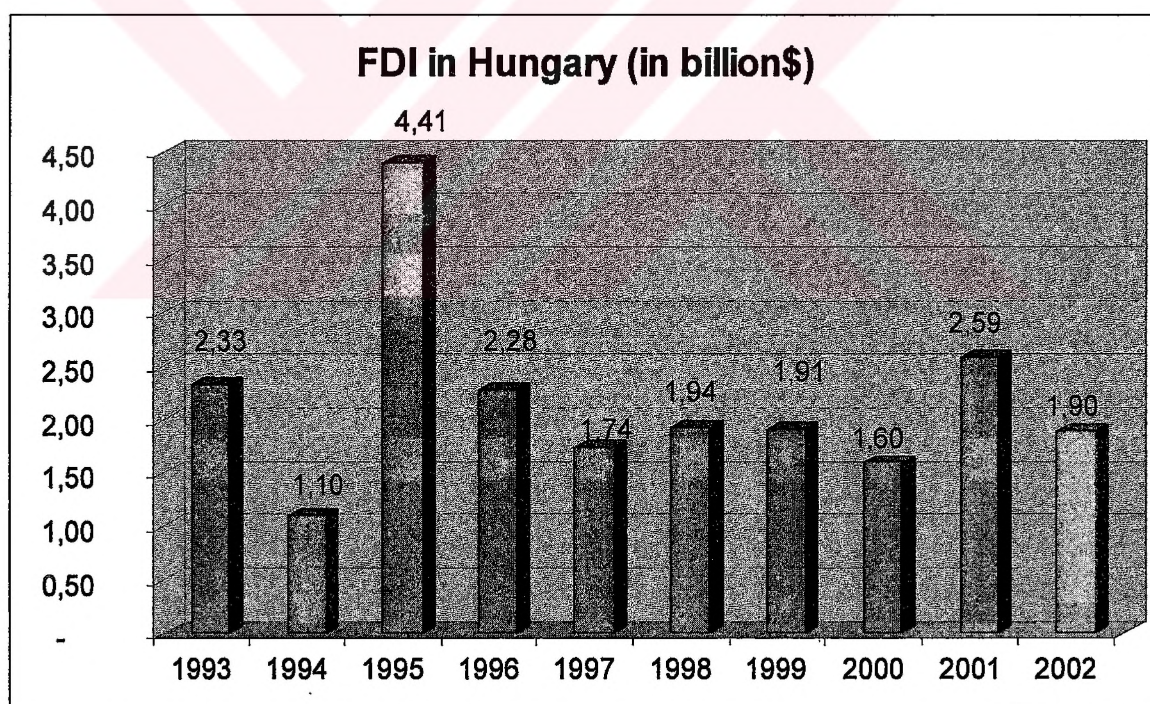
[91] Sample privatizations include a consortium of Ameritech and Deutche Telecom, which jointly acquired national telecommunications firm MATAV; two German utilities, RWE and EVS; and ABB which acquired the Lang Machine Factory.
[92] Richard Lyon "Hungary- the business view" *European Business Journal;* London; 1999
[93] Estrin.S; Hughes K; Todd S; "FDI in Central and Eastern Europe Multinationals in Transition" Royal Institute of International Affairs 1997

investments in the energy sector where the majority stakes of the gas ands electricity suppliers and the two largest power plants were privatized.

In 1997 and 1998 FDI flows were almost similar amounted to over 2 billion dollars. The total value of the greenfield FDI in the country was US$ 3,8 million at the end of 1997 representing 296 projects and 22% of total foreign direct investment. In 1998 greenfield projects accounted for investment over US$ 450 million with Japanese accounting for 200 million dollars alone that year. This trend continued in 1999 with investment by Nokia, Temic and Shinwa, among others, and greenfield projects now account for well over one quarter of the total investment volume in Hungary.[94]

Table 3.6

Foreign direct Investment in Hungary



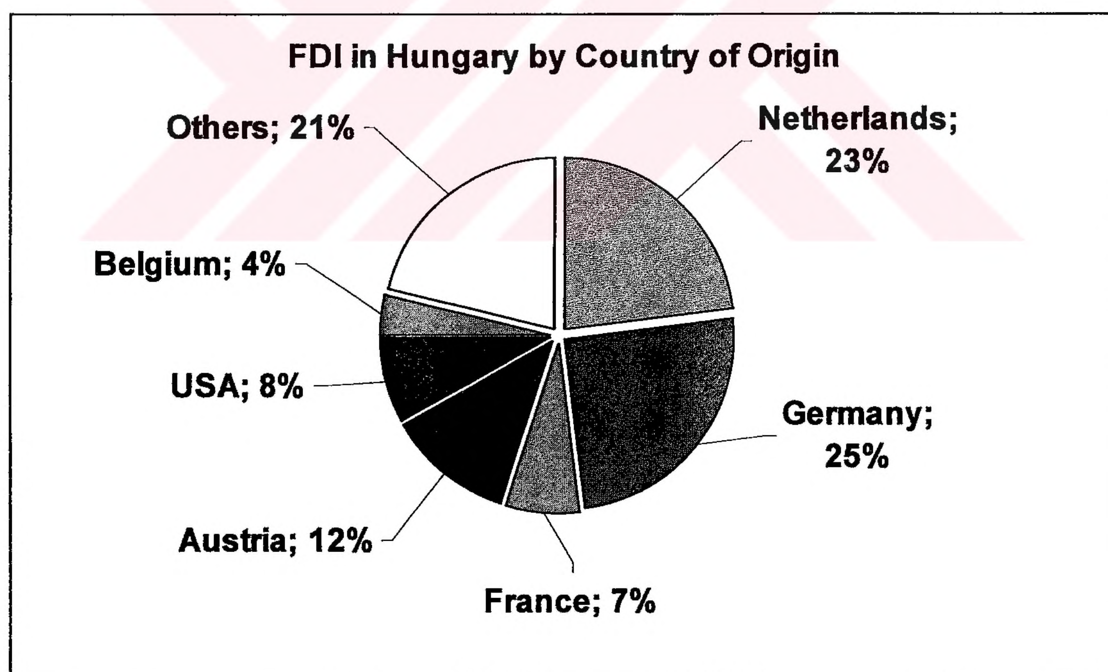
Source: UNCTAD World Investment Report 2002

[94] Ibid OECD country review p16

As the privatization process is nearing completion as almost 80 per cent of the economy has been privatized and only a very few large assets are left in state hands, FDI inflow has slowed down to US$ 1.60 billion in 2000 but the following it again increased sharply. The importance of foreign investors to the economy is reflected in the fact that foreign-owned companies, mainly multinational firms, generate 77 per cent of Hungary's exports, some 33 per cent of its GDP and 25 per cent of private sector employment. More then 18,000 joint ventures are registered in Hungary and 35 of the world's 50 largest multinational companies have a Hungarian subsidiary. Much of the early investment was the result of the strategic privatization of state-owned enterprises. However, in recent years more and more FDI has been in the form greenfield investments.[95]

Table 3.7

Foreign Direct Investment by Country Origin in Hungary in 2002



Source: Ministry of Economic Affairs of Hungary

[95] EBRD Hungary Investment Profile 2001

As far as the countries of origin are concerned the bulk of the inward stock is owned by firms of the European Union. Almost the two third of the foreign investment in Hungary comes from EU countries, with companies present in a wide variety of sectors and with different forms of investment. In 2001 the major investors were Germany with 25%, followed by the Netherlands 25%, Austria 12%. USA was the major investor with 32% in 2000 but decreased its investment to 8% in 2001. Of the 50 largest multinationals, 40 of them are present in Hungary, providing more than 60 % of total FDI. Multinationals, originating mainly in the United States, Germany and France, account for over two thirds of the total investment volume.

A large number of foreign companies see Hungary as a natural springboard for the region, as a total of 80 multinational companies have their regional headquarters in the country. Multinationals produce nearly 25 % of GDP, according to estimates. Even overseas owners used to register through their European affiliates, regional headquarters. Therefore, Hungarian economy is rather strongly integrated in European corporate networks. Central Europe became the most important backyard of EU-based multinational companies.[96]

Table 3.8

Main Macroeconomic Indicators of Hungary

	1998	**1999**	**2000**	**2001**
Real GDP Growth	4.9	4.2	5.2	3.8
Unemployment Rate	7.8	7.0	6.4	5.7
Inflation rate	14.3	10.0	9.8	9.2
Real Exchange Rate Against Euro	-0.3	1.6	1.8	8.2

Source: OECD Economic Outlook no.72 Statistical Annex Table[97]

[96] Wesolowsky T; "East meets west: European Union expansion and the troubled former communist countries" *Multinational Monitor*, Washington May 2002

[97] Retrieved on http://www.oecd.org/EN/document/0,,EN-document-654-8-no-1-37571-654,00.html

Based on the past structural reforms and careful macroeconomic management, economic growth reached 5.2% in 2000, in its highest levels since the beginning of transition. Despite a slowdown in late 2001, in line with global trends, growth remained robust at 3.8% and is expected to return to earlier levels. GDP growth contributed to some increase in FDI inflows, from $1.6 billion to $2.56 billion, the highest inward FDI flow since its privatization program ended in 1998. Even with structural reform and infrastructural investment, systematically broadening the growth base of the economy, growth rates, after a temporary slowdown, could return to levels of 5% and beyond over the next few years. Export account for around 50 per cent of the country's GDP at present and the Hungarian government attributes much of its competitiveness as an exporting country directly to foreign investment. Foreign owned companies generate around 80 per cent of Hungary's industrial export.[98]

According to the 1988 Act on Investments of Foreigners in Hungary governs the establishment and operation of companies with foreign participation, and grants significant rights and benefits to foreign investors. It guarantees national treatment for foreign investments and abolishes the general requirement of government approval. It also provides protection against losses resulting from nationalization, expropriation, or similar measures, and guarantees free repatriation of invested capital and dividends. Over the last few years, in an effort to harmonize with EU regulations, the government has been shifting to a strategy supplying.[99]

At the report on Macroeconomic and Financial Sector stability Developments in Candidate countries, it is stated that "*Hungary is becoming vulnerable to foreign investors' sentiment. With credit ratings approaching those of developed countries and capital movements liberalized. Hungary ranges more and more prominently in the emerging markets' portfolio of institutional*

[98] European Union Acession: Practical Implications for Business in Central *Europe Economist Corporate Network Ernest&Young* April 2002 London

[99] Evaluation of the 2001 Pre accession Economic Programs of Candidate Countries" European Economy Enlargement Paper Directorate General Economic and Financial Affairs Number: 7 January 2002

investors"[100] According to the Hungary Investment Profile 2001, Hungary's primary strengths for investors are its favorable policies towards foreign investors and special tax incentives (which were in place until 1995), its transparent and commercially viable method of privatization, its high economic growth, well-developed financial and commercial infrastructure, well-educated labor pool, and its geographic location.

As it is always mentioned in many areas Hungary offers well-trained labor force and a tradition of productive research at its universities. Hungary's status of having produced the highest per capita number of ten Nobel Prize winners supported by the government. Hungarian governments give priorities at their industrial policy to interlinking with foreign companies, domestic firms, and universities in order to improve R&D capacities. With lobbing multinational corporations to get them to locate research and development facilities in the country, created Szechnyi Plan.[101] According to the Hungarian Investment and Trade Development Agency (ITDH), foreign investors are applying with serious proposal and generally receiving the funds from Szenchyi Plan. State is co-financing between a quarter and a third of selected projects in seven prioritized sectors; infrastructure, housing, small and medium sized enterprises, tourism, regional development, R&D and information society.

In Hungary Statistical figures indicated that foreign firms spent 45 % of total industrial Research and Developments in 2000, and the share was increasing. R&D intensity of foreigners was much higher than of the domestic companies. A series of companies moved R&D capacities from abroad to Hungary (for example: Audi, Nokia, Philips, Siemens, GE, Knorr Bremse, ABB, Ericsson). There are even firms in Hungary that have no production facility just an

[100] Report on Macroeconomic and Financial Sector Stability Developments in Candidate Countries" by Directorate General for Economic and Financial Affairs Number:8 April 2002

[101] The primary objective of the plan is to open up the economically less developed eastern part of the country. Public sector investment will focus upon motorway development, home construction, truism, research and development, information technology and employment. Creation of industrial parks, industrial clusters, and incubator houses, R&D cooperation between industry, university and Academia are supported. Payments are usually received by local governments, or their agents.

R&D center (for example Japanese Tateyama)[102]. There is another fact that mostly the effective not only for Hungary but also for Poland and Czech Republic, EU membership. With the first wave enlargement those countries will become member states. Although for each of them there are still much to be done in specific areas, the announcement of the future membership will cause a bulk of investment flows into those countries.

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[102] Hungary Investment Profile 2001 EBRD

3.3 POLAND

Poland is the largest of the candidates in Eastern Europe and seventh largest in Europe with its 39 million populations and was one of the first communist countries to start to show positive results from market transformation. In Poland the door to foreign direct investment was first opened by a government decree of 14 May 1976 which permitted the establishment of small business by foreign nationals of Polish extraction. Under these regulations firms could be wholly owned by citizens of other countries. They were to operate on the basis of licenses issued by local authorities who specified precisely what and how much they were allowed to produce. Public officials kept a close watch on fulfillment with these obligations and there were cases of foreign firms being penalized for making goods for which there was market demand but were not itemized in their concessions.

In the 1980s the rules governing foreign enterprises were subject in Poland to the short of frequent changes observed in other East European countries. On the one hand, there was a gradual expansion of the scope of foreign investment, while on the other, often unfavorable modifications to the tax system. Even at the end of the 1988, before Poland had freedom from communism, there were 700 small enterprises in the country although their combined contribution to the economy was very small. The growth of the foreign ownership sector was thought too rapid by some communists, and the liberal provisions of the new law viewed with dismay by officials responsible for overseeing foreign investment.[103]

Like Hungary and the Czech Republic, Poland succeeded in rapidly curing the past after the first decade following the anticommunist earthquake that shook the Soviet controlled camp in 1989. FDI flows to the region were very small, less than 0.1% of the world total and represented a very small proportion of total flows for developing countries at the beginning of 1990s. With the help of the new law

[103] Dobosiewicz Z. "Foreign Investment in Eastern Europe" Routledge London 1992

established in 1991[104] Poland attracted relatively large inflows of FDI, especially in the second half of the 1990s.

Opening to foreign investment, Poland did not attract significant FDI inflows until 1995 following its agreement with the London Club, the value of FDI inflows into Poland surged to US$3.6 billion (net of repatriation), which amounted to around 80 percent of the aggregate value of FDI inflows over 1990-94 and was double of the value in 1994. Measured against the GDP, the volume of FDI was equal on average to around 3% over 1995-97 and 5% in 1998-99. The share of foreign firms in total investment outlays increased from 20% in 1994 to 33% in 1996 and 40% in 1997.[105] In Poland, and also in other transition economies as they liberalized their respective economic regimes, was a gradual shift from joint ventures to wholly owned investments. Companies with 100 percent foreign ownership accounted for 40% of FDI projects in Poland in 1993, 45% in 1995 and 50% in 1998. In consequence, as the composition of FDI inflows shifts from partial to full ownership, Poland is likely to benefit more from inflow of sophisticated technologies and superior marketing skill.

According to the studies of Kaminski and Smarzynska during the initial stages of transition, there were two notable factors attracting FDI to Poland. First, there was unsatisfied demand for consumer goods and services, a legacy of central planning which was strongly biased against services and consumer products. Many Polish industries created a great opportunity for new products coming from the West. In manufacturing, foreign investors have focused primarily on food, beverage (especially beer and soft drinks), tobacco, cosmetics and publishing industries. Large investors such as Coca Cola Amatil, Pepsico, United Biscuits, Philip Morris, Unilever and Nestle have entered the market in response to excess demand. The underdevelopment of the Polish service sector also represented a huge market opportunity for foreign investors, and a large number

[104] The law of 1991 states that foreign enterprises are no longer required obtaining the approval of the state administration, except in some activities like the administration of ports and airports, manufacture of armaments, creation of consulting enterprises and trade in real estate.
[105] EBRD "Investment Profile Poland"

of foreign enterprises were attracted into the trade, retail and consumer services. The second pull factor was tariff jumping. As the European Agreement signed with the EU imposed significant restraints on changes in tariff rates.[106]

Poland's membership in OECD in 1996 constituted a guarantee for adapting regulations and procedures applied to foreign investment in the developed countries. Other factors increasing the attractiveness of Poland as an investment location were strengthening the country's geopolitical stability by joining the NATO in 1999 and commencing negotiations as an EU candidate. The process of implementing *acquis communautaire* contributed to the creation of advantageous conditions for business activity in Poland, as an improvement of the investment climate and an increase in the capital inflow into the economy. Pursuit of EU membership also provided investors with the promise of European harmonization and economic and political stability.

Table 3.9

Main Macroeconomic Indicators of Poland

	1998	1999	2000	2001
Real GDP Growth	**4.8**	**4.1**	**4.0**	**1.1**
Unemployment Rate	**10.6**	**13.9**	**16.1**	**18.2**
Inflation rate	**11.8**	**7.3**	**10.1**	**15.5**
Real Exchange Rate	**5.8**	**- 3.8**	**11.1**	**12.9**

Source: Polish Official Statistics*

[106] Kmaniski B; Smarzybska B; "FDI and Integration into Global Production and Distribution Networks: The case of Poland" July 2002 World Bank

*Polish Official Statistics. Retrieved November 20,2002 on the World Wide Web: http://www.stat.gov.pl/english/index.htm

Since the mid 1990s the Polish economy was expanding at a fairly rapid pace. The average growth rate for the period 1995-1999 was 5.7%. Slower GDP growth in 1998 (4.8%) and in 1999 (4.1%) largely reflected the steps taken to cool down the economy and unfavorable pattern of external developments. In 2000 the Polish economy grew at a rate similar to the average of Central and Eastern European countries. However, its rate of growth was higher than average growth in the European Union countries.[107] The last few years have seen a marked slowdown in growth, with both consumer demand and investment slowing. Lack of restructuring and growing problems in the small business sector was exacerbated by a fiscal crisis and a soaring current-account deficit.

In 2001, the economy came virtually to a standstill, with the 1.1% growth largely due to exports. In 2002, growth will remain low at 1.5%, with a weak pickup expected in the medium term. An economic recovery program aims to raise growth to 5% in 2004. The drop in consumer demand, lower oil prices and appreciation of the zloty helped bring inflation down to a low of 3.6% year-on-year in December 2001. It should stay around this level in 2002, rising to 4% as growth picks up. According to the report of "Macroeconomic Stability Developments of Candidate countries" it is stated that progress in enterprise restricting and structural reforms over the last years, there are reasons to believe that the quality and rate of return on this high level of investment is adequate. Inward FDI amounted to some 5.2% of GDP in 2000 from levels closer to 2% of GDP in the 1995/1997 period. In 2000 FDI inflows covered around 83% of the current account deficit.[108]

According to the estimation the main macroeconomic challenge for Poland in the run up to EU accession will be ensure that the economy can expand at a rate of growth of above 5% and thereby ensure real catching up, while maintaining a sustainable current account deficit and curbing the rapid rise in unemployment. There is a risk of further increase in the already very high level of

[107] Wallace H; "Poland: A Partnership Profile" Sussex European Institute OEOS Policy Paper 4/01
[108] ibid from"Report on Macroeconomic and Financial Sector Stability Developments in Candidate Countries"

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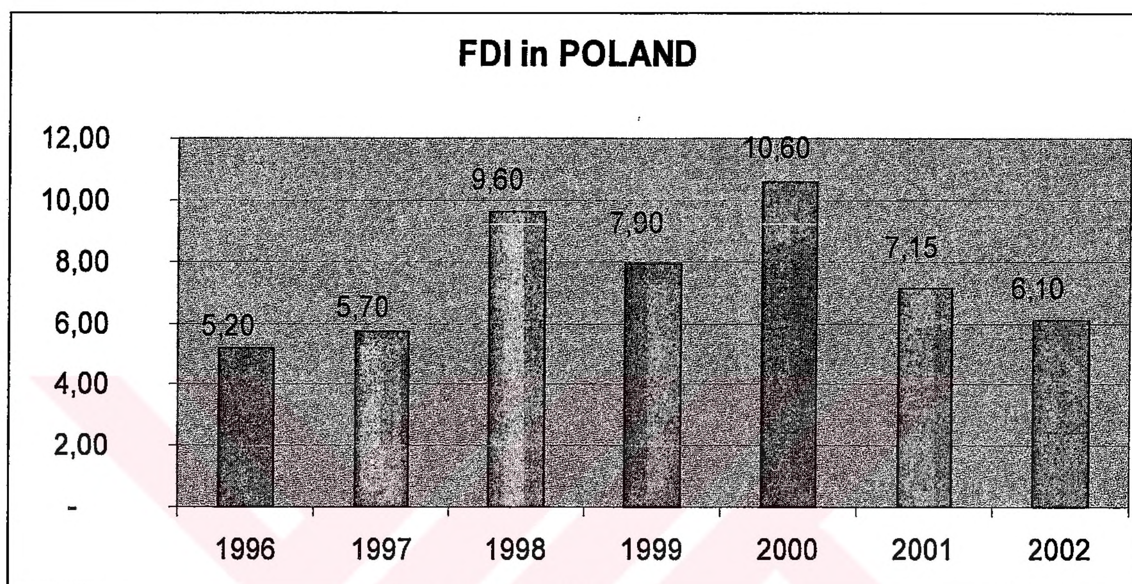
unemployment which, currently around 18%, is now the main domestic imbalance in the polish economy. Poland has by now experienced more than half a decade of investment boom with private savings remaining broadly stable.

Table 3.10

Foreign Direct Investment Inflows to Poland



Source: Polish Agency of Investment*

According to PAIZ calculations, foreign companies invested in Poland USD 7,146.6 million in 2001 and the foreign capital invested in 1990-2001 exceed the amount of 61.6 billion dollars. The inflow of foreign investment into Poland comes mainly from the Triad countries (the European Union, the USA and Japan). EU is the major investors in the country with 68%, North America is followed with 15% and 4.4% of foreign investment came from Asia. In 1993 there were 193 companies which invested more than one million dollars in Poland, in 1995 the number increased to 362 and to 585 investors in 1997. As it is given in Annex VI, list of the major foreign investors in Poland consisted of 920 companies from 35 countries. The largest group of investors with 212 companies comes from Germany; the USA is in the second position with 125 investors before France

*Retrieved Polish Agency of Investment (PAIZ) January 15,2003 on the World Wide Web: http://www.paiz.pl

with 87, the Netherlands 76 companies and followed by Italy with 61 companies. In 1993 there were 193 companies which invested more than USD.

In 2001 French corporations invested in Poland the largest amount of capital of USD 2.4 billion, that is 33.3% of the foreign investment. The German investments, worth jointly USD 1.36 billion, have been ranked as the second 19 % of FDI, and the United States with USD 687 million as the third 9.6%. The following position in the ranking belongs to the Belgian investments which have reached USD 578 million over 8%, and Great Britain is the fifth with the investment value of USD 419 million nearly 7%. As it is listed in Annex VI, foreign investors allocated 3.23 billion dollars, like in previous years, the investment realized in Poland in the first half of the year to a great extent comes from the Triad. Analysis of the structure of the investment inflow to Poland in the first half of the year 2002 according to the country of origin of the capital shows that investments from the EU countries constitute 81% of the whole structure, from North America 4% and from Asia 3%.[109]

In the Annex VII, major sectors that have attracted are listed among them most investment made in food processing and manufacturing branches. The analysis of FDI sector structure in the recent years points to some continuing tendencies in the allocation of foreign capital in Poland. In 2001, 83.6% of the capital was invested in three sectors: trade and repairs (29.3%), manufacturing (27.6%) and financial advisory (26.7%). Automotive industry on the other hand attracted the largest foreign investments to date from Fiat (Italy), Daewoo (South Korea) and General Motors (USA). Along with firms such as Isuzu (Japan), Delphi (USA), Volkswagen (Germany), Man (Germany), Volvo (Sweden), and Toyota (Japan), they have invested a total of some US$ 6 billion in car and vehicle components manufacture in 2000. As it is clearly seen from the information and data that, Poland will be a shooting star example of EU after Ireland and Spain in the case of attracting foreign investment. It is obvious that there will be more foreign capital inflows to Poland after the EU membership.

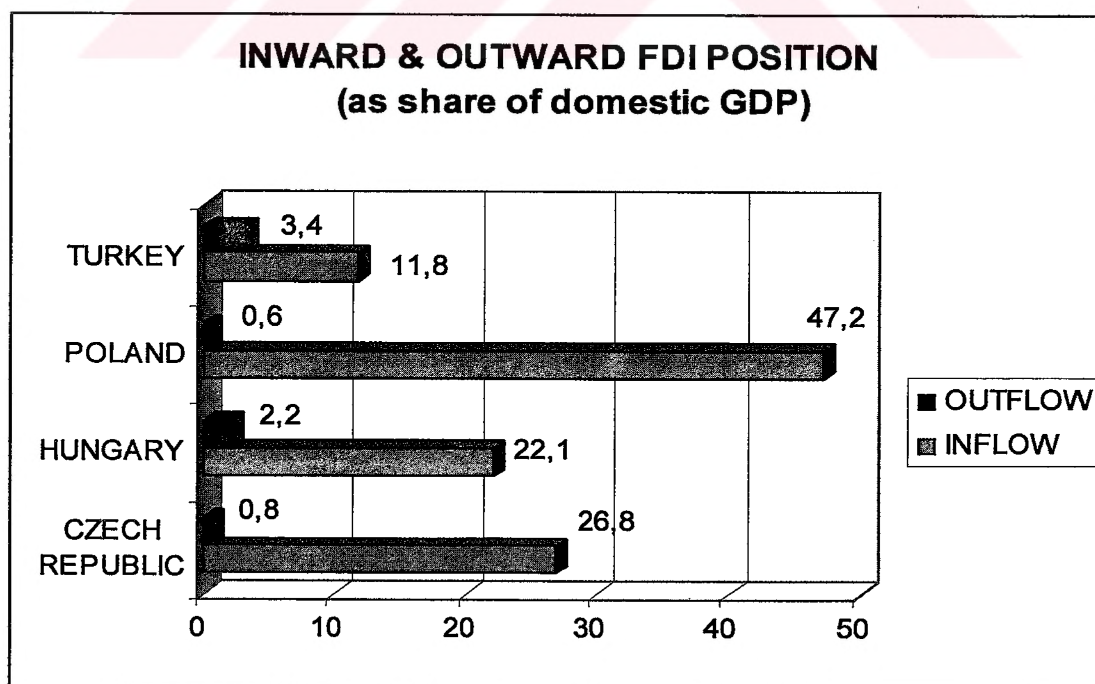
[109] For more information see: www.paiz.org.pl

IV. TURKEY'S COMPERETIVE POSITION IN ATTRACTING FDI COMPARE TO THE SELECTED COUNTRIES

Hungary, Poland and the Czech Republic not only received far greater inflows in FDI in absolute magnitude, but from five to ten times as much as Turkey in relation to their economic size. During the 1990s, annual FDI inflows averaged about 4 % GDP per year in Hungary and the Czech Republic, and over 2 % in Poland. Over the same period FDI inflows averaged less than 0.5 per cent of GDP in Turkey and over the last five years, the ratios of FDI to GDP in Hungary, Poland and The Czech Republic have range from 5.3% to 13.6%. From 1990 to 2001 FDI net actual inflows amount to 11.7 billion dollars to Turkey when this value considered, the annual average actual inflows to US$ 977 million net per year, equivalent to less than 0.5 percent of GDP.

Table 4.1

Inward and Outward Foreign Direct Flows



Source: World Investment Report 2002

Table 4.2

Inward FDI Performance Index 1998-2000

Rank	Country	Value
13	**Czech Republic**	**2.5**
38	**Poland**	**1.4**
49	**Hungary**	**1.1**
121	Niger	0.1
122	Bangladesh	0.1
123	**Turkey**	**0.1**
124	Haiti	0.1
126	Lebanon	0.1
127	Zimbabwe	0.1

Source: World Investment Report 2002

According to Direct Investment Index of World Investment Report, countries are dived into four groups concerning to their performance to attract foreign direct investment,[110] Turkey stand bottom lines in the 4th group with the underdeveloped countries such as Kenya, Indonesia, Congo, (even these countries had higher value than Turkey) and Zimbabwe. As it is given in Table 4.2, Inward FDI Performance Index[111] of the World Investment Report, with 0.1 Turkey ranks 123rd place out of 137 countries, whereas Czech Republic ranked the highest grade among the four countries with 2.5 point and Poland placed 38th and Hungary was in 49th place. According to the Inward Potential Index, Czech Republic ranked 39th place, Hungary 42nd, Poland 51st and Turkey placed 72nd

[110] At the first group leading countries (with high potential and high performance), in the second group countries that beyond their potential (with low potential and high performance), in the third group, countries below potential level (with high potential and low performance), in the last group countries at the bottom level (with low performance and low potential take places).

[111] The *Inward FDI Index* is the unweighted average of three ratios reflecting the propensity to attract FDI after adjusting for the relative economic size and strength of a host economy in the world. It captures the ability of countries to attract FDI after taking into account their size and competitiveness. An index value of "one" means that a country's share in world FDI matches its economic position in terms of these three indicators; GDP, employment and exports. For more detailed information see World Investment report 2002

among the world ranking. These results are not only sad for Turkey but also a shame for a country with high potential and motivation.

For 1998-2000, the value of the Index ranged from 17.3 for the highest ranked economy, Belgium and Luxembourg to –0.8 for Yemen. Czech Republic had a significant place with 2.5 in the 13th place in the world ranking. FDI receipts with high values of the Index (the "over-performers") include the majority of developed countries and Czech Republic, Poland and Hungary as well with Hong Kong and Singapore. According to the Index there are 53 countries with ratio higher than one and 79 with ratios lower than one. The last group in the index so called "the under- performers" in terms of attracting FDI includes Turkey with some advanced economies like Japan and Greece

Annex VIII, shows the Global Competitiveness Index, the most dramatic decline concerned Turkey, which slips to the 69th place this year, compared with a rank of 54 in 2001. Report states that " *Argentina, having suffered from a similarly severe financial crisis and an even larger fall in output, drops by 14 places to 69 on this year's rankings. Argentina's and Turkey's declines would have been slightly less dramatic in an unchanged sample, but still very substantial. With the exception of Haiti, all new entrants are ranked higher than Argentina and Turkey, technically exacerbating the decline in their competitiveness rankings.*" On the other hand Turkey's main competitors Hungary and Poland have enjoyed the relatively fastest growth rates.

Michalet [112] during his research about the facts that affected the FDI, made an interview with several American and European investors, asked them to rank among thirteen selected countries. Hungary, Poland Czech Republic and Turkey are always at the first five for all investors and there was a complete consistency with results. This outcome was obviously not surprising but (also Michalet states in his research), the surprising thing; although Turkey is shown as one of the most attractive country, the FDI flows isn't as much as it should be. Michalet

[112] From The FIAS Report on the Strategies of Multinationals and Competition for Foreign Direct Investment

emphasized that there is not an easy explanation for the figures, in his study Turkey has higher scores than in Hungary and Poland which in the reality stood very behind of them.

At the survey American firms give first place to Turkey at the telecommunication sector where the European investors choose Hungary. Many investors pointed out the fact that inexpensive factors of production and offering a base of access to European market make Hungary and Poland special in their investment decision. Although Turkey has the same advantages especially with its custom union with EU, could not be as successful as these countries. Turkey is losing projects to Hungary and other countries. For example, Samsung's $21 million, 500 job plant in Hungary is actually going to supply the Turkish market. In many cases Turkey is simply not on the investment map[113].

A favorable FDI "enabling environment" is a pre-condition for attracting inward investment. The FDI enabling environment involves the facilitation and support a location gives to inwardly investing companies. It has several components including FDI legislation and procedures, attitudes towards foreign investment, incentives, and investment promotion. The broader enabling environment for FDI is generally identical with best practices for creating a dynamic and competitive domestic business environment. The principles of transparency (both as regards host country regulatory action and business sector practices) and nondiscrimination are instrumental in attracting foreign enterprises and in benefiting from their presence in the domestic economy. FDI is unlikely unless investors have a reasonable understanding of the environment in which they will be operating. Moreover, a lack of transparency may lead to illicit and other unethical practices, which generally weaken the host country's business environment.

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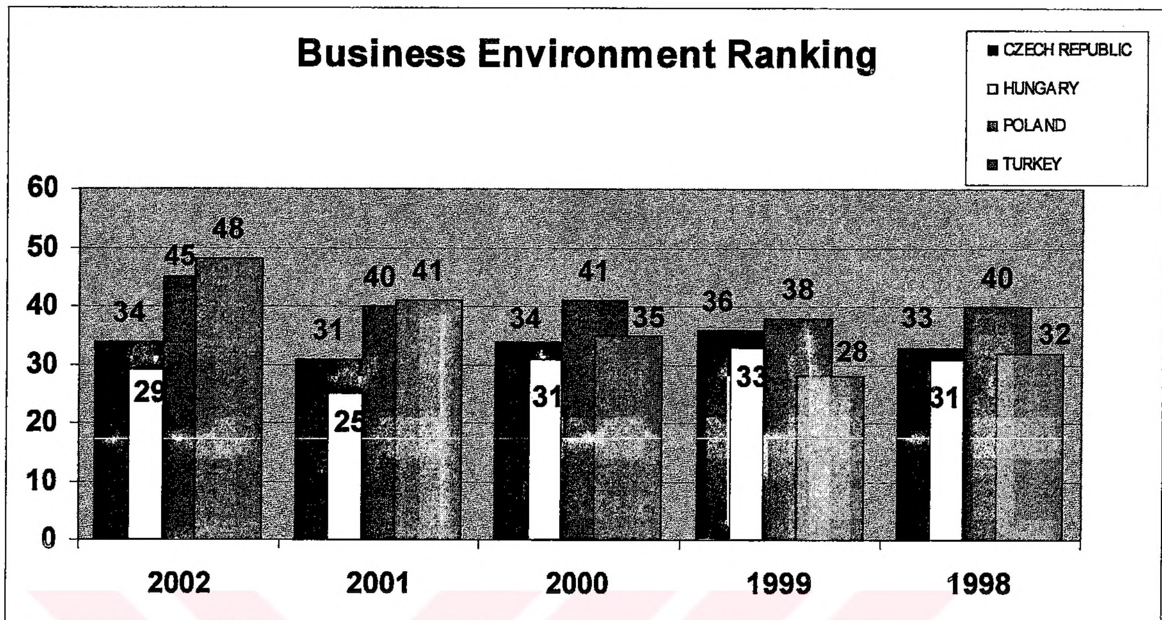
[113] Loewendahl E; Lowendahl E; "Turkey's Performance in Attracting Foreign Direct Investment" *European network Economic Policy Research Institutes* Working Paper no:8 November 2001

Table 4.3

Business Environment Ranking



Source: Global Competition Report 2002

Turkey's FDI enabling environment was only narrowly behind Hungary, perceived more favorable than the Czech Republic and Hungary between 1998 and 2000. Although Hungary steadily increased her place in the world ranking by improving the business environment condition in the country, Turkey and Poland showed a serious decline by the same period. Turkey used to be placed in the 28th in the world ranking in 1999 with 20 steps decline became the 48th, according to the Global Competition Report 2002. Although Poland is very successful for the recent years in attracting FDI, she scaled back to 45th place in business environment ranking.

4.1 DOMESTIC MARKET AND LABOR FORCE

Various market characteristics have been found to influence the inflows of FDI, including market size and growth in market size. The market size in conjunction with the growth prospects of the host country market are important 'pull' factors and theoretically positively related to the level of FDI flows. Because a large market size is conducive to increase in demand for the products and services provided by foreign investors. Moreover, a huge market size allows the attainment of economies of scale, and transaction costs are thought to be lower in countries with higher levels of economic development.[114] According to Thomsen market size is the primary determinant of the global distribution of FDI flows. He stated in his article that what matters for host developing countries is how much investment they receive relative to the size of their economies.[115]

Turkey should be in a highly privileged and rare position, with its relatively large domestic market as an emerging market, that of developing country that is able to attract substantial amounts of both export and domestic-oriented FDI. Among the existing foreign investors in Turkey, the large domestic market was most frequently cited as the most important determinant to invest in Turkey. [116] According to the World Economic Forum survey of more than 4000 firms, Turkey's domestic firms are found more competitive than Hungary, Poland, and the Czech Republic, and similar to those in Spain and Italy. For example more clusters are present in Turkey in international industries compared to all other countries mentioned above, with the exception of Italy.[117]

According to the United Nation demographic studies, total population is projected to stabilize at 85 million in 2025, and urban population at 70 million.

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[114] Erdal F; Tatoglu E; "Locational determinants of FDI in an emerging market economy: Evidence from Turkey" *Multinational Business Review*; Detroit; Spring 2002

[115] Thomsen, S. "Investment Patterns in a Long Term Perspective" *Working Papers on International Investment* 2000/2, OECD, April.

[116] The FIAS field survey, in January 2001, as part of the diagnostic study, included input from 56 foreign investors in Turkey.

[117] FIAS Report May 2002 p9

This demographic force is bound to make a positive impact on the economic growth process in the country. Turkey will have a younger productive population for years to come. If the new entrants to the workforce are properly educated, this will give Turkish economy a much needed flexible over the next two decades. With her demographic condition, compare with them Turkey's domestic market is extremely huge and very attractive for investors.

The competition atmosphere enhanced, with increasing numbers of multinational companies, the demand of the new products and production techniques, which can be managed by educated and talented labor force. Increasing the costs of the highly qualified managers in western countries, cause a shift of foreign investments into developing countries that where the educated and good managerial skilled labor force is high and cheap. So that the good quality of professional education and short qualification periods of the labor force represent an asset in competition for foreign direct investment. In the Czech Republic, the share of persons with tertiary education amounts to 12%, which is low in international comparison while most of the labor force has completed secondary schools (66%).

Hungarian Labor force defined as cheap, well educated and trained. On the other hand as regards qualified workforce,as it is stated in the report of the Hungarian Investment and Trade Development Agency (ITD)[118] foreign companies in Hungary have increasingly been facing the problem of not immediately finding qualified labour, especially blue-collar skilled workers to meet their requirements. This is partially due to the fact that the companies that came to Hungary in the early and mid-1990's settled in the Western part of the country, nearer to the developed regions of Europe. The result is almost full employment in this part of Hungary.[119] As it is always mentioned in many areas, Hungary offers well-trained labor force and a tradition of productive research at its

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[118] Competitiveness 2002 on International Comparison of the Competitive Advantages of Hungary 2002

[119] According to the report; Hungarian labor force especially skilled workers defined as rather immobile so that those living in the Eastern part of the country are not mobile enough to seek employment West of Danube.

universities. Cheap, well-educated and skilled work force in Hungary and Poland gives and edge over Turkey and this reduce Turkey's competitiveness.

On the other hand cost and qualification of the labor and its cost counted as the most powerful items in attraction to the foreign investment into Turkey.[120] Most foreign investors agree that the Turkish labor is very cost-effective. Labor costs are relatively low, which are three to five times lower than in the EU, depending on the sector and the percentage of skilled man power is higher than most of the developing countries. While blue-collar wages are still relatively low, white-collar salaries much below Western standards.

Turkey is in a more enviable position than many developed countries. According to the World Competitiveness Yearbook, Turkey scores 15 out of 49 in availability of skilled labor than most of its Eastern Competitors and even higher than Ireland, a country which has been attracting FDI on this basis There exists a highly educated managerial class and extremely dynamic entrepreneurial class which to establish co-operative ventures. With rapidly changing requirements on the labor markets and increasing integration into the world economy, the Turkish education system faces the challenges of increasing the share of academics and of providing tools to enable the workforce to adapt to life long learning. On the basis of availability of competent senior managers Turkey ranks 20th in the world and on the basis of experience in international business and postings abroad, ranked 19th ahead from Eastern European competitors. Moreover the Turkish labor force is one of the most productive and hardworking of any country in Europe. Turks work more days and longer hours (280 days per year and 9 hours per day). Turkey ranks 11th in the world for the average number of hours worked per year[121]

According to the results of the IMD survey, benchmarking quality of labor in Turkey is higher than her competitors, as it is previously stated Turkey has

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[120] ISO "Uluslararası Doğrudan Yatırımlar ve Türkiye Durum Tespiti ve Stratejik Plan" Ocak 2002 Istanbul
[121] IMD "World Competitiveness Year Book" 2001 and FIAS Report May 2002

highly educated managerial class than many countries in Europe but Hungary with its special position in engineering and IT employees has an imperative advantages compare to the other countries. Hungarian governments give priorities at their industrial policy to interlinking with foreign companies, domestic firms, and universities in order to improve R&D capacities and a large number of companies have shifted their development centers and R&D activities to Hungary.[122] The country also enjoys the benefits of having produced the highest per capita number of ten Nobel Prize winners.

Table 4.4

Benchmarking Quality of Labor of the Countries

IN THE COUNTRY	TURKEY	HUNGARY	POLAND	CZECH R.
Labor Regulations are flexible enough	11	5	17	19
Competent senior managers are available	8	31	40	46
Management has international experience	12	30	40	46
Qualified engineers are available	13	1	26	33
Qualified IT employees are available	12	2	16	31

Source: World Competitiveness Yearbook 2001

(The IMD surveyed 3,263 senior managers in 47 countries, rank out of 47 countries)*

One of the most important inputs provided by FDI is knowledge capital, managerial, engineering, financial, marketing, information services, and similar intermediate business services. In multinationals these services are centered in headquarters in the developed countries of origin. They require high levels of human capital and enjoy returns to scale (due, among others to their high information content), and this is the source of their comparative advantage in

[122] These include General Electric, General Motors/Opel, Nokia, Audi, Siemens, Flextronics, Philips, Ericsson, and more. GE Lighting decided to move its London-based regional centre, responsible for Europe, Middle-East & Africa, to Budapest in February 2002

developed countries. They have a very important positive impact on production and growth, through the agglomeration effect of their externalities[123].

Table 4.5

Region of Headquarters in Per cent

	North America	Western Europe	Asia Pacific Rim
Czech Republic	19	49	4
Hungary	15	34	4
Poland	16	47	12
Turkey	8	28	0

Source: Derived from Multilateral Investment Agency Report

According to Markusen, the business services included under knowledge capital, are not easily tradable, and therefore require FDI. They are non-tradable because their dissemination requires the physical presence of the people with the appropriate skills in the host country, in order to work closely with local people and to be able to keep intensive and meaningful interaction with the headquarters abroad. Much of the knowledge capital is tacit, disseminated through learning-by-doing and not through formal instruction or by instructions from abroad. The good quality of professional education and short qualification periods of the labor force represent an asset in competition for foreign direct investment.[124] According to the Foreign Direct Investment Report 2002 conducted by MIGA, Poland %26, the Czech Republic %28 Hungary %21 and Turkey with %13 listed by multinational companies according to their investment location interests in the worldwide. According to Investment Profile Hungary by European Bank of Reconstruction and Development (EBRD) as a total of 80 multinational companies have their regional headquarters in the country.

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[123] Keren M; Ofer G; "The role of FDI in trade and financial services in transition: What distinguishes transition economies from developing economies?" *Comparative Economic Studies*; Flushing; 2002

[124] Markusen, "Foreign Direct Investment in Services and the Domestic Market for Expertise". EBRD, Working Paper 7700, 2000.

4.2 INSTITUTIONAL ENVIRONMENT

Turkey at present has a laborious and inefficient registration process for the establishment of a company. Compared to other countries, procedures to set up a company are lengthy and the fastest it can take two and a half moths before business operations can start, compared to two weeks to one month on average in many Central and Eastern European Countries. According the survey of FIAS, about 20 per cent of management time is spent dealing with government regulations and administrative requirements compared to only 8 per cent in Central and Eastern Europe and 4 per cent in Latin America[125]. According to the Global Competitiveness Report of the World Economic Forum, bureaucratic "red tape" is pointed as one of the leading competitive disadvantages of the Turkish business environment. Turkey ranked 52nd among 59 countries for government bureaucracy and red tape and 49th for management time spent with government bureaucracy. In the same category, the Czech Republic ranked 14th, Hungary 26th place, as an overall ranking Turkey placed 55 out of 59 countries.

Table 4.6

Average Registration Days in Different Stages

	TURKEY (Days)	Competitor's Average* (Days)
Setting up a company	75	15
Buying real estate	725	90
Obtaining construction license and Preparations for construction	360	60

Source: FIAS Report "Turkey Diagnostic Study of FDI Enviroment"
(* Poland, Czech Republic, Hungary, Malaysia, Singapore)

125 The Opacity Index Price Water House Coopers January 2001

According to the FIAS Report, setting up a company takes 75 days on the other just 15 days among the competitor's average. Especially in obtaining construction license and preparations for construction is really lengthy process with 360 days compare with 60 days average of competitor countries. As it is mentioned study of Morisset and Neso in Chapter 2, the administrative costs faced by private investors in 32 developing countries analyzed, at the current practices 26 core administrative procedures that are generally required to set up and operate a business. According to the research in Turkey it requires the largest number of steps, up to 125 when the land is purchased from the state.

Table 4.7

Competitiveness among Red tape Efficiency in 2002

	Turkey	Hungary	Poland	Czech Republic
Legal Procedures	35	19	33	43
Bureaucracy	27	20	26	34
Time losses causes of bureaucracy	49	26	48	14

Source: Derived from World Economic Form, Competitiveness Report 2002

As it is given the table 4.7 Turkey's position in institutional measures don't consist huge gaps between her competitors despite the fact that Poland in three dimensions and the Czech Republic in two categories have similar ranking despite this reality Turkey is the one that always criticized as having the bureaucratic obstacles. In reality Poland's situation is not better than Turkey but still attracting three or four times more FDI inflows compare to Turkey. Another interesting fact seen from the table that although Czech Republic is the worst positions in *Legal procedures* and *Bureaucracy* criteria with 43rd and 34th respectively, in "Time *losses causes of bureaucracy*" measure get the best ranking with 14th, whereas Poland 48th, Czech Republic 26th and Turkey placed 49$^{th.}$

Table 4.8

Institutional Environment Ranking

IN THE COUNTRY	CZECH REPUBLIC	HUNGARY	POLAND	TURKEY
The public service is immune from political interference	38	29	24	35
Risk of political instability is very low	42	19	41	43
Bureaucracy doesn't hinder business development	34	20	26	27
Bribing and corruption doesn't exist	41	28	30	33
Competition laws don't prevent unfair competition	40	24	44	36
Justice fairly administrated in society	41	23	37	34
TOTAL	**236**	**143**	**202**	**208**
AVERAGE	**39.33**	**23.83**	**33.66**	**34.66**

Source: Derived from IMD World Competitiveness Yearbook 2002(ranking out of 47 countries)

When it is looked as the average of the three measures, Turkey has a very poor institutional environment when measure across 6 dimensions, Table 4.8 shows that Turkey ranked behind Hungary and Poland, from small proportion above of the Czech Republic and small proportion below Poland. According to the averages only Hungary has an important success in institutional environment. When it is looked to the overall average there aren't so many differences with the countries and accept than Hungary, the rest stood the bottom line of the rank out of 47 countries. These results also show the consistency with the World Competitiveness Report in which Hungary has better position than the others Turkey performs particularly badly in terms of political instability this can be basically because of ruling by 11 governments in the last decade. However, Poland has had 9 governments in the last eleven years which is also had the one of the lowest rank out of 47 countries, still successful in attracting FDI. This

supports the idea of the political instability is not a constraint to attracting FDI unless it prevents structural reform and reduces markedly policy certainty.

Corruption of bureaucrats and other people poses another problem during the locational process and reduces inward FDI as well as affects the choice of entry, joint venture versus wholly owned subsidiary. For instance, using firm-level data in Eastern Europe, it is found that corruption makes bureaucracy less transparent, thereby reducing the probability to invest and raising the value of a joint venture. Corruption can be both the cause and the consequence of high administrative barriers. Along the same lines, it can be argued the degree of political freedom affects the capacity of bureaucrats or incumbent enterprises to exploit rents derived from administrative procedures. According to the Progress Reports on candidate countries commonly it is stated that despite a number of important measures taken to fight against corruption, it remains an area of concern where recent efforts need to be reinforced in all three countries.[126]

According to the corruption index of the Global Competition Report; Czech Republic ranked as 45, Hungary 29, Poland 62 and Turkey take 75th place out of 80 countries. Between the competitors, Hungary had the best place with her score 25th out of 80, still can not be stated as success. According to the country credit rating, again Turkey's position seems depressive, Czech Republic ranked 30, Hungary 27, Poland 53 and Turkey placed 63.

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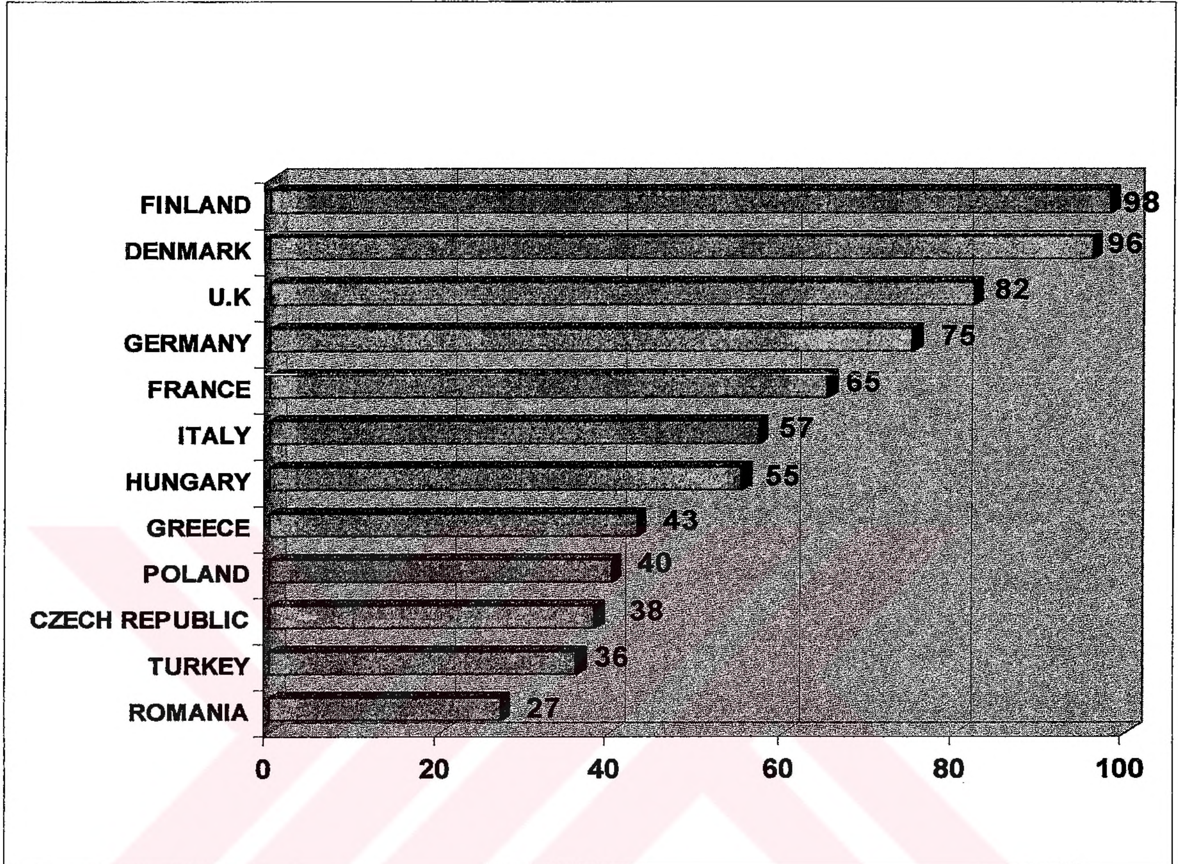
[126] In November 2000 the Czech Republic signed the Council of Europe Civil Law Convention on Corruption. The other major anti-corruption conventions have already been ratified. The Czech Republic continues to participate actively in the monitoring of anti-corruption measures adopted by the OECD working group on bribery in international commercial transactions.

Table 4.9

Corruption Index 2001



Source: Corruption Perception Index 2001

4.3 INFRASTRUCTURE AND TECHNICAL DEVELOPMENTS

According to the report conducted by Foreign Investments Commission of Turkish Industrialists and Businessmen's Association (TUSIAD), Turkey's infrastructure needs to be upgraded. Report stated that contrary to Poland and Hungary electricity is expensive and in short supply in Turkey. Unfortunately Turkish electricity generating capacity per capita is less than half of Poland and Hungary. The ratio of paved roads to the total road network in Turkey is about one third of the ratio of Poland. Railroads are poor in condition and the capacity of seaport is limited. Turkey's budget allocation for investment was mere %5 in 2000. This share was reduced far because of the tight budget measures. Turkey's aggregate investment (public and private) per capita US$ 800, is %18 less than Poland and %39 lower than Hungary.[127]

Table 4.10

Competitiveness Input Factors: Infrastructure

	2002	2001	2000	1999	1998
Czech Republic	27	32	39	34	36
Hungary	32	27	25	25	29
Poland	48	48	40	42	45
Turkey	39	35	33	31	31

Source: World Competitiveness Year Book 2002

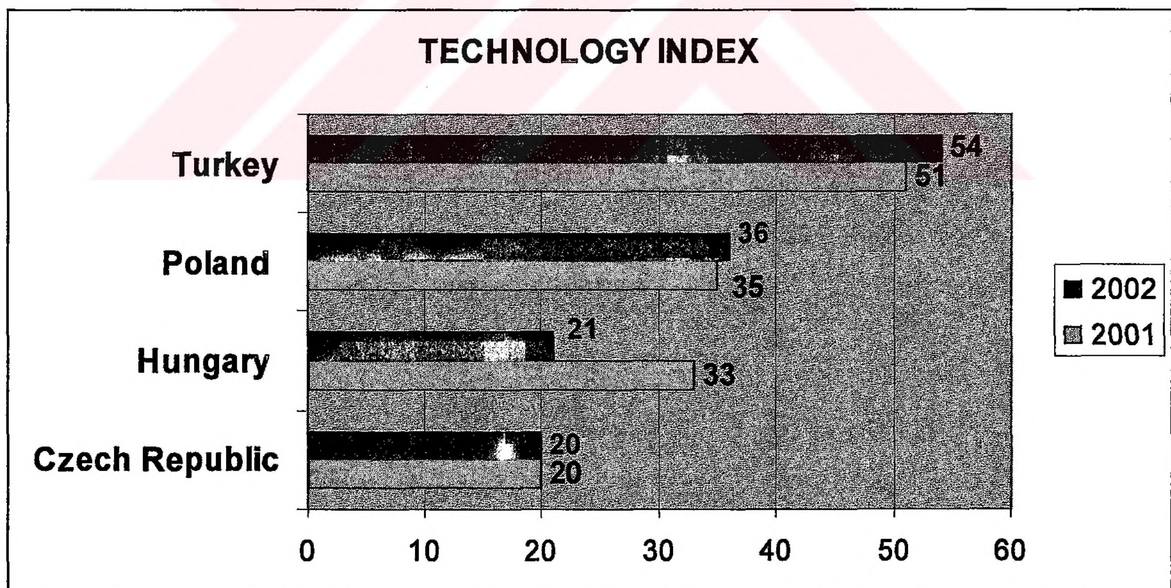
According to the Competitiveness Report, based on the infrastructure factor, Turkey placed between 39 and 31 during the last five years out of 75 countries. According to the calculations Czech Republic made an improvement by the years and Poland has the worst situation among the four countries. In fact

[127] Insight YASED Volume: 3 Issue:1 July 2001 Istanbul

there aren't so many big differences between the ranges in the category of infrastructure.

According to the 2002 Regular Report Turkey's infrastructure is characterized by a rather well developed road network, in particular in the industrial core areas in the western part of the country. The railway network, on the other hand, is worn out and urgently needs to be improved. Turkey's railway company is a state monopoly and represents a major budgetary burden. The length of motorway has increased by 20% during the last 5 years, while the length of the railway network has remained much the same. The energy distribution network has a considerable energy saving potential. Other infrastructure facilities, such as gas and oil pipelines, have been extended in recent years.[128]

Table 4.11
Technology Index



Source: World Competitiveness Yearbook 2002

[128] "2002 Regular Report on Turkey's Progress Towards Accession" *Commission of the European Communities* 10/2002

Turkey must improve the infrastructure such as the expansion of the network of roads and highways; the establishment of a reliable supply of energy and water; and the development of an extensive telecommunication network that provides cheap and reliable service. According to the technology index of World Competitiveness Report, Turkey stood behind her competitors, as it is given in the table. Czech Republic has been standing the highest score among the four countries both in both 2001 and 2002 with the place of 20, at the world ranking.

4.4 PROMOTION ACTIVITIES

Developing countries are becoming more interested in increasing the inflow of FDI and are taking steps to encourage new flows, including the establishment of their own investment promotion programs. A number of countries are taking steps to improve their investment promotion programs. Hungary and Poland are very well-know countries with their promotion programs and at present Turkey doesn't have a single entity that effectively conducts a targeted investment promotion effort to increase the flow of investment. Turkey needs to develop a comprehensive investment promotion strategy, involving an institution and staff. Turkish government indicated plans to establish a Foreign Investment Promotion Agency as a step towards promoting the country as an investor destination however no concrete progress can be reported yet.

There is no doubt that no unique implementation of the all possible policies or a single best practice FDI strategy for the countries. Velved stated in his research that each country should focus on its own structure while planning the strategies for attracting the foreign capital, by examining the profile of the country right promotion program and strategies can be found. He pointed the fact that the FDI strategy, within which FDI policies are framed, depends partly on preconditions for instance a large country with few local capacities and weak trading infrastructure is unlikely to benefit significantly from attracting high-tech FDI. A small country with no natural resources near a large market is more likely to benefit from export-intensive FDI. Countries with sufficient government resources and bear the risk of developing key sectors, spending on FDI promotion and preparing industrial estates, while those without many want to develop local capabilities first.[129] A cursory looked through the each investment agencies; would give the idea of how beneficial the implementation of promotion program for attracting the foreign direct investment.

[129] Velde W. "Policies Towards Foreign Direct Investment in Developing Countries: Emerging Best Practices and Outstanding Issues" Overseas Development Institute London March 2001

4.4.1 Czcehlnvest

The Ministry of Industry and Trade set up Czechlnvest national investment agency of the Czech Republic in November 1992 as to assist foreign investors in establishing or expanding manufacturing operations throughout the country. Czech Invest has facilitated 201 investment projects during its 10-year existence in the Czech Republic. As of October 31, 2002, these companies have undertaken to invest a total of 6.608 billion USD Investors from Germany (24%) and Japan (21%), particularly companies from the automotive industry (48 %) and the sector of electronics - electrical engineering sector (21 %). The agency for foreign direct investment, mediated 64 new investment projects in the Czech Republic in 2002, which represent investment worth $1.041 billion. With its sucessful history as a promotion agency Czech Invest was awarded by Corporate Location magazine, as the "European Investment Promotion Agency of the Year 2000".

On national level the agency, provides information services and assistance to investors from the industrial sector embarking on greenfield and joint venture projects. On behalf investors, agency process incentive applications, provides sector specific data, identifies sites, production facilities, contracts with national and local institutions. The agency plans to include in the near future into its activities service sector projects in the areas of shared services, call centers, software development, R&D design centers and advanced distribution centers.[130]

To convince potential foreign investors to locate in the Czech Republic, the agency introduced its Supplier Development Program in 1999, designed to improve links between Czech supplier of components and services and foreign affiliates operating in the Czech Republic. It had three objectives: to promote modern industrial technology, to heed environmental protection considerations and to raise qualifications of the local labor forces. In January 2001, the Supplier

[130] OECD Country Reviews "Foreign Direct Investment Czech Republic 2001"

Development Program introduced a new "Twining Program" co-funded by the EU and the Government of the Czech Republic.

This two-year subprogram focuses specifically on the electronics and electro-technical industry. If the program proves to be successful, the Supplier Development Program is expected to extend its coverage to other industries for the 2003-2005 periods. The Government of the Czech Republic had financed the operational costs of the program, which is about $3 million for a three year period, with co-funding from the EU's Phare program. The government plans to continue the Supplier Development Program during the EU accession negotiations and expects that it would subsequently qualify for the EU's Structural Fund program.[131]

4.4.2 The Hungarian Investment and Trade Development Agency

According to the OECD Country Review on Hungary, investment promotion stated as the prominent element of the economic development strategy of the economic development strategy of the Hungarian government. Objectives include the achievement of a lasting investment ratio 20 to 25 per cent support of R&D activities, development of supplier networks, and the strenthgening the spillover effect from FDI on general economic performance of the country. At government level, investment promotion falls primarily under the responsibility of the Ministry of Economic Affairs.[132]

Apart from undertaking the necessary coordinating and regulatory functions the Ministry of Economic Affairs puts a special emphasis on meeting the information demands of potential investors and in 1993, Hungarian Investment and Trade Development Agency (ITDH) established in 1993. Agency has been jointly supervised by the Ministry of Economic Affairs, and the Ministry of Foreign Affairs. As a local point agency for developing investment and trade in Hungary,

[131] World Investment Report 2001 p189
[132] OECD Reviews of Foreign Direct Investment Hungary 2000

ITDH operates 32 trade service offices and 10 representative offices in 28 countries, as well as 13 regional offices spread all over Hungary which assist the Budapest-based headquarters in serving foreign and domestic clients.

The services provided by the ITDH staff to promote investments include:

- Providing information on Hungary's general legal, taxation, and financial environment,
- Searching for business partners and trading partners and match-making,
- Identification of industrial sites for greenfield and brownfield investments in Hungary, with special regard to the industrial parks operating in the country,
- Coordination of regional projects.

ITDH organizes communications and "Public Relation" events both in Hungary and overseas. It issues and disseminates numerous publications in foreign languages. As a result of their efforts, a total of USD 808 million worth of investments were committed last year alone. In 2001, ITDH organized 305 professional events, of which 225 were related to trade promotion, and 80 to investment promotion, two thirds of the sum abroad and the rest in Hungary.

The types of events include designated partner searches, product shows, business seminars, domestic regional professional events, trade and investment promotional conferences, and exhibitions. With the help of ITDH, production worth approximately USD 461.4 million was started in 2002, which established more than 10 thousand new workplaces. Apart from traditional Hungarian export items, in order to help Hungarian small and medium-size businesses find market, the government promotes the vehicle industry, electronics, informatics, engineering and metallurgical industry, and the Hungarian innovative capacity.

4.4.3 Polish Agency for Foreign Investment: PAIZ

More than $61.6 billion of foreign capital has been invested in Poland since the political and economic reforms started in 1989. A significant part of this impressive amount is due to the efforts of Polish Agency for Foreign Investment (PAIZ). PAIZ was established in 1992 to promote Poland's investment opportunities and to encourage foreign companies to choose Poland as their preferred investment location. At the 8th Annual Convention of Investment Promotion Agencies held in Chicago in September 1997 PAIZ received the title of the European Investment Promotion Agency of the Year. The Agency is a joint stock company, wholly owned by the State Treasury and helps businesses considering investment in Poland by:

- providing information, advice and guidance to foreign investors;
- facilitating the initial stages of their investment process;
- providing legal, technical and financial information;
- assisting foreign investors in identifying potential business partners; and
- maintaining a link between foreign investors and appropriate government and local authorities.

PAIZ's role is that of an intermediary serving individual and corporate foreign investors. By maintaining an on-going dialogue with the Polish authorities PAIZ aims to improve the local environment for foreign investment, and ensure that potential investors have access to key players in the Polish market. In 2001 PAIZ completed 115 projects in cooperation with or on behalf of foreign investors who started their activities in Poland. The partners created over 3200 jobs that year and the total value of their financial engagement amounted to $500 million.[133]

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[133] For more detailed information see www.paiz.org.pl

CONCULUSION

There is no doubt that FDI is one of the most significant factors leading to the globalization the international economy. The rapid and interrupted expansion of international direct investment over the decades is part of a long-term trend towards increasing economic integration of the world economy, by contributing to build strong economic links between industrialized countries and developing countries. Industrial countries recognize the increasing importance of international business and the need for domestic firms to be competitive in the international economy. Thus, many industrial countries are looking with increased favor on foreign direct investment. Through their international presence, multinational enterprises lower the transactions cost involved in international business and help top channel goods, services, capital, labor and technology worldwide, when appropriate trade and active competition policies are in place. In developing countries and transition economies FDI is seen as a source of economic development and modernization, income growth and employment.

The steady expansion of FDI flows has been driven by several inter-related factors; rapid technological change, trade and investment liberalization at a national, regional, global level, privatization, deregulation, demonopolization and the switch in emphasis by firms away from product diversification towards a more balanced geographical distribution of production and sales. Although the net benefits from FDI do not occur automatically, and their magnitude differs according to host country and context, FDI has the potential to bring social and environmental benefits to host economies through the dissemination of good practices and technologies within MNEs, and through their subsequent spillovers to domestic enterprises.

FDI might also lead to undesirable outcomes such as rising inequality between (groups of) individuals or regions, direct or indirect crowding-out of local capabilities or an erosion of the tax base or labor and environmental standards.

There are abundant believers emphasize that corporations move operations freely around the world, escaping through pollution control laws, labor standards, and even the taxes that pay for social and environmental needs. These issues relating to who and what gains from FDI within the societies can be the subject of further studies. The factors that hold back the full benefits of FDI in some developing countries can be listed as; the level of general education and health, the technological and infrastructure level, insufficient openness to trade, weak competition and inadequate regulatory frameworks.

As the countries are becoming more interested in the inflow of FDI and taking steps to encourage new flows, protectionist policies are disappearing. Countries are almost forced to be more open towards foreign investment; the emerging environment implies that it is difficult to build up an industrial capacity behind closed door. By relaxing rules regarding market entry and foreign ownership, improving the standards of treatment to foreign firms, and improving the functioning of markets, they liberalize their national policies. In the global standpoint Multilateral Agreement on Investment (MAI), although couldn't came into force, was one of the most important actions towards eliminating barriers in front of the foreign capital movements. On the other side the growing number of the demand for foreign capital might bring a new start for negotiations in the near future.

Although the rapid expansion of FDI makes it "the main force in international economic integration", the limited share of FDI that goes to developing countries is spread very unevenly. The arming feature is the widening gap between the developing countries, with the top five countries received 55% of all developing country inflows in 1990s and the 48 least developed countries received less than 1% in the same period. The *Triad* -Japan, the European Union and the United States- has long accounted for the bulk of international production, providing and receiving most of the global. The 30 largest host countries account for more 95% of the total world inflows and 90% of the total

world FDI stocks, while 30 home countries, mainly industrialized countries, generate around 99% of outwards flows and stocks.

Global competition for attracting foreign investment is such that potential investors invariably face a number of attractive options for any new project, and they will tend to locate where the policy environment is most attractive and where the investments are welcomed and facilitated. Simply opening an economy is often no longer enough to attract sustained inflows of FDI an upgrade its quality, most foreign investors prefer open and unrestricted policies. Therefore governments are moving to more simple, transparent and automatic investment policies that offer special financial and fiscal incentives to governments through offering discretionary grants to multinationals and tax holidays or special tax rates on business profits in host countries and on dividends payment to home countries. Host countries ability to provide the complementary skills, infrastructure, suppliers and institutions to operate technologies efficiently and flexibly is on the check list of the locational decision.

Although the availability of location-bound resources or assets such as the size of markets for goods and services, and the cost advantages in production are still important factors, according to the World Investment Report the new driver skills are, technological capabilities, supply networks, good logistics and support institutions and their developments becomes a key for attracting international production. The experiences of successful countries in winning the increased share of FDI showed that governments that are seeking to increase inflows of investment need to reform investment policy to ease the difficulties foreign investors face in establishing new projects and to establish an investment promotion to formulate and implement an investment promotion strategy that suits the requirements advantages and resources of the country.

When it is looked at Turkey, country has been pursuing liberal and outward-oriented economic policies since the beginning of '80s. Accordingly, on paper, Turkey has one of the most liberal investment regimes of the OECD. Almost all

areas open to the Turkish private sector are also fully open to foreign participation and investment. Foreign investors can freely move capital goods, capital profits, and dividends in and out of the country, and have the same rights, exemptions, and privileges as Turkish investors. The cumulative FDI until 1980 was only $228 million, since the middle of 1980s, foreign investors had been taking an increasingly prominent role in the Turkish economy as the recent liberal foreign investment and privatization policies began to show their results.

Although Turkey used to rank around 20's during the early 1990, yet it failed to hold on to this volume of FDI inflows and started downgrading in the world rankings to 40's and in 2000s unfortunately fall to the 70's. Turkey couldn't benefit from its advantageous position she had obtained at the beginning of 90s and during the recent years, annual inflows of FDI remained below 0.5% of GDP, which is significantly below her potential. Turkey with her domestic market of around 68 million people, proximity to the huge markets of Europe, the Middle East and North Africa, low labor costs, a well-educated managerial class, should have more foreign investment flows than it takes. Whereas Turkey has attracted a total FDI of around USD 17 billion in the last 50 years, some countries attract 4 to 5 fold of this amount annually. Based on international ranking, Turkey is the country whose gap between actual and potential FDI inflows in the largest. Countries like Romania, Bolivia, Columbia, Nigeria, Egypt, and Malta ranked higher than Turkey; that gives a general idea of Turkey's position in FDI inflow.

Economic and political stability sighted as the prerequisite for attracting FDI inflows into the host countries. Steady economic growth and exchange rate and low level of inflation are the basic macroeconomic determinants; Turkey's performance has been characterized by high volatility and a low average growth rate in the recent years. A severe banking and currency crisis in late 2000 and early 2001 caused the collapse of three-year exchange rate based stabilization program only 14 months after its launch. Following the crisis, the deepest recession occurred since World War II. By the first quarter of 2002, a recovery had begun and continued in the second half. The downward trend in inflation

which started in late 2000 consistently surprised the markets by its steepness. By the application of short-term oriented economic policies of coalition governments and lack of applying the political will, resulted postponing the structural reforms. Turkey needs to continue reform process in order to achieve macroeconomic stability and fiscal sustainability. With frequently changing coalition governments, Turkey ruled by populist policies. After the election in 2002, it seems that political stability sustained at least ruling by a single party government. To have the enough proportion to pass necessary laws through the parliament, it is expected from the government to apply regulatory changes in administrative barriers.

Turkish bureaucracy with its slow action and cumbersome mechanism, changing rules and lack of transparency creates uncertain environment and administrative barriers are having dampening effect on competitiveness in Turkey. According to the Global Competitiveness Report, bureaucratic red-tape is one of the leading competitiveness disadvantages of Turkish business environment. Turkey placed 52nd among 59 countries for government bureaucracy and red-tape, and 49th for management time spent with the bureaucracy in the same category Czech Republic ranked 14th, Hungary 26th. According to the FIAS report on "Administrative Barriers to Investment" to get approval for business involves 19 different steps and average time to accomplish this is approximately 3 months which is a very lengthy and cost effective process to obtain investment licenses. According to the report 20% of management time is spent dealing with government regulations and administrative requirements, compare to only 8% in Central and Eastern Europe.

On the other side Czech Republic, Hungary and Poland also had many steps coming to their position in the world today. They were succeeding in rapidly curing the past after the collapse of the eastern bloc in 1989. FDI flows to the region were very small, less than 0.1% of the world total and represented a very small proportion of total flows for developing countries at the beginning of 1990s. With opening of Central European economies to the world, FDI had become an

important mechanism of their integration into the world economy. Unsatisfied demand for consumer goods and services, a legacy of control planning which was strongly biased against services and consumer products, and the privatization of the state owned enterprises can be counted as the two notable factors for entrance of the foreign investors.

During the transition period each country had its own type of development process. Poland with the highest population in the region had to face with more problems than the others. Before opening to the world economy they had different degree of welcoming to the foreign investors but could not compare with any liberalized economy. As all other Soviet-oriented countries they had a centrally planed economic system and under the communist regime foreign equity could not exceed 50% of the capital.

In the Czech Republic, the door to foreign direct investment was not opened until 1986 when regulations were issued permitting the establishment of joint venture, however foreign capital stock could not exceed 49% and majority holding had to be retained by Czechoslovak enterprises. In Poland the door to foreign direct investment was first opened by a government decree of 1976 which permitted the establishment of small business by foreign nationals of Polish extraction. According to PAIZ calculations, foreign companies invested in Poland 7,146.6 million dollars in 2001 and the foreign capital invested in 1990-2001 exceed the amount of 61.6 billion dollars. The Czech Republic has attracted almost 20 billion dollars in FDI between 1989 and 2000 and about half of which was invested during the last two years.

In Hungary investment opportunities came more gradually for larger multinational companies, initially through exports, and then progressively through the privatization of the state owned enterprises and greenfield investments Hungary privatized a bigger share of its economy than any other OECD country. Inward investment amounted to about US$ 2 billion on average annually over the period

1990 and 1999 and foreign owned companies now account for more than one third of GDP and 30 % of private sector employment in the country.

Hungary, Poland and the Czech Republic are not only received far greater inflows in FDI in absolute magnitude, but from five to ten times as much as Turkey in relation their economic size. According to "Direct Investment Index" of World Investment Report 2002, Turkey ranked 123rd, whereas Czech Republic placed 13th, Poland 38th and Hungary was in 49th place out of 137 countries. When it is looked through the major indicators that affect the foreign investment flows Turkey is not far away from her competitors and has comparative advantages with her huge market size and young population.

According to the demographic studies Turkey will have a younger productive population for years to come. If the new entrants to the workforce are educated, this will give Turkish economy much needed flexibility over the next decades. Eastern European countries do not show this particular demographic pattern. Their economic growth will come entirely from a shift in the aging labor force to more productive areas. Turkey offers a highly educated managerial class and extremely dynamic entrepreneurial class which to establish cooperative ventures, on the basis of availability of competent senior managers Turkey ranked 20th in the world and on 19th on the basis of experience in international business and postings abroad.

Most foreign investors agree that Turkish labor is very cost-effective and it is one of the most productive and hardworking of any country in Europe, they ranked 11th in the world for the average number of hours worked per year with 280 days per year and 9 hours per day. On the other hand Hungary with its special position in engineering and IT employees has an imperative advantages compare to other countries. Hungarian governments give priorities at their industrial policy to interlinking with foreign companies, domestic firms and universities in order to improve R&D capacities, consequence of these efforts and a large number of companies have shifted their development centers and R&D activities in Hungary.

As in the case of infrastructure and technological developments, Turkey's infrastructure needs to be upgraded, Turkish electricity is expensive and in short supply and electricity generating capacity per capita is less than half of Poland and Hungary. The ratio of paved roads to the total road network in Turkey is about on third of the ratio of Poland, on the other hand the railway and network, is worn out and urgently needs to be improved.

"CzechInvest", "the Hungarian Investment and Trade Development Agency" and "Polish Agency for Foreign Investment" are working as a promotion agency and assisting foreign investors through their countries by providing legal, technical, and financial information. Agencies are also developing projects to convince potential foreign investors, maintaining a link between foreign investors and government and local authorities. They are also supporting the R&D activities, development of supplier network and strengthening the spillover effect from FDI on general economic performance of the economy.

While analyzing the evolution of FDI in the selected countries, it is observed that both in the transition and pre-accession periods, EU governments effectively supported foreign investment by insuring the Western companies with state banks or public financial institutions that want to make investment into the region and assisting them during the decision making process. For the sake of the political and economic interests, by diverting the foreign investors from other regions, they increased the inflow of direct and portfolio investments into those countries.

It is certain that enlargement process creates a new set of motives in favor in investment in Eastern Europe over other global locations; it reduces risk by quarantining a certain level of political and macroeconomic stability and accession will over time change the quality of investment. However there is a widening gap between FDI receipts to the front-runners and back-markers among the applicants. Hungary, Czech Republic and Poland are already attracting the

major share of FDI in the region and the prospect of their joining the EU first will further widen economic disparities. The EU has to consider its role as a development agency after enlargement, as the countries on its periphery are likely to experience widening gaps with their neighbors.

By reducing the risk foreign investors face with and improving the countries' business climate, EU reduces the fair competition to attract EU-oriented FDI. Although Turkey has many advantages, because of its special position compare to other applicants not only for long accession and waiting process that its entrance block made by EU for many decades, could not get the FDI inflows that normally should come during the pre-accession period. Moreover having Custom Union with EU did not affect the foreign direct investment inflows as it was expected and caused a big disappointment. The political attitudes of EU bring to mind the question that if EU wants to accept Turkey as a member in the next decades or still continue to block her entrance. It is obvious that foreign investors can not see Turkey as future member state instead of building the investment in Turkey they prefer countries somehow have the similar properties.

Consequently Turkey should need to meet the requirements to join the EU, obtaining some criteria and having some steps in the negotiations therefore will be helpful to remove the physiological barriers in front of the foreign investors. Turkey also can not take advantages of custom unions without attracting more FDI into the country. The EU on the other hand, will to consider additional measures to help countries that can not join for many years, not only Turkey but also Bulgaria and Romania in the future in order to eliminate the gap. In the longer term, a more comprehensive development policy will be needed if the union is to be effective in encouraging the economic development of all candidate membership. There is no doubt that their joining to the EU will further widen the economic disparities between Turkey and the selected countries.

As it is observed, Turkey have many advantageous compare to selected countries but the economic and social structure of the countries show big

disparities so that making a healthy comparison is very difficult. Rather than the candidacy to EU, proximity to the European market and having the cheap labor force, those countries don't have much in common and after the membership of the selected countries differences will be diversified. To a certain extent they still will be competitors for Turkey but main competitors of the country would be Bulgaria and Romania for EU-oriented FDI.

According to the study, there are two important results come on the surface for improving the situation to attract foreign direct investment in Turkey. It is certainly true that the bureaucratic habits are hard to break without a strong commitment from the highest political level. The overall objective needs to be streamlined the current procedure and to eliminate all requirements to a point at which only the really necessary authorities are involved and only the justified documents are requested. This does require serious administrative reform to centralize the system and decrease the number of involved bodies to a minimum level. Keeping one central organization in charge of the main registration process instead of many sequential steps will also be helpful. The Government undoubtedly has the power the pass the necessary law and to establish the new regulations that are eliminating the all duplicative procedures.

Government should immediately take steps towards promoting the country as an investor destination by the establishment of a focused and pro-active "Foreign Investment Promotion Agency" that can enhance the marketing of the country and develop a better image in the eyes of international investors. The promotion institute should be organized according to the international best practices and the best suits for Turkish promotional needs and it should be established as the local point to advocate improvements in FDI environment. Universities should more concentrate on the academic studies that would help to develop an effective strategy to attract FDI by recognition of strengthen and weakness of the business environment and motivating factors behind the investment decision in Turkey.

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www.itd.hu The Hungarian Investment and Trade Development Agency

www.ipa.net Investment Promotion Agency

www.mfa.gov.tr Ministry of Foreign Affairs

www.miga.org Multilateral Investment Guarantee Agency

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www.unido.org United Nations Industrial Development Organization

www.waipa.org World Association of Investment Promotion Agency

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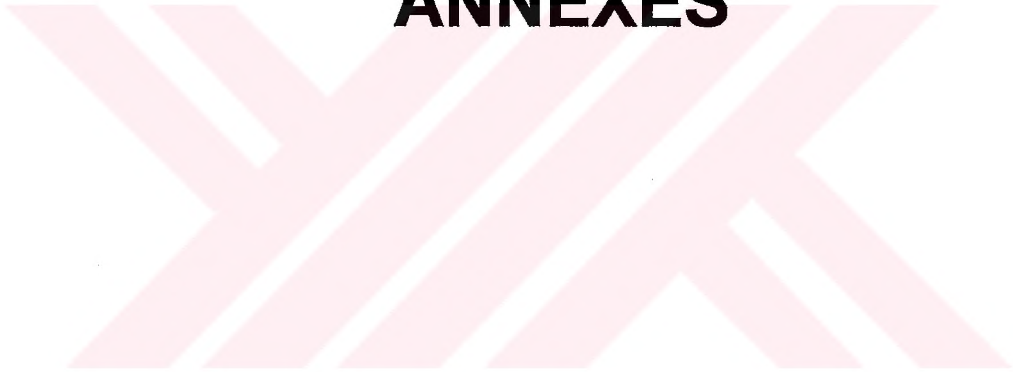
ANNEXES



ANNEX I: FDI inflows in Selected Countries between 1990-2001

	COUNTRY	1990- 1995	1999	2000	2001
1	USA	40.8	283.3	300.9	124.4
2	CHINA	24.2	64.9	102.7	69.6
3	UK	17.4	87.9	116.5	53.7
4	FRANCE	16.2	47.0	42.9	52.6
5	BELGIUM	9.7	133,0	245,5	50.9
6	HOLLAND	8.0	41.2	52.4	50.4
7	GERMANY	4.1	54.7	195.1	31.8
8	CANADA	6.2	24.4	66.6	27.4
9	MEXICO	8.08	12.5	14.7	24.7
10	BRASIL	2.0	28.5	32.7	22.4
11	SPAIN	10.7	15.7	37.5	21,7
16	IRELAND	1.1	14.9	24.1	9.7
17	POLAND	1.3	7.2	9.3	8.8
20	S. AFRICA	0.3	1.5	0.8	6.6
22	PORTUGAL	1.7	1.2	6.4	6.0
25	CZECH REP.	0.9	6.3	4.9	4.9
28	TAILAND	1.9	3.5	2.8	3.7
31	INDIA	0.7	2.3	2.3	3.4
32	**TURKEY**	**0.7**	**0.7**	**0.9**	**3.2**
34	ARGANTINA	3.4	24.1	11.1	3.1
39	MOROCCO	0.4	0.8	0.2	2.6
40	RUSSIAN F.	1.1	3.3	2.7	2.6
41	HUNGARY	1.8	1.9	1.6	2.4
46	GREECE	1.0	0.5	1.0	1,5
47	SLOVAKIA	0.1	0.3	2.0	1.4

Source: UNCTAD, World Investment Report 2002

ANNEX II: FDI IN TURKEY BY YEARS

Years	Number of Foreign Capital Firms Cumulative	Foreign Capital Permits (Million $)	Amounts of Actual Investment (Million $)	Amount of Cumulative Investment (Million $)
1980	78	97	35	35
1981	109	337	141	176
1982	147	167	103	279
1983	166	102	87	366
1984	235	271	162	528
1985	408	234	158	686
1986	619	364	170	856
1987	836	655	239	1095
1988	1172	820	488	1583
1989	1525	1511	855	2438
1990	1856	1861	1005	3443
1991	2123	1967	1041	4484
1992	2330	1820	1242	5726
1993	2554	2063	1016	6742
1994	2830	1477	830	7572
1995	3161	2938	1127	8699
1996	3582	3835	964	9663
1997	4068	1678	1032	10695
1998	4533	1647	976	11671
1999	4950	1700	817	12488
2000	5328	3060	1719	14207
2001	5841	2738	3044	17251

ANNEX III: FDI FLOWS FROM EU COUNTRIES TO TURKEY in 2001

EUROPEAN UNION	No. of firms	Present foreign capital	% in total foreign capital	Total capital of the companies	% of foreign capital in total capital
Germany	1,013	420,501,194	10,75	561,405,721	74,9
Austria	100	7,838,835	0,2	36,247,868	21,63
Belgium	75	46,802,711	1,2	53,409,741	87,63
Denmark	47	22,753,246	0,58	34,295,120	66,35
Finland	20	1,952,431	0,05	3,031,414	64,41
France	264	317,503,198	8,12	571,112,750	55,59
Netherlands	419	1,134,127,471	29	1,744,757,070	65
UK	366	389,999,287	9,97	602,417,831	64,74
Ireland	26	9,633,926	0,25	14,931,897	64,52
Spain	43	42,156,242	1,08	45,072,481	93,53
Sweden	50	48,661,181	1,24	50,034,844	97,25
Italy	219	95,008,196	2,43	186,963,175	50,82
Luxemburg	51	110,136,752	2,82	132,740,634	82,97
Portugal	5	111,775	0	125,283	89,22
Greece	58	6,355,042	0,16	12,637,866	50,29
EUROPEAN UNION – TOTAL	***2,756***	***2,653,541,487***	***67.87***	***4,049,183,695***	***65.53***

Source: Treasury,GDFI

ANNEX IV: FOREIGN INVESTMENT LEGISLATION IN TURKEY

National Treatment Principle: Upon receiving the permissions within the scope of Law No: 6224, the firms and branch offices established according to Turkish Commercial Code and registered to Turkish Trade Registry are considered as Turkish firms and branch offices.

Field of Activity: Real persons and legal entities residing abroad may engage in all types of industrial, commercial, agricultural and other fields aimed at the production of goods and services, which are also open to Turkish private sector.

Form of Capital: Foreign capital to be brought in Turkey can be in the form of; Capital in cash in the form of convertible foreign currency bought and sold by Central Bank of Turkey. Machinery, equipment, tools and similar goods approved by Undersecretariat of Treasury (UT), General Directorate of Foreign Investments (GDFI) Assets and receivables of foreign nationals under Foreign Exchange Legislation approved by GDFI Intellectual property such as patent rights and trade marks approved by GDFI

Minimum Capital Requirement: Real and legal persons resident abroad must bring a minimum 50.000 - USA Dollars per person to establish corporations, become partners in existing companies and opening branch offices. In the case that the number of foreign shareholders is above one, the participation amounts of foreign partners in total capital can be arranged freely. If it is requested, the foreign exchanges transferred from abroad, without being converted into Turkish Liras, can be kept in Banks at the foreign exchange deposit accounts to be opened in the name of the company to be established or the shareholders who transfers his/her shares or the company, which increases its capital and, can be paid to the beneficiary as foreign partner's capital share.

Participation Ratios: No limitation in participation of foreign capital, a company can be 100% foreign owned except broadcasting where the equity participant ratio of foreign shareholders is restricted to 20 % and aviation, maritime transportation and ports where the equity participation of foreign shareholders is restricted to 49% free transfer of profits, fees and royalties and repatriation of capital in the event of liquidation or sale are also guaranteed.

Forms of Companies: Real persons and legal entities residing abroad can establish a joint-stock company (minimum 5 partners), limited liability company (minimum 2 partners), or branches in compliance with the Turkish Commercial Code for the purpose of making investments and carrying out commercial activities in Turkey. They can also establish liaison offices, which cannot carry out commercial activities and must be funded by the parent company abroad.

Participations: Real persons and legal entities residing abroad shall apply to GDFI to purchase shares from existing companies in Turkey. In transfer of shares, the value of shares is freely determined between the parties within the prevailing market conditions. The transfers of shares between the foreign shareholders are realized freely without authorization.

License, Know-How, Technical Assistance, Management and Franchising Agreements: Public and private sector enterprises shall apply to the GDFI for the registration of license, know-how, technical assistance, management and franchising agreements to be made with persons and legal entities residing abroad. These agreements shall become effective only after the registration by GDFI.

Capital Increases: In case the existing foreign capital companies wish to increase their capital; if the participation ratios between the foreign and local partner do not change, application shall directly be made to the Ministry of Industry and Trade without a need for further permission from GDFI.

Transfer of Profits, Dividends and Capital Shares: Following the deduction of the taxes in accordance with the current tax laws from the profits and dividends, corresponding to the shares of foreign shareholders of foreign capital entities, the net amount can be transferred abroad via banks freely. In the case that shares of foreign shareholder of enterprises with foreign capital are either partially or wholly sold to the persons and legal entities resident in Turkey, the amounts received or liquidized in case of liquidation, will be transferred through banks concerned, provided that the permission for sale or liquidation is obtained from GDFI. **Source: Treasury, GDFI**

ANNEX V: The European Union's recommendation on Company Registration Procedure

Throughout the European Union, the procedural requirements for forming a business entity are undergoing changes. The trend in corporate law of individual EU Member States is towards removing administrative burdens through greater operational efficiency.

The European Union has recommended to its Member States several proposals for simplifying the registration aspect of starting a new business, which is outlined in the Commission Recommendation on Improving and Simplifying the Business Environment for Business Start ups. Recommendations include:

1) Introduce a single business registration form

2) Set up a single contact point where business can register

3) Institute a single business identification number system

4) Take a measure to eliminate duplicate or superfluous forms and/or contact points

5) Allow business to reject requests for duplicate information field with other government agencies

6) Set deadlines for processing request and granting licenses or authorizations;

7) introduce a system whereby an application is deemed to be approved if the administration does not meet its deadline;

8) Utilize information technology and databases to share information among government agencies.

These recommendations give a clear indication of the tendency towards simplification of the registration process for enterprises in Europe. Many Member States have taken numerous measures to improve the interface between administration and business community.

ANNEX VI: Cumulative value of foreign investments in Poland by countries of origin of the capital as of June 30th 2002.

No	Country	Capital Invested (USD million)	Investment Plans (USD million)	Number of companies
1	France	11,503.0	1,975.5	89
2	USA	7,985.2	2,389.0	126
3	Germany	7,444.57	1,290.86	212
4	The Netherlands	4,976.05	563,7	76
5	Italy	3,701.1	1,272.7	61
6	Great Britain	2,899.1	349.5	40
7	International	2,803.3	913.5	18
8	Sweden	2,653.7	963.8	57
9	Belgium	1,649.05	127.0	23
10	Korea	1,621.8	20.0	4
11	Denmark	1,331.0	241.5	38
12	Russia	1,286.4	301.0	2
13	Ireland	1,039.7	N/A	2
14	Cyprus	911,7	175.0	1
15	Switzerland	904,7	338.5	21
16	Austria	843,4	79.2	41
17	Norway	599,3	173.9	14
18	Japan	598,7	111.0	13
19	Spain	536,2	N/A	9
20	Greece	501,5	4.0	2
21	Portugal	493,1	66.6	4
22	Finland	424,4	122.8	19
Investments over USD 1 million		**57,610.3**	**12,323.3**	**920**
Estimated investments under USD 1 million		**3,990.1**		
Total		**61,600.4**		

ANNEX VII: Cumulative value of FDI in Poland by sectors in 2002

European Classification Activities	Capital invested (USD million)	Investment Plans (USD million)
Manufacturing	**23,300.2**	**5,184.3**
Food processing	5,932.7	619.2
Transport equipment	5,517.1	827.7
Other non-metal goods	3,241.2	861.5
Pulp and paper & publishing and printing activities	1,667.1	285.4
Electrical and optical machinery	1,656.5	348.0
Chemicals and chemical products	1,613.0	707.1
Wood and wooden products	1,296.9	193.2
Rubber and plastics	629.1	233.2
Metals and metal products	542.5	691.7
Other products	502.4	285.5
Other machinery and equipment	436.8	84.2
Fabrics and textiles	250.3	47.1
Leather and leather products	14.6	0.5
Financial intermediation	**13,442.9**	**143.5**
Trade and Repairs	**7,176.2**	**1,019.8**
Transport, storage and communications	**5,872.0**	**478.9**
Construction	**2,818.4**	**1,062.7**
Community, social and personal services	**1,769.1**	**586.0**
Power, gas and water supply	**1,663.6**	**1,746.5**
Real estate and business activities	**707.6**	**1,836.1**
Hotels and restaurants	**597.0**	**242.2**
Mining and quarrying	**218.5**	**7.0**
Agriculture	**44.8**	**16.3**
Investments over USD 1 million	**57,610.3**	**12,323.3**
Estimated investments under 1 million USD	**3,990.1**	
Total FDI in Poland	**61,600.4**	

ANNEX VIII: Growth Competitiveness Index Rankings

Country	Growth Competitiveness Ranking 2002	Growth Competitiveness Ranking 2001
United States	1	2
Finland	2	1
Taiwan	3	7
Japan	13	21
Germany	14	17
Hungary	29	28
France	30	20
South Africa	32	34
China	33	39
Greece	38	36
Italy	39	26
Czech Republic	40	37
India	48	57
Poland	51	41
Namibia	53	
Colombia	56	65
Bulgaria	62	59
Argentina	63	49
Russian Federation	64	63
Romania	66	56
Turkey	69	54
Guatemala	70	66
Zimbabwe	79	75
Haiti	80	

Source: World Competitiveness Yearbook 2002

ANNEX X: COMPETITIVENESS RANKINGS

	Czech Republic	Hungary	Poland	Turkey
Growth Competitiveness rank	37	28	41	54
Current Competitiveness Index	35	26	41	33
Macroeconomic Environmental Index	49	38	50	68
Macroeconomic Stability Sub-index	43	22	48	71
Public Institution Index	53	26	41	46
Corruption Sub-index	58	26	45	50
Country Credit Rating	43	31	32	49
Quality of the Business Environment	33	25	40	31
Technology Index	20	21	35	51
Network Access	29	29	48	45
Network Use Component Index	28	32	36	39
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