The Quality of Institutions and Multinational Corporation: The Political Economy of Foreign Direct Investment in Turkey

by

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ABSTRACT

The major focus of this chapter is on the relationship between political, social and economic institutions and Foreign Direct Investment in Turkey.

For a decade, the relationship between institutions and Foreign Direct Investment has been receiving growing attention. The link between the quality of institutions and FDI in developing countries, especially in transition economies, has led scholars to focus on the quality of institutions as determinants of FDI in developing countries.

In order to attract higher amounts of FDI, numerous developing countries have liberalized their investment environment since 1980. Turkey is not an exception. However, not all countries succeed at attracting FDI as they expected. The volume of FDI flows differ among the countries. One of the countries which did not succeed at attracting FDI as expected is Turkey.

This article explores how social economic and political institutions help explain the low level of FDI flows into Turkey by offering a political economy approach and applying a questionnaire survey for the recent period.

INTRODUCTION

Since 1980, with the liberalization of developing economies, the volume of FDI has grown significantly. The recent experience of a number of countries – especially in Central Europe and East Asia – has shown that FDI can play a crucial and catalytic role in the development process (FIAS, 2001:vii). Hence, FDI is perceived by many governments of developing countries as one of the most stable components of capital flows and an important factor for economic growth. As the FDI-promoting effect of good institutions may be an important channel of their overall effect on growth and development, to study the links between FDI and institutions has become relevant.

In order to attract higher amounts of FDI, numerous developing countries have liberalized their investment environment since 1980.[1] Turkey is not an

[1] Policy changes still continue. For instance, a total of 205 policy changes were identified by UNCTAD in 2005. In terms of regional distribution, Africa accounted for 53 policy changes, followed by Asia and Oceania (48), developed countries (44), South-East Europe and the CIS (39) and Latin America and the Caribbean (21). Most of the changes in 2005 made conditions more favorable for foreign companies to enter and operate. The types of measures most frequently adopted were related to sectoral and cross-sectoral liberalization (57 policy changes), promotional efforts (51 policy changes), operational measures (22 policy changes) and FDI admission (19 policy changes). For detail information; see: *World Invest Report*, 2006.

exception. However, Turkey, which has one of the most liberal encouragement laws of Foreign Direct Investment in the world, did not receive a satisfactory amount of FDI until 2005. The issue becomes more interesting when a number of international institutions, scholars and government officials in the mid-1990s announced that Turkey has a potential of 30 billion dollars FDI inflow, whereas the country received only 800 million dollars annually during the decade (Garten, 1996; DPT, 2000). The inadequate flow of FDI is not a characteristic of the 1990s; the level of FDI inflows to Turkey has remained low since the 1920s.

In this chapter I follow several ways to analyze the impact of political and economic institutions on FDI in Turkey. The chapter comprises both political economy approach and empirical analysis for recent period. For this purpose, I conduct a questionnaire survey to the 52 executives of MNCs operating in Turkey.

PATTERNS OF FOREIGN DIRECT INVESTMENT IN DEVELOPING ECONOMIES

This chapter focuses on one of the most stable of the international capital flows, Foreign Direct Investment. According to one of the oldest definitions of Foreign Direct Investment, by Kindleberger, FDI is referred to as long-term capital flow and differs from portfolio investment by taking place in kind, through the exchange of property (patents, technology or machinery) and by acquiring control of a company (Kindleberger, 1969:2). It also differs from other kinds of international capital movements in that direct investment proceeds by the reinvestment of profits and accompanied by varying degrees of control, plus technology and management.[2]

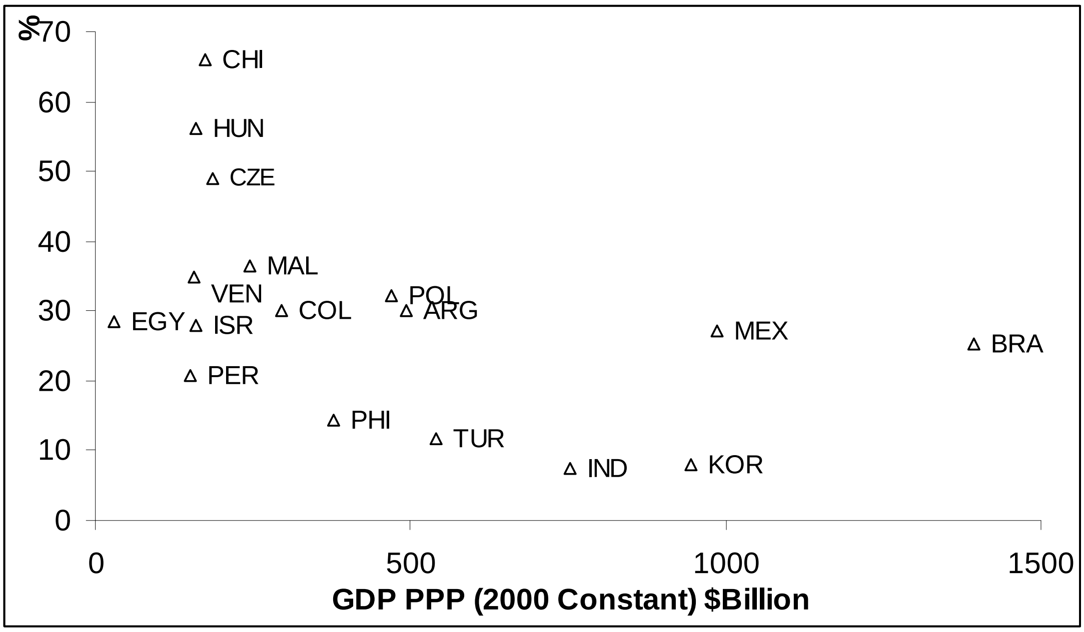
Investing abroad by MNCs constructing subsidiaries called "Greenfield Investment", whereas, these firms may also invest abroad, a common form in developed countries, by investing in established firms, through mergers and acquisitions, or through privatization programs (called as Brownfield Investment). Several developing economies have received this form of FDI due to the privatization programs took place especially after 1980.

With the increasing globalization, changes in government policies in trade and investment environment facilitate FDI into developing economies. Due to their growth performances and huge market sizes, many of these economies became attractive for many MNCs. Since 1980, economies of many developing economies have been growing significantly, their industries are structurally changing and their markets are promising but volatile. Comprising more than half of the world's population, many developing economies are often featured with strong market demand and high growth rates. The recent progress they have made in economic liberalization, especially after 1980 is noteworthy. In many of these countries the entry

[2] However, some definitions put more emphasis on the "control" factor. OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise….An effective voice in the management, as evidenced by an ownership of at least 10 percent, implies that the direct investor is able to influence, or participate in the management of an enterprise; it does not require absolute control by the foreign investor" (OECD, (Organization for Economic Cooperation and Development); *OECD Benchmark Definition of Foreign Direct Investment*, 3d Edition (Paris: OECD, 1996), p.8. For a detail study about definitions of FDI, see R. E. Lipsey, "Foreign Direct Investment and the Operations of Multinational Firms: Concepts, History and Data. *Working Paper 8665 National Bureau of Economic Research* 1050 Massachusetts Avenue Cambridge:NBER, MA 02138 (December 2001).

of MNCs is welcome as it represents an inflow of foreign savings into the country, supplementing domestic savings and directly increasing the level of investment.

Fig. 1 FDI stock as percentage of GDP in selected developing economies – 2005.



Source: UNCTAD (2006), WDI (2006).[3]

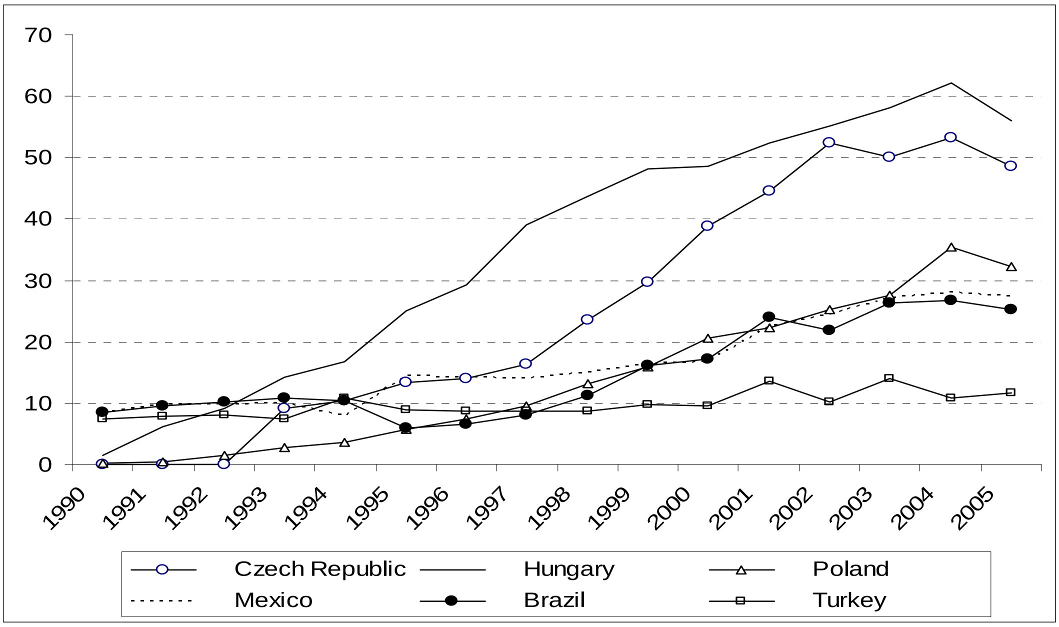
However, the FDI performances of these countries vary. Figure 1 shows the FDI stock as percentage of GDP in some of the developing economies. Czech Republic, Hungary and Chile are the most successful countries receiving FDI stock over 50 percent of their GDP. On the other hand, Philippines, Turkey, Korea and Indonesia receive low level of FDI stock when compared to their market sizes.

FDI PERFORMANCE OF TURKEY IN A COMPARATIVE PERSPECTIVE

Despite several efforts, Turkey has never been able to attract the substantial FDI inflows that would be expected from a nation with a strategic location between Europe, the Middle East and Central Asia. Turkish FDI levels have stagnated during the 1990s while total FDI worldwide increased by a factor of 12. This lack of interest by multinational companies becomes even clearer when FDI inflows are adjusted for the size of the economy. Over the last decade, the average of FDI inflows to middle-income countries in Europe was 1.1 percent of GDP compared to less than 0.5 percent in Turkey. As shown in the following figure, this disparity is considerably greater when Turkey is compared to the countries investors consider to be its main regional competitors: Hungary, the Czech Republic, and Poland.

[3] Selected developing countries are; Argentina, Brazil, Chile, Colombia, Czech Republic, Egypt, Hungary, Indonesia, Israel, Korea (South), Malaysia, Mexico, Peru, Philippines, Poland, Turkey, Venezuela.

Fig. 2 Inward FDI Stock as percentage of GDP in Selected Emerging Economies



Source: UNCTAD, Handbook of Statistics, 2006.

Figure 2 reveals the inward FDI stock levels of selected emerging economies as a percentage of GDP. Comparing Turkey with other emerging economies such as Brazil, Mexico, Hungary, Czech Republic, and Poland, it can be argued that the inward FDI performance of Turkey is ineffective. The level of FDI stock in Turkey remained stagnant at approximately 10 percent during the 1990s, fluctuated after 2000 and reached approximately 12 percent in 2005. Whereas inward FDI stock of all other countries increased significantly. Hungary and the Czech Republic are the most successful countries at attracting increasing inward FDI stock.

The transition economies of Central and Eastern Europe, although entering the competition in the beginning of the 1990s, attracted more FDI in comparison to Turkey in the period.

Another way to view Turkey's relative FDI performance as a host country is in terms of two indices developed by UNCTAD: The FDI Performance Index.

Table 1. The Inward FDI Performance Index - Rankings

Selected Countries	2003-2005	2002-2004	2001-2003	2000-2002
Czech Republic	32	25	13	10
Hungary	40	46	33	27
Poland	57	75	68	56
Mexico	75	79	61	64
Brazil	82	62	46	37
Argentina	83	82	82	85
Turkey	95	111	110	109

Source: UNCTAD, 2006.

The Inward FDI Performance Index ranks countries by the FDI they receive relative to their economic size. It is the ratio of a country's share in global FDI inflows to its share in global GDP.[4]

[4] The index captures the influence on FDI of factors other than market size, assuming that, other things being equal, size is the "base line" for attracting investment. These other factors can be diverse, ranging from the business climate,

According to the inward performance index, Turkey ranks at 95 with a score of 0.917. This low score indicates that Turkey receives less FDI than its relative economic size. Interestingly, Turkey's performance was relatively better at the end of 1980s. Turkey had a rank of 70 with a score of 0.502 in the period 1988-1990. During the 1990s, Turkey's position moved backward.

According to the matrix of the FDI performances of the countries, Turkey takes place within the list of countries that have high FDI potential but low FDI performance (UNCTAD, 2006:6).

These statistics reveal that Turkey, which has a vast market potential in the world, received low levels of FDI inflows until 2005. Compared to many developing countries that have attracted and benefited from significant inflows of FDI, Turkey did not succeed in increasing FDI inflows even though significant increase in FDI flows due to globalization process in the 1990s. Plus, the low level of FDI inflows is not a characteristic of the recent period. Turkey, from the beginning of the Republican Era, attracted low level of FDI inflows.

Below, offering a political economy approach, I evaluate the FDI performance of the country, the attitudes of government to FDI, and the relationship between economic conjuncture and FDI.

POLITICAL ECONOMY OF FDI IN TURKEY – THE PRE-1980 PERIOD

During the 1970s and earlier, Turkey like many other developing countries adopted an inward-looking import substitution strategy, combined with widespread state ownership of companies throughout the manufacturing sector and some important services. The provisions of Law No. 6224, encouragement law of FDI, seemed liberal and compared favorably with the investment laws of many countries. However, between 1951 and 1980, a total of $230 million in capital came through this channel.[5] Since its inception in 1954, the flow of private capital into Turkey remained far below expectations.

"The Law No. 6224", enacted in 1954, was in force until 2003 with minor changes and brought very liberal provisions. It abolished restrictions on the transfers of profits, dividends and interest to ten percent of the capital as well as the restriction of foreign direct investment in certain specified areas of economic activity.[6]

The government by enacting law no. 6224 aimed at an increase in FDI with the purpose of reducing the shortage of foreign exchange that took place in the country in 1953 and 1954. Increasing FDI inflows, in the end, would help to decrease the balance of payment deficits.[7] However, the laws that

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economic and political stability, the presence of natural resources, infrastructure, skills and technologies, to opportunities for participating in privatization or the effectiveness of FDI promotion.

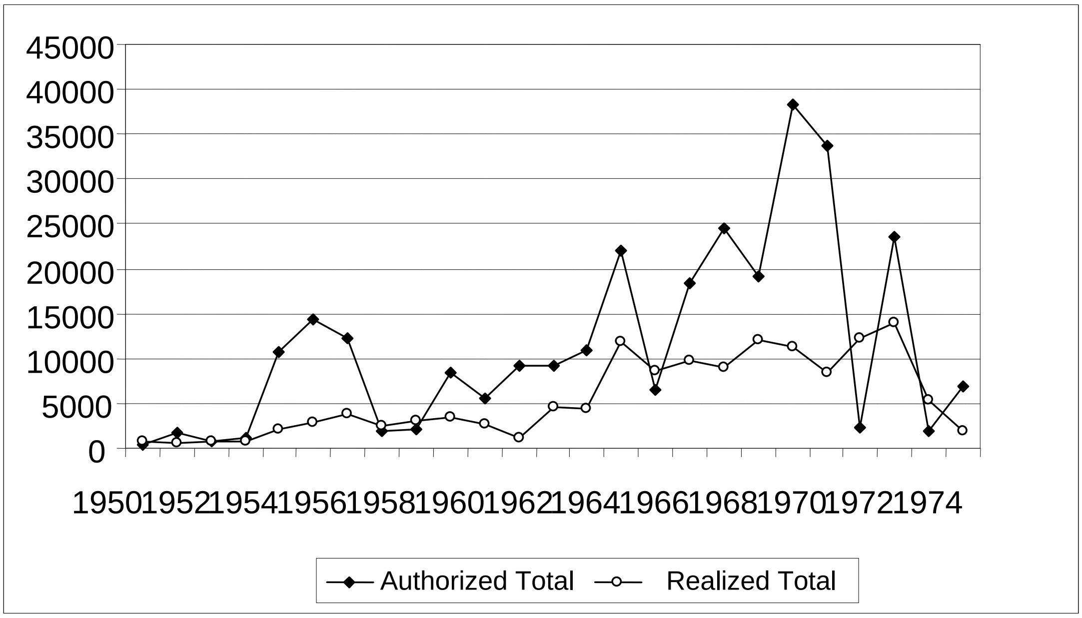
[5] The statistics of FDI flows between 1950 and 1980 differ in various studies. The State statistics (DPT) and the World Bank, UNCTAD statistics differ to a large extent in this period.

[6] However, the law included an ambiguous article which was used by governments as a tool to deny investment permission to some foreign investors. According to this article, foreign investment should contribute to the economic development of Turkey and should be in a field of activity open to Turkish private enterprise. In addition, foreign investment should not entail any monopoly or any special concessions. See: K. Oksay, *Türkiye'de Yabancı Sermaye Yatırım Kılavuzu* (İstanbul: Doğan Kardeş, 1967)

[7] Also there are other views about the law's timing. For instance, according to Eralp foreign encouragement laws coincided with the period when the local bourgeoisie was attempting to collaborate with the MNCs. See A. Eralp, "Türkiye'de

were enacted subsequently in the first half of the 1950s did not attract FDI as expected[8].

Fig. 3 Inward FDI with current prices – (US Dollars-thousand)



Source: Erdilek, A. *Direct Foreign Investment in Turkish Manufacturing* (Tubingen: Mohr,1982), Appendix.

As seen in Figure 3 the amount of realized FDI did not exceed $15 million annually between 1950 and 1974. In spite of the subsequently enacted FDI laws, the inflow of FDI was below $5 million annually in the 1950s. The obvious increase in FDI inflows took place in the 1960s, yet again; the realized investment was below $15 annually. What is interesting here is the big difference between the realized and authorized investments during the whole period.

One of the reasons for this divergence was the political and economic instability. During 1958-1960, under the economic stabilization program designed by the IMF and the OECD, the Turkish economy was still too risky for new FDI. Most of the investors preferred to wait for the suitable time after taking the investment permission.[9] For instance, the ratio of realized investment of authorized investment was only 30 percent between 1951 and 1965. Most of the time foreign investors tried to receive permissions before their competitors, and after, preferred to wait for the appropriate time to invest.

The divergence between the actual and realized investment gives a significant idea about the political and economic instability for the period.

İzlenen İthal İkameci Kalkınma Stratejisi ve Yabancı Sermaye" in *METU Studies in development*, Special Issue (1981) p.623.

[8] From 1950 onwards, foreign direct investment entered into Turkey according to four main categories. These were Laws No. 5821 and No. 6224, long-term credits of the Turkish Industrial Development Bank of Recovery and Development, Petroleum Law No. 6326 (which was enacted on March 1954), special Law No. 7462 about the Ereğli Iron and Steel Factory (which was enacted in 1960).

[9] Until 2003, foreign investors had to apply for investment permission. After receiving permission they had a chance to either invest at the time, or wait for a period of time or abandon the process. Therefore, the authorized FDI and the actual FDI used to be different generally.

In the 1960s, substantial demand for domestic commodities (due to significant increase in real wages) and the growth of the domestic market are expected to encourage the inflow of FDI to Turkey. However, in the 1960s both authorized and realized foreign investments continued to be statistically insignificant, in spite of significant growth of domestic market.[10] In this period, called the golden age of ISI, the economic growth rate was seven percent and the manufacturing sector's growth rate was between 11 and 12 percent (Herschlag, 1968). MNCs mostly invested in the manufacturing industry especially between 1950 and 1980 in developing countries. In Turkey, like in other countries, operations of foreign firms mostly concentrated in the manufacturing industry.

In 1960, with the military intervention, the new regime sought to quicken the pace of development by relying to a great extent on state plans in which, the ISI strategy was institutionalized. With the establishment of the State Planning Organization (SPO) in September 1960, the development plans were based on long-term models rather than short-term policies and were obligatory for the public sector and only problem-solving for the private sector.[11] They maintained the coordination between the economic sectors and the agents, achieved economic growth and economic stability, and encouraged the inflow of foreign investment.[12]

1970 – 1980 PERIOD: A CHANGE IN ATTITUDE TOWARDS FDI

The 1970s witnessed several economic and political instabilities in both Turkey and in the world. In developing countries, the easy stage of ISI came to an end and the foreign exchange crisis and increasing dependency of imports led them to shift towards export promotion. Plus, most of the developed and developing countries were negatively affected by the 1974 oil crisis.[13] However, FDI flows in the world continued their steady increase. During the 1970s, the FDI inflows to Turkey continued to be statistically insignificant and fluctuated.[14] Figure 4 shows the FDI inflows to Turkey in comparison with those of Brazil and Mexico.

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[10] This fact can be strengthened by reference to the proposed first five-year development plan about foreign direct investment. The five-year development plan forecasted the need of $50 million annually FDI inflow since the beginning of the plan in 1963. However, not only realized investment but also authorized investment had not reached the $50 million level since 1951. See Devlet Planlama Teşkilatı, *First Five-Year Development Plan, 1963-1967* (Ankara: Turkish Republic Prime Ministry, 1963) pp.237-239.

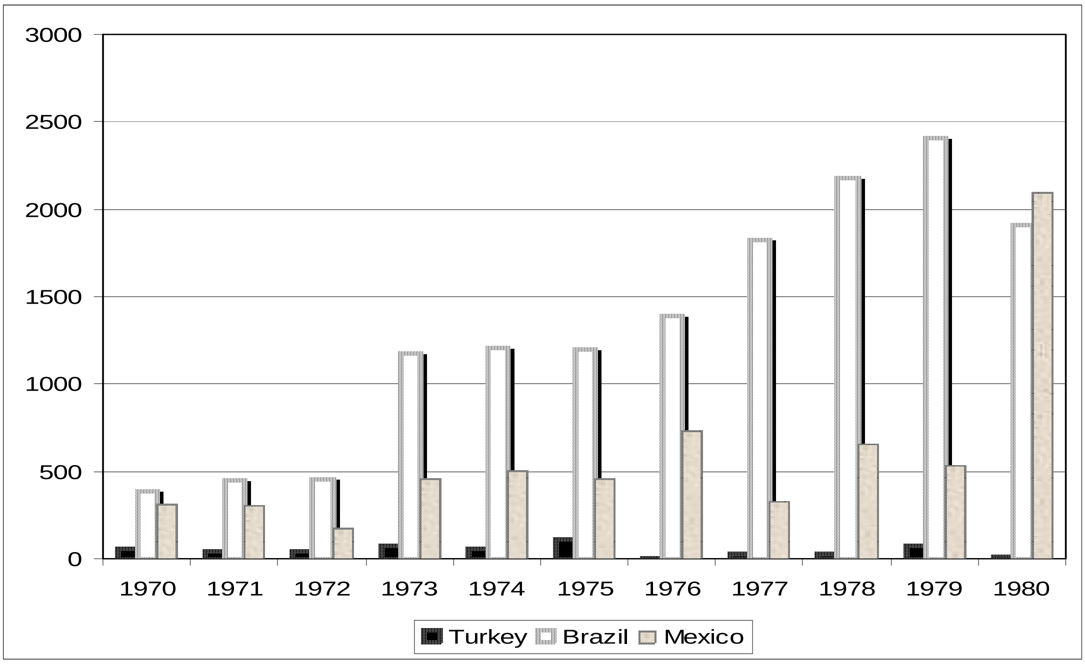
[11] In 1967, Law 933 amended Law 6224, abolishing the Committee to Encourage Foreign Investment, and transferring the FDI authority to the SPO.

[12] In the first development plan, the balance of payments effect received focus rather than the technological and employment effects of FDI. Plus, in this plan, for the first time the problem of low realized investments was mentioned.

[13] However, owing to the remittances sent by workers in Europe, with the support of the foreign exchange reserves and an accommodating monetary policy, Turkey did not experience the negative impacts of the oil crisis simultaneously with other countries in 1974 and the growth rate of the economy reached 8.9 percent in 1975 and 1976. Yet, borrowing abroad and expansionary policies only delayed the crisis. Turkey found itself in its most severe balance of payments crisis in 1978 and 1979. See Ş. Pamuk and R. Owen, *A History of Middle East Economies in the Twentieth Century,* (Cambridge: Harvard University Press, 1999).

[14] By 1976, 106 firms containing foreign capital were operating in Turkish economy. This amount began to decrease slightly after that year. By the end of 1977 the number of firms with foreign capital was 99. 86 of these firms were operating in the manufacturing sector. 11 firms were operating in the service sector, one in mining, and one in agriculture. In 1979, the number of firms decreased to 91. See Taner Berksoy, S. A. Doğruel and F. Doğruel ,*Türkiye'de Yabancı Sermaye* (İstanbul: Tüses, 1989).

Fig. 4 FDI inflows US dollars with current prices (million dollars)



Source: UNCTAD, 2006.

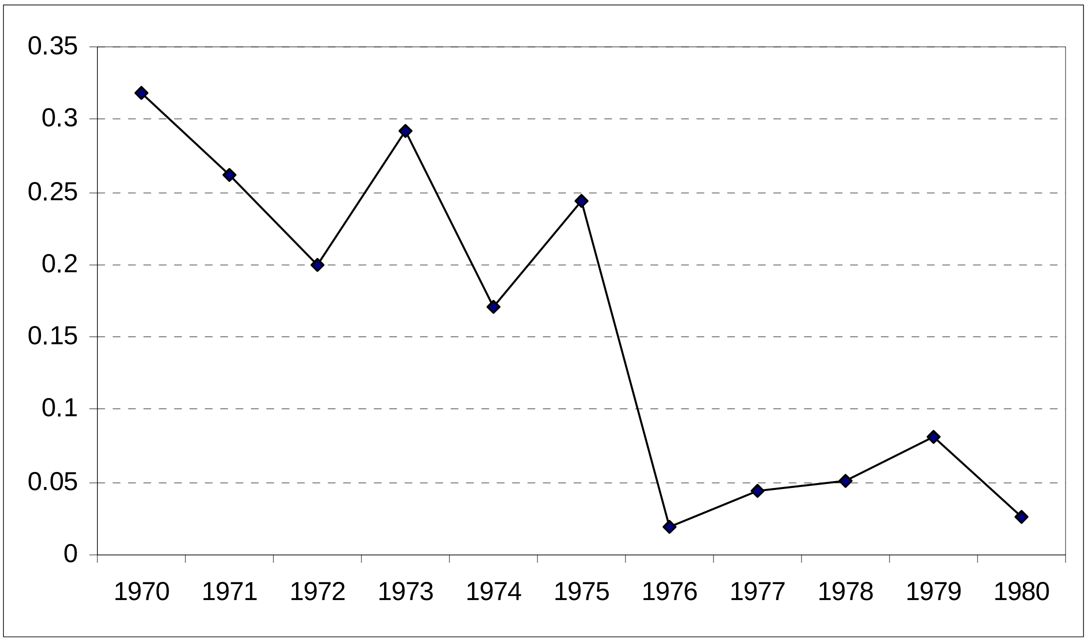
Although governments in these countries took active measures towards FDI in the 1970s, Brazil and Mexico attracted much more FDI than Turkey. In Brazil, until the late 1970s, the entry of foreign investment was encouraged and promoted by various incentives and very few restrictions were imposed on such inflow. With few exceptions, all sectors of manufacturing industry were open to foreign investments through wholly foreign-owned subsidiaries. Foreign investments increased considerably during the period 1976 -83, from 9 billion to $ 22.3 billion (UNCTAD, 2006). In Mexico, during the 1950s and 1960s, with the growing demand for a variety of consumption goods and intermediate products, the government followed a policy of import substitution, and foreign and domestic companies were given many incentives, including duty-free import of machinery, permission to import used equipment, tax concessions, and a high level of protection through tariffs and quantitative import restrictions (Grosse, 1989; Bennett and Sharpe, 1985).

However, in Turkey the picture was somewhat different from that of Brazil and Mexico, except growing government intervention which was problematic in the Turkish case. In addition to the economic and political instability in the 1970s, although Law No. 6224 remained in effect, the attitudes of governments towards FDI changed in this period. After 1971, the non-party government under the premiership of Nihat Erim adopted new measures which indicated a shift from the liberal foreign investment policy. The new government announced that future applications for FDI would be judged on provision for majority Turkish ownership, capacity for export, ability to induce an inflow of technology, and utilization of economies of scale (Ashkin, 1972). In reality, the demands of the Turkish governments had not been met by the MNCs. The Turkish government's demand for increases in export commitments increase in local content and restrictions on the local credits available to FDI firms were harshly criticized by the MNCs operating in Turkey. They found the Turkish government's demands irrational (Erdilek, 1982:22).

Figure 5 shows that inward FDI stock as percentage of GDP fluctuated during the period. Plus, especially in the second half of the 1970s, the ratio of

FDI to GDP was below 0.1 percent, which is an insignificant ratio.

Fig. 5 Inward FDI Stock as percentage of GDP in Turkey



Source: UNCTAD, 2006

The foreign firms were quickly affected by the new improvements and the regulations of the Turkish governments. Figure 5 reveals that after 1972 the level of inward stock of FDI as a percentage of GDP had begun to fall, especially sharply after 1975.

One of the reasons for the fluctuations was a scarcity of foreign exchange. In the 1970s the scarcity of foreign exchange, especially after 1976, obstructed transferring profits and obtaining imported inputs. The inputs of the MNCs, as well as domestic companies, mostly relied on imported intermediary and capital goods.

Due to the scarcity of foreign exchange, firms containing foreign capital had difficulties in obtaining foreign exchange. The imports of foreign firms depended mostly on intermediary and capital goods. This can be explained by the inadequacy of local producers in producing commodities which require technology, management skill, and economies of scale. This picture also shows the failure of the ISI strategy as the firms became more dependent on foreign inputs in the later step of the model.

AN EVALUATION OF THE 1950-1980 PERIOD

As mentioned, the provisions of Law No. 6224 seemed liberal and compared favorably with the investment laws of many countries. However, between 1951 and 1980, a total of $230 million in capital came through this channel.[15] Since its inception in 1954, the flow of private capital into Turkey remained far below expectations. Therefore the inflow of foreign capital can not be increased only by liberal regulations alone. If the inflow of foreign capital is below the expected level, the reason must be sought elsewhere.

[15] The statistics of FDI flows between 1950 and 1980 differ in various studies. The State statistics (DPT) and the World Bank, UNCTAD statistics differ to a large extent in this period.

One of the reasons is that, in this period of Turkey actually lacked the political and economic stability to provide an attractive investment environment for investors. In the 1960s and 1970s, several coalition governments and two military coups showed Turkey to be politically unstable in its second experiment with democracy. The period 1974-1979 also witnessed rising political instability and widespread violence between political factions and ideologies, which drastically worsened the environment for FDI.

Another problem involved an article of Law No. 6224, concerning the contribution of FDI to the economic development of the country. According to Law No. 6224, foreign companies could realize investment in all sectors of the economy, provided it aided the country’s economic development. It was not clear, however, how this was to be determined. Many representatives of foreign companies claimed that the SPO used this provision as a tool to discriminate against MNCs (Erdilek, 1982:67).

THE ROLE OF THE BUREAUCRACY

A regulatory framework is only as good as its implementation. Administrative barriers that reduce the efficiency of the regulatory system due to inefficient administration or procedures can have an enormous negative impact on foreign investors. An inefficient bureaucracy often results in investment plans that become outdated for the investor, unnecessary costs for management time not efficiently used, and expensive equipment and employees that are idle.

In Turkey, bureaucratic procedures surrounding the investment process were often lengthy, unnecessarily cumbersome, and unpredictable. The administrative procedures did not reflect international best practice. For instance, acquiring establishing a firm permit or a trademark registration could take many months or even years.

In most of developed countries, the bureaucracy tends to be somewhat autonomous from political pressure and to have an established mechanism for recruitment and training. The institutional strength and quality of the bureaucracy is another shock absorber that tends to minimize revisions of policy when governments change. However, in Turkey, there has been a disparity between the governments and the bureaucracy when FDI is considered.

Therefore, although governments seemed to favor FDI inflows, the ambiguous arts of the FDI laws were used as tools to hinder FDI by the Turkish bureaucracy. For instance, Article 1 of Law No. 6224 implied that FDI had to benefit the economic development of the country. This vague law over the years became open to use as a tool for the bureaucracy and sometimes for the government to discriminate against some FDI activities. Hence, especially for foreign firms, the SPO and the red tape of public institutes were responsible for the low inflow of FDI. There was, in other words, a clear discrepancy between the law and its bureaucratic implementation.

In a closed economy in which foreign economic relations are subject to extensive state control, each connection with foreigners also involves an encounter with the state authority. Many foreign investors accused the Turkish bureaucracy of straight and simple violation of the law in order not to implement its various provisions. For instance, the bureaucracy did not allow the capitalization of intangible rights reduced and even stopped royalty payments in the 1970s.

One of the important obstacles for foreign firms was the long waiting period to receive permission from the Council of Ministers. In the 1970s, the average time between a firm's application for permission and its publication in the Official Gazette was about two years. Another problem was the SPO's unwillingness to process the FDI applications quickly enough. The SPO often increased the red tape for the application procedures for foreign firms so that the permissions for foreign firms would be delayed at least for three or four months. The SPO officers denied that the SPO was anti-FDI and blamed the delays on political facts and a shortage of expert personnel. The last fact was the main problem of the institutions, which were responsible for evaluating FDI applications. For instance, there were only a few experts in the Ministry of Commerce's (MOC) FDI division and they were fired for political reasons when the new government came into power. Hence, with no skilled employees, as the chief of the MOC's FDI division stated, his division was no longer capable of evaluating the FDI applications on a technical level.

Lack of consistency of the implementation of laws and regulations in different municipality authorities is another area that requires attention. Before 1980, at some point investors might receive two contradictory permits from different authorities in Turkey. However, lack of coordination between administrators or policy-makers on the national and municipal levels results in inconsistent behavior of the administration. Laws and regulations were not applied by local administrators on the same standard as on the national level. Local politicians in some cases might delay the issuance of necessary permissions for unrelated reasons. A prospective foreign firm could be forced to get as many as 23 signatures from various official authorities in order to receive FDI permission, which could take as long as three years (Dumludag, 2002:87).

POST 1980 PERIOD - A CHANGE IN THE ATTITUDE TOWARDS FDI

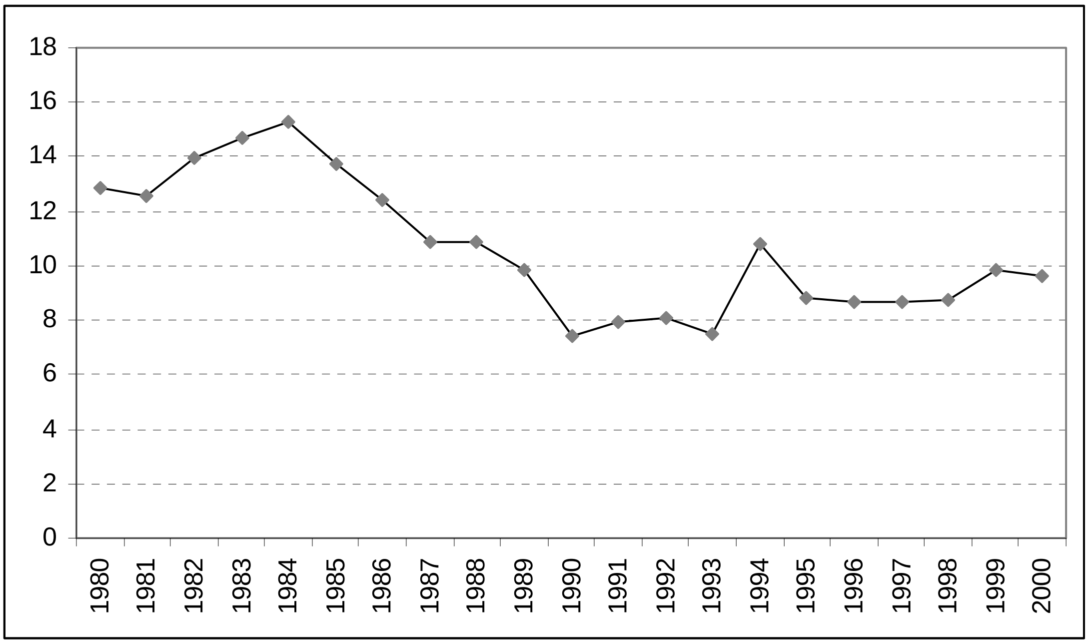
1980 marks a turning point for many developing countries including Turkey. After 1980, most of these countries integrated into the international economy through liberalizing their economies. The governments, especially in Latin America, suffering the negative impacts of hot money transactions turned towards FDI, as a reliable foreign source, in order to realize sustainable growth rates. In these countries, FDI laws including several restrictions were replaced by new laws offering significant incentives to foreign investors. As a result of opening economies, and governments' positive attitudes, FDI inflows were significantly increased into developing economies.

In the same way, with the 24 January 1980 program, Turkey's integrated into the world economy through several measures. The economy became much more open to international trade and later, financial markets. The government launched an economic stabilization and structural adjustment program aimed at encouraging a private-sector-led, export-oriented growth. The program included a flexible exchange rate, incentives to promote exports, deregulation of interest rates to promote domestic savings, reform of state enterprises, and import liberalization. Plus, quantitative restrictions on imports were also removed, and tariffs were significantly reduced. When the Turkish Lira became convertible, the country received significant amount of portfolio capital flows. However, Turkey's integration with the world economy through FDI continued to remain weak in comparison to other developing countries.

In Turkey, after 1980 the attitude of governments' toward FDI issue changed dramatically. Governments, in order to attract foreign firms, revised the regulations concerning FDI. Before, there had been a lack of a strong and efficient organization dealing with the FDI application process. In the 1980s, all restrictive regulations about FDI implemented in the 1970s were eliminated. The negative attitudes of the public and of the bureaucracy softened gradually. With decree No: 8/168, a newly created Foreign Direct Investment Department, within the SPO, acquired the consolidated authority which had been previously split among several different government agencies to manage the relations with foreign firms (Erdilek, 1986:173). Law No. 6224, encouraging FDI, still remained in effect with minor but important changes and the red-tape was by and large reduced. For instance, the 49 percent foreign ownership limit, which was introduced in 1971, was removed in this period. Also new measures were taken in the foreign employee regulation. Plus, a significant change took place in the public opinion. Since 1980 there has been a great interest of the public in the FDI issue. This is an important development when the excited discussions about the FDI issue in the parliament and public in the 1960s are considered. And finally, in 1980, in order to inform the public about issues regarding FDI, a foreign investors association (YASED) was established.[16] YASED held conferences in order to change the suspicious attitude in the public towards FDI.

Although significant measures were taken in order to attract FDI inflows in the 1980s, the amount of FDI increased annually but not as expected. The graph in figure 6 demonstrates FDI inward stock as percentage of GDP in Turkey, which after a short period of acceleration from 13 percent in 1980 to 15 percent in 1984, began to decrease considerably by the end of the 1980s. The share of FDI inward stock stagnated in the 1990s.

Fig. 6 Inward FDI inward stock as share of GDP in Turkey



Source: UNCTAD, 2006.

There are several reasons for the substantial increase in the first half of the 1980s. The Turkish government transformed the repayment of commercial credits borrowed from foreign financial agents into foreign direct investment. Also an export-oriented strategy and increasing trade relations between Turkey and countries in the Middle East attracted foreign firms motivated by vertical strategy.

The level of FDI inflows with current prices as US dollars, continued to remain low in the 1990s. The average of FDI inflows was $170 million during

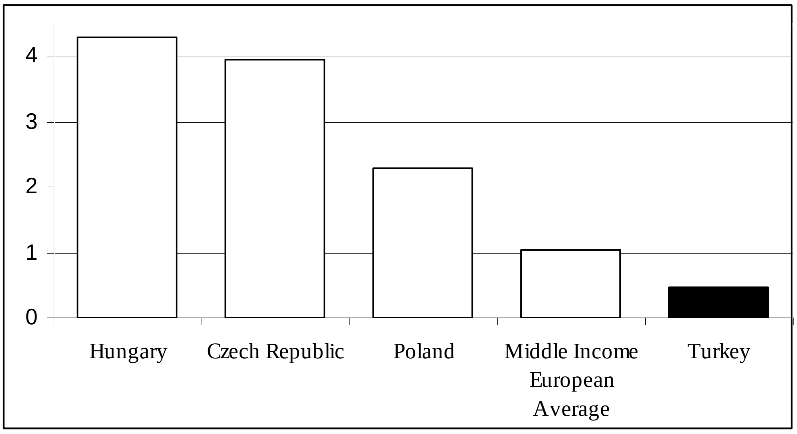
[16] The name of the organization was changed to International Investors' Association in 2005. (Logo remains the same).

the 1980s. This can be considered as a success when the $227 million total FDI inflow to Turkey is considered. However, after 1980 FDI flows into developing countries increased rapidly.

In the 1990s average annual FDI inflow of $770 million fluctuated between $680 and $980 million. A comparison of the FDI levels of Turkey, Brazil and Mexico gives an idea of Turkey's performance during the period.

In the 1990s the inflow of FDI to Turkey reached 1 billion annually. However, when we compare Turkey with other developing countries such as Brazil and Mexico we see that Turkey was not successful at attracting FDI in relative terms. For instance, Brazil attracted two times grater FDI than Turkey in 1990; in 2000, the ratio reached 1:40. The ratio between Mexico and Turkey was 1:1.5 in 1990; however, the ratio reached 1:15 to the disadvantage of Turkey.

Fig. 7 Average FDI Inflows as a percentage of GDP, 1990-99 (%)



Source: FIAS, 2001.[17]

In the 1990s countries of former communist regimes entered into the competition for FDI. With faster and more thorough reforms in many of them, very well educated workers, technical, and scientific personnel, success in fighting inflation, greater geographic proximity to the EU as well as, in total, a very large and unsaturated market, led Central and East Central countries to receive more FDI flows than Turkey. Hungary, Poland and the Czech Republic became major targets of FDI – not only from Western Europe but from the USA and to some extent from Asia as well.

The failure of Turkey's FDI performance in this period can be explained by several economic and non-economic factors.

The 1990s called the lost decade in Turkey due to severe, subsequent economic crises. The political and economic instability obstructed higher amounts of inflow of FDI. While in the 1970s executives of foreign firms typically complained about the negative attitude of governments, in the 1990s they mostly complained about the macroeconomic and political instability (Erden, 1996). In this period, Turkey had 9 coalition governments in 10 years. By this way there was no chance for government's ability to carry out its declared programs, and its ability to stay in office.

Economic growth was increasingly infrequent, with sharp rises and falls, including a financial crisis in 1994, followed by a severe recession.

[17] Middle income European countries include Albania, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, FYR, Poland, Romania, Russian Federation, and Slovak Republic.

Inflation accelerated and exceeded 100 percent in 1994. [18]

In this period, governments, in order to diminish public budget deficits, attracted portfolio capital transactions rather than promoting FDI inflows. The importance of FDI as a source for sustainable growth rates lost its importance. Attracting FDI remained shadowed by hot money. The lack of success in reducing the inflation rate, as well as instability in government, contributed to reinforce the perception of Turkey as an unstable and unpredictable place to invest. In sum, the Turkish Government was unable to facilitate and promote an attractive investment environment through stable and market oriented economic policies. Financial crisis and continuous economic and political instability deterred not only foreign investors but also local entrepreneurs.

RECENT PERIOD: STRUCTURAL CHANGE

At the end of 1999, Turkey adopted a three-year economic stabilization and structural reform program with the support of the International Monetary Fund (IMF). However, after the subsequent crises of November 2000 and February 2001, the program collapsed. The support of the IMF and the World Bank continued and structural reform and economic stabilization programs continued. Turkish governments decisively adopted administrative reforms and the Turkish Parliament approved a sweeping revision of the country's codes to bring them closer to European Union norms.

Significant reforms were approved especially in the financial sector. In order to strengthen the quality of economic institutions, new measures were adopted. At the end of the period the rate of inflation decreased to fewer than 10 percent. The economy experienced high growth rates while there was no progress in diminishing the unemployment level.

The coalition government and succeeding AKP government paid special attention to inward FDI and approved legislative revisions concerning FDI. A new FDI encouragement law was enacted in 2003, the complicated entrance procedures were simplified, and for the first time, the state accepted to work in accordance with non-governmental organizations and the private sector in order to improve the investment environment for foreign investor.

Plus, in support of these efforts, Foreign Investment Advisory Service of the World Bank has been asked to analyze the business climate in Turkey and prepare this report which indicates the government willingness to attract more FDI inflows to Turkey. For this purpose Foreign Investment Advisory Service (FIAS) prepared a report, based on extensive field work consisting of surveys and interviews that declared that administrative barriers hinder more FDI flows into Turkey.

In this period, for the first time, remarkable measures were taken showing the decisive attitude of governments towards attracting FDI. As mentioned, the existing law of FDI, which dated back to 1954, was replaced by the new foreign investment Law No. 4875 in June 2003.[19] This law replaced the old FDI approval and screening system with a notification and registration

[18] On the other hand, inflation may not be a serious problem in some cases. For instance, Brazil, Mexico and Argentina attracted significant FDI inflows although high inflation took place in these countries in the 1980s.

[19] Since the new FDI law, 6,000 new FDI firms were established in Turkey. Between 1954 and 1999, the cumulative of foreign firms was 4,192. However, most of the newly established firms are small and medium scale and most of them are far away to be called as MNCs. By 2005, most of the foreign firms concentrated in major cities; Istanbul, Ankara, Izmir, Antalya, Bursa and industry centers Kocaeli, Tekirdağ and Bursa.

system, bans nationalization without fair compensation, guarantees national treatment to foreign investors, does not restrict FDI in any sectors or impose any performance requirements, eliminates the old minimum capital limit, grants foreign investors full convertibility in their transfers of capital and earnings, allows them to own property without any restrictions, and recognizes foreign investors’ right to international arbitration.

Second a Coordination Council for improving the investment climate (CCIIC) consisting of government and private sector representatives was established. The council included government and private sector representatives and aimed to improve the investment environment in Turkey. For this reason the council formed several technical committees for in-depth study of individual issues that concern the improvement of the investment environment.

Third, for the first time under the presidency of the prime minister of Turkey, the Advisory Investor Council held its first meeting in 2003. The council consisted of the chief executive officers or chairpersons of 15 foreign affiliates such as Citigroup, Siemens and Toyota. The council held its first meeting, chaired by the Prime Minister, in March 2004, identifying 13 key areas on which the government was advised to focus its efforts to improve the FDI environment. After its second meeting, chaired by the Prime Minister, in April 2005, the council commended the government for its progress in improving the FDI environment, drawing attention to 10 important issues that needed to be worked on.

In sum, although FDI received attention from the governments since 1980, the intense efforts in order to increase the FDI inflow have taken place since 2001. The coalition government and succeeding AKP government approved legislative revisions concerning FDI. A new FDI encouragement law was enacted in 2001, the complicated entrance procedures were simplified, and for the first time, the state accepted to work in accordance with non-governmental organizations and the private sector in order to attain a higher level of FDI inflow.

However, these concrete efforts did not increase the FDI inflow as expected. The FDI inflow was $982 million in 2000; it reached $3.2 billion in 2001. However, the increase of FDI inflow did not continue, rather, it fluctuated. The inflow was $1 billion in 2002, $575 million in 2003 and $2.7 billion in 2004 (UNCTAD, 2006). These data suggest that the inflow of FDI remained far below the expected $30 billion potential inflow level.[20]

Having examined the relationship between economic and political context and FDI in Turkey, and having analyzed the comparative FDI performance of Turkey in detail, below, the results of questionnaire survey are interpreted in order to understand the role of institutional variables as determinants of FDI inflows in Turkey.

THE ROLE OF INSTITUTIONS - THE QUESTIONNAIRE SURVEY

Empirical research on the impact of host country institutions on FDI has demonstrated that the general institutional, social and legal framework influences FDI.

[20] This chapter focuses on FDI in Turkey until 2006. This is because FDI inflows to Turkey, in 2006, reached $20 billon for the first time in history. It is too late to say that Turkey will attract over 20 billion dollars continuously. This increase, as the share of mergers and acquisitions is considered, may be a temporary increase. Hence, in order to propose a complete analysis, a couple of years should pass.

To meet the needs for an in-depth and exhaustively researched analysis of the non-economic variables such as potential risks to international business operations, several organizations created statistical models to calculate risks and backed it up with analyses that explain the numbers and examine what the numbers do not show. The result is a comprehensive system that enables various types of risk to be measured and compared between countries.

However, in Turkey studies on FDI rarely treat the role of institutions on FDI and rather they focus of the main determinants of FDI.

In a recent study, Foreign Investor Advisory Service of the World Bank (FIAS) conducted reports, mentioning the importance of institutions. FIAS of the World Bank Group was asked in September 2000 to study the FDI environment and make recommendations for its improvement, as part of the World Bank Group's 2001-2003 Country Assistance Strategy for Turkey, which stressed the importance of FDI repeatedly and underscored the role of FIAS in improving Turkey's FDI environment.

FIAS, with the support of the Turkish government and with cooperation of the private sector, prepared two studies: A Diagnostic Study of the Direct Foreign Investment Environment in Turkey in February 2001, and Turkey: Administrative Barriers to Investment in June 2001 (FIAS, 2001).

The reports pointed administrative barriers political and economic stability, slow and partial judicial system as an impediment to new investments and suggested workshops and establishment of study groups focusing on the issues company registration, sectoral licensing, land access and site development, taxation and incentives, intellectual property rights, investment legislation and investment promotion.

According to the first report, the Turkish administration has been fixated on control instead of service and enforcement. This control, combined with lack of accountability and transparency, and exercise of discretion, has resulted in widespread corruption. The second report focus on the list of issues relating to company registration and reporting, location and operation of FDI companies; among the operational issues are taxation, trade and customs regime, and intellectual and industrial property rights.

The analyses of these issues are followed by specific recommendations including the establishment of an Investment Promotion Agency (IPA) for reform. Its conclusions emphasize the need to build the political will required for an action plan with broad support and to monitor improvements as that plan is implemented.

THE QUESTIONNAIRE SURVEY[21]

In my empirical analysis, I engaged in substantial fieldwork in 2006. I applied a questionnaire survey to explore the mechanisms linking political institutions to FDI flows, and interviewed representatives of Multinational Corporations (MNCs) operating in Turkey. In these interviews I asked both open-ended and closed ended questions regarding the factors were important in multinationals selecting investment locations, and I followed up these questions with specific questions on how they evaluated the importance of

[21] The results of the questionnaire survey were presented at several conferences at Tartu University and the seventh European Historical Economics Society conference at Lund University. Also the empiric study took place in Devrim Dumludag "Türkiye'de Doğrudan Yabancı Yatırım Hareketlerinde Kurumların Rolü" in *Türkiye'nin Küreselleşmesi: Fırsatlar ve Tehditler*, ed. Ibrahim Öztürk, Istanbul: ITO yayınları, 2008.

specific policies and institutions. Also, I had the opportunity to conduct interviews with some of the representatives of nongovernmental organizations.

The questionnaire examines the impact of institutional variables on FDI. The case study of how institutional variables affect FDI in Turkey is a result of field work of twenty weeks. The questionnaires were sent in October 2006 and the receiving of the results was completed in February 2007. The questions examine for the period between 2001 and 2006.[22] The answers of the questions are converted to numeric values from (very low: 1 to very high: 5, very unimportant to very important 1:5). The questionnaire survey was drafted in such a manner as to follow a systematic comparison of the surveys of the World Bank and UNCTAD.

The MNCs firms are at the top 500 big (according to initial capital stock) MNCs in located on the website of the Treasury. All participants in the study were guaranteed complete confidentiality in their responses. Hence, in-keeping with this confidentiality clause the data presented in this chapter is based upon the summary statistics drawn from the database of survey respondents.

The questionnaire sent by mail to 300 executives of MNCs. However, 52 executives return their surveys. 18 firms replied that they were either unable or unwilling to participate in the study, most stating company policy and/or confidentiality issues as reasons for their nonparticipation. A further 40 questionnaire packets were returned unopened and given the fact that these firms had recently relocated.

In the survey, 40 of 52 respondents were general managers; five of them were finance managers, four of them marketing managers and three of them assistant general managers.

Thirty-seven percent of the firms belong to financial intermediation; manufacturing is the second largest sector with a share of 27 percent to which the respondents belong. The transport, storage and communications sector is the third largest sector with 12 percent. Wholesale and Retailed Trade has eight percent, whereas, construction sector has a share of four percent. Other sectors, including agriculture, electricity, real estate, wholesale and retail have 12 percent in total.

On the other hand, the sectoral distribution of MNCs operating in Turkey by 2006 was about; 40 percent of the MNCs in Turkey operate in the financial intermediation sector, the transport, storage and communications sector has a share of 38 percent, very close to financial intermediation. Third largest sector MNCs belong to is manufacturing with a share of eleven percent. The wholesale and retail trade sector has a share of five percent.

The sectoral distribution of respondents firms is similar with the sectoral distribution of total MNCs in Turkey, except the second largest sector is manufacturing with 27 percent in the questionnaire survey, whereas it is the third largest sector with a share of 11 percent. On the other hand, the transport, storage and communications sector is the second largest sector with 38 percent in Turkey it has a share of 12 percent in the survey.

[22] I was concerned if the respondents reply the survey considering only the year 2006. In order to minimize this, at the questionnaire, the importance of regarding the period 2001-2006 essentially mentioned. However, there is no guarantee that all respondents act in accordance to this fact.

THE ROLE OF INSTITUTIONAL VARIABLES

In Turkey for foreign investors, political and macroeconomic instability are seen as the most significant facts that hinder higher inflows of FDI. Stability is a crucial factor when it comes to FDI because it is a way that investors measure the security of their investment. It indicates the likelihood that the government in power will be destabilized in unconstitutional or by violent means. Where investors are uncertain about a country's political and economic stability they adopt a "wait and see" attitude.

Table 2. Barriers to Foreign Direct Investment in Turkey

(General)	Number of Responses	Mod	Mean	Standard Deviation
Political instability	52	5	4.37	0.817
Macroeconomic instability	52	5	4.35	0.738
Exchange rate risks	49	4	3.92	1.017
Inflation	47	4	3.89	0.759
Insufficient development of financial markets	49	3	3.22	1.066
Slow progress of privatization program	48	3	3.02	1.101
Possible obstacles against EU membership process	47	2	2.89	1.088
Competition from Central and East European Countries	48	3	2.88	1.044

In the survey, political instability has a mean of 4.37 and macroeconomic instability has a mean of 4.35. Stability is a crucial characteristic of an economy that investors want to see prior to establish their investment in a host country. Political and economic stability enhances the amount of predictability and the ability to forecast future events. In Turkey, some link political stability with a single-party government rather than with coalition parties ruling the country. However, indicators of political stability are government effectiveness, regulatory quality, and the rule of law. Most investors, when creating a business plan or project proposal, want to be able to estimate costs, competition, regulations, and potential returns. Government effectiveness is a measure of the government's ability to stay in office and carry out its declared program(s), depending upon such factors as the type of governance, cohesion of the government and governing parties, approach of an election, and command of the legislature. Economic stability can be captured in macro-economic indicators, such as inflation and growth. It can be argued that only if the country can provide a politically and economically more stable and open environment, can more specific efforts, targeted at improving the investment environment directly, be effective.

High means of exchange rate risk and inflation reflect that respondents consider the 2001-2006 period when answering the survey. If the survey had been applied five years earlier the mean scores would be much higher. However, the exchange risk and risk of inflation with mean scores of 3.92 and 3.89 are welcome as deterrent indicators for investors.

Insufficient development of financial markets has a 3.22 mean score. Progress in establishing financial infrastructure and capital markets is important for foreign investors because it facilitates access to local capital markets. The better developed markets encourage business to set up operations, as they can access complementary local finance more easily, and face lower transaction costs for local financial services such as the payment system. However, foreign investors may substitute locally raised capital for capital raised on international capital markets, which would lead to a reduction of recorded FDI inflow. Nonetheless, the received consensus is that the former effect dominates over the latter.

Although in many studies the positive effect of privatization on FDI is emphasized, interestingly the slow progress of privatization programs does not have a priority as an obstacle of higher FDI inflow with a mean score 3.02.

Privatization is a signal to multinational investors that a country is ready to foster a competitive market economy. FDI can also be very useful to a nation's privatization process by bringing in additional management expertise and marketing channels. Given that Turkey needs significant FDI to enhance its infrastructure and to achieve its privatization goals, it needs a good environment for privatization and private participation in infrastructure. It also needs to privatize to attract even more FDI.[23]

Also possible obstacles against EU membership do not have a priority as an obstacle for higher FDI inflow with a mean score of.

Interestingly, respondents do not identify Central and East European countries as primary competitors of Turkey. However, during the FIAS field mission in 2000, more than 50 foreign and domestic firms interviewed identified Hungary, Poland, and the Czech Republic as primary competitors of Turkey for FDI attraction. This finding is also supported in the study of the Loewendahl and Loewendahl (2001).

Table 3. Barriers to Foreign Direct Investment in Turkey

Institutions, Administrative Barriers	Number of Responses	Mod	Mean	Standard Deviation
Anti-competitive practices by government	47	4	3.98	0.872
Consistency/predictability of officials' Interpretations of regulations	51	4	3.92	0.744
Unstable and unreliable, non transparent legal and regulatory framework	50	5	3.84	1.131
Problems with recognition of patent rights	48	4	3.81	0.915
Corruption	45	4	3.8	1.079
Start up procedures	49	3	3.76	0.99
Too many days to resolve a commercial Dispute in the country's courts	46	3	3.59	0.884
Lack of enforcement of laws and Contracts effectively	50	4	3.54	1.014
Complex, slow and expensive property registration process	48	3	3.54	0.824
Delays in the courts	48	3	3.5	0.968

[23] A FIAS study on "Facilitating Foreign Participation in Privatization," for a sample 36 countries implementing privatization programs concluded that every dollar of privatization revenues attracted on average an additional 88 cents in FDI. See F. Sader, Facilitating Foreign Participation in Privatization, FIAS Occasional Paper no. 8, Washington, DC, 1996.

Table 3 demonstrates significant results regarding institutional variables. Anti-competitive practices by the government (with a mean 3.98), consistency and predictability of officials' interpretations of regulations (with a mean 3.92), unstable and unreliable, non-transparent legal and regulatory framework (with a mean 3.84) problems with recognition of patent rights (with a mean 3.81) and corruption (with a mean 3.80) are significant facts hindering the higher level of FDI inflows for foreign investors.

Beyond the establishment of markets as basic institution for the exchange of goods and services, regulatory institutions such as a competition policy are required. While liberalization has been rapid throughout the developing countries including Turkey, the process of designing and implementing competition policy has been far more complex (P.G. Hare, J. Batt, M. Cave, and S. Estrin, 1999:1-30).

Governments in the less reformed countries continue to protect the markets of their local firms, even at the sub-national level. Studies, especially those focusing on transition economies reveal that only successful implementation has a strong positive relationship with the economy-wide intensity of competition, whereas the mere existence of rules does not.

Unstable and unreliable, a non-transparent legal and regulatory framework with a mean 3.84 is regarded one of the most important deterrent factors by respondents. This is because an efficient legal infrastructure reduces institutional uncertainties for foreign investors, facilitates the establishment and enforcement of contracts and in various other ways reduces the transaction costs of doing business in an economy. Turkey has fallen behind many other developing countries in effective liberalization of its legal framework, and in its enforcement practices to reap the benefits of the rapid globalization that is transforming international economic relationships.

Poor implementation of existing legislation is one the main problems in Turkey. Missing implementing rules and administrative guidelines, inconsistent application of laws, incompetent bureaucrats in charge, and lack of judicial enforcement are the issues mentioned most frequently by foreign investors in interviews. The rule of law refers to the enforceability of contracts, something on which foreign investors place great importance. Investors want to know that their rights and their business will be protected when operating abroad. Corruption diminishes the rule of law, most simply because some businesses do not operate within the law and this reduces fair competition.

In the perspective of foreign investors, legislative reform in Turkey does not appear to be sufficiently reliable. Adopted laws are often not implemented on time.

One of the executives replied the question about the newly enacted laws: "Are you satisfied with the progress in the judicial system? By giving an answer, governments may carry on enacting laws; however, we are suspicious about the way they are interpreted." Another point frequently raised by investors is a lack of confidence in the impartiality and quality of the commercial courts. Plus, most of the executives mentioned that unstable, non-transparent legal and regulatory framework make the Turkish business environment difficult to operate. Some argued that recently enacted law about the recognition of patent rights are not applied with sensitivity.

Corruption is another issue raised by investors. Corruption within the political system that is a threat, especially in the long-run, to foreign investment by distorting the economic and financial environment, reducing the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability, and introducing inherent instability into the political process.

While the recent government efforts to curb corruption deserve much praise, investors suggested that they do not trust in the impartiality of administrators in critical cases, especially in customs administration and municipal level procedures such as site development. Corruption is marked in the Transparency International's year 2000 corruption perceptions index (CPI) Turkey ranks 50^{th} among 90 nations listed.

Table 4. Transparency International Rankings

Rank	Country	2005 CPI score	2000 CPI Score
1	Iceland	9.7	9.1
	Finland	9.6	10
2	New Zealand	9.6	9.4
4	Denmark	9.5	9.8
5	Singapore	9.4	9.4
6	Sweden	9.2	9.4
47	Czech Republic	4.3	4.3
48	Brazil	3,7	3.9
49	Mexico	3.5	3.3
	Peru	3.5	4.4
	Turkey	3.5	3.8
50	Poland	3.4	4.1
51	India	2.9	2.8

Source: Transparency International 2006.

Most of the executives I interviewed mentioned that corruption is a deterrent factor for foreign firms. I asked whether corruption may make things easier in the first steps of the investment process. In other words, I asked the question whether corruption is effective in the short-term or not. All the answers emphasized that large corporations pay special attention to the institutional organization of the corporations. An institutionalized corporation pays special attention to certainty when operating in another country. Corruption makes things uncertain in a business environment which in the end may have negative affect on all firms operating in the long run.

The weakness of the judicial system and enforcement of contracts and the recognition of property rights create a feeling of insecurity and arbitrariness. Under such circumstances, the long-term commitment of substantial investment funds seems risky if plans are challenged or overturned from day to day, or whenever an official is replaced. The weakness of the judicial system causes the increasing and unrestrained power of such officials. Plus, in countries in which the enforcement mechanisms are weak, the share of informal economy is large, in parallel. In other words, compliance with the formal institutions is too costly and the government does not have the power to effectively enforce its costly rules in these countries.

It is important to improve the enforcement of dispute resolution and "conflict of interest" legislation. However, in Turkey the executives that I interviewed emphasized that some of the laws in Turkey are ambiguous and therefore difficult to enforce. The rule of law is perceived as weak by foreign investors. This problem can be improved by creating an independent dispute resolution mechanism or by improving the legitimacy of those responsible for regulating legal disputes and contracts.

Table 5. Doing Business in 2005 – Selected Developing Economies

	Protecting Investors			Enforcing Contracts		
Economy	Rank	Disclosure Index	Investor Protection Index	Rank	Procedures (number)	Time (days)
Argentina	96	6	4.7	65	33	520
Brazil	58	5	5.3	117	42	616
China	114	10	4.3	59	31	292
Colombia	33	7	6	141	37	1,346
Czech Republic	81	2	5	55	21	820
Egypt	114	5	4.3	157	55	1,010
Hungary	114	2	4.3	11	21	335
India	33	7	6	173	56	1,420
Indonesia	58	8	5.3	144	34	570
Malaysia	3	10	8.7	78	31	450
Mexico	133	7	4	82	37	415
Peru	18	7	6.3	106	35	381
Philippines	151	1	3.3	50	25	600
Poland	43	7	5.7	111	41	980
Singapore	2	10	9.3	23	29	120
Turkey	58	8	5.3	69	34	420
Venezuela	162	3	2.7	125	41	435

Source: The World Bank, 2006.

Not only are the administrative procedures time-consuming; enforcement procedures for commercial cases at the courts take much longer than many other countries. Table 5 shows that cases in Turkey and in several emerging economies take often more than a year. This is worse than in Poland (an average of 6 months, though in Warsaw up to 40 months), Hungary (80-90% solved within 1 year) and Czech Republic (average of 1.5 years). However, it is essential to note that the key policy strategy of these nations has been to recognize the problem and take action to improve the situation, while Turkey has only recently recognized the problem.

The protection of intellectual property rights (IPR)is particularly important for producers with a high rate of innovation like computer software developers or pharmaceuticals, as well as producers of products with well-known trademarks like some beverages, cloths, or automobiles. As globalization has taken hold, good IPR protection is becoming more and more important to attract world-class technology and the export-oriented plants that have to use it.

As in other dimensions of the business environment in Turkey, the major problems in IPR protection are caused not so much by inadequate laws as by a lack of effective enforcement. Internationally known brand names and trademarks are increasingly subject to illegal exploitation and pirating. Since 1992, the US Treasury has listed Turkey on its Priority Watch List, under its Special 301 provision for continuous violation of intellectual property rights (FIAS, 2001).

Whole legal framework for intellectual property rights is relatively new in Turkey, and much effort has been spent on fulfilling obligations stemming from the membership of the World Trade Organization (WTO) and the accession to the European Union (EU).

In the survey, administrative barriers such as complex, slow and expensive property registration process and too many days to resolve a commercial dispute in the country's courts have 3.59 and 3.50 mean scores. The mean scores are significant although these indicators stay behind the several institutional variables at the list.

THE QUALITY AND INTEGRITY OF PUBLIC SERVICES

The overall quality and efficiency of services gives an idea about the legislation, infrastructure, and the sensitivity towards protecting property rights. As they find these services attractive, they inform the quality of the services to the foreign investors outside the country.

The overall quality and efficiency of services delivered by the following public agencies or services: (1 very bad to 5 very good)

Table 6. Functioning of Institutions and Public Services

Indicators	Number of Responses	Mod	Mean	Standard Deviation
Property rights	49	3	3.14	0.89
Labor regulations	49	3	3.04	1.06
Business licensing	47	3	3.02	0.737
Tax regulations/administration	49	3	2.69	0.713

When the quality and integrity of public services are considered, it can be argued that indicators such as property rights, labor regulations and business licensing have moderate mean scores except for the quality of tax regulations and administration. Property rights has a mean score 3.14; labor regulations; 3.04, and business licensing 3.02. Executives, during the interviews, mentioned that tax regulations were complex, inefficient and hence, a deterring factor for FDI inflows.

Table 7. Infrastructure and Legislation (1 very bad 5 very good)

Indicators	Number of Responses	Mod	Mean	Standard Deviation
Communication service	52	4	3.87	0.793
The electric power	51	4	3.51	1.189
Transportation service	52	3	3.4	0.774
Roads	50	3	3.22	1.016
Functioning of government	51	3	3.16	1.007
The parliament	50	3	2.8	0.857
Judicial system	52	3	2.65	0.861

Table 7 demonstrates that whereas indicators belonging to infrastructure have high mean scores, administrative and legislative issues have relatively low scores. Communication service is at the top of the list with a mean score of 3.87. Electric power has a mean score of 3.51, while transportation service has a score of 3.40 and the quality of roads has a mean score of 3.22. On the other hand, the quality of the functioning of government comes after the indicators of infrastructure with a mean score of 3.16. The score of 2.86 for the parliament and 2.65 for the judicial system reveal that foreign investors are suspicious about the quality of legislative and administrative functioning.

As seen from the survey, the functioning of the judicial system and the predictability of rules and regulations are perceived as significant by respondents. In order to get specific results, I asked questions regarding the year 2001 and the year 2006, in order to see whether any progress had taken place in five years on these specific issues. In order to get specific results, I offered specific statements and asked if the respondents agreed with the statements or not.

Table 8. Statement: "In general, information on the laws and regulations affecting my firm is easy to obtain"

Years	2001			2006		
Number of firms	Agree	Disagree	No Idea	Agree	Disagree	No Idea
51	15	12	24	37	4	10

The responses to the statement reveal that there was progress in obtaining information on the laws and regulations affecting respondents' firms. Considering the year 2001, 15 respondents stated that receiving information on the laws and regulations, whereas regarding the year 2006 the number of respondents agreeing with the statement reached 37. Twelve respondents disagreed with the statement for the year 2001 whereas this number decreased to four for 2006. The number of indifferent respondents decreased from 24 for 2001, to 10 for 2006.

Table 9. Statement 2: In general, interpretations of regulations affecting my firm are consistent and predictable

Years	2001			2006		
Number of firms	Agree	Disagree	No Idea	Agree	Disagree	No Idea
51	8	27	16	22	17	12

Especially during the interviews, one of the important tasks that executives faced was the interpretations of regulations. Most of the executives stated that, although significant changes took place in many areas such as the legislative and judicial system, and different interpretations of laws affect their operations negatively. However, the table demonstrates that over the years, the number of respondents considering the interpretations of regulations as predictable and consistent increase significantly. Regarding 2001, eight respondents believed in the consistency and predictability of regulations whereas, by 2006, the number increased to 22. While the share of respondents decreased, the number of indifferent respondents, only slightly changed.

These results suggest that for the respondents, access to the information of laws and regulations, and the predictability and consistency of the regulations regarding their business improved during five years.

PREDICTABILITY

However, according to respondents, while the predictability and consistency of regulations related with their business increased, in general they are skeptical about the certainty and predictability of the general policy changes in the country.

Table 10. Changes in economic and financial policies are (1:highly unpredictable 5: highly predictable)

Indicators	Number of Responses	Mod	Mean	Standard Deviation
Changes in rules, laws and regulations	51	3	2.37	0.999
Changes in economic and financial policies	50	3	2.22	0.996

The lowest mean scores in the survey are related to the predictability in changes of rules, laws and regulations (2.37 mean score) and changes in economic and financial policies (2.22). Law-making procedures often lack participation of the people subject to it. Business organizations in Turkey complain that they are often not consulted when important legislation for the business environment is being drafted; this is again indicates that most officials do not see investors as a constituency which they should heed. The business community feels left out in the democratic process of discussing changes in the legislation.

In sum, in the questionnaire survey, I had a chance to see the impact of more institutional variables on FDI. What I find is that institutional variables have significant impact on FDI inflows. In addition, the questionnaire survey results are compatible with other surveys of institutional corporations.

CONCLUSION

In this chapter, my results point out that institutional variables such as; low level of corruption, government stability, enforcement of contract law, functioning of judicial system, transparent, legal and regulatory framework political and economic stability, intellectual property rights, efficiency of justice and prudential standards have significant impact on FDI in Turkish economy.

The results of the chapter are encouraging in the sense that efforts towards raising the quality of institutions (especially in the Turkish case) may help developing countries to receive more FDI, hence help them to enjoy of higher GDP per capita. The findings presented in this chapter, when incorporated with the existing works on FDI, provide an explanation of the distribution of foreign direct investment across countries. The empirical results point to the importance of political and economic institutions for foreign direct investment.

The political economy approach and the empirical study in this chapter reveal that the nature of the interaction between MNCs and each country is the result of a more complex set of factors than only market size or market related variables orientation. It takes place within the host country's unique economic, social, and legal structures; it involves institutions.

Generally, legal infrastructures, including legal system development and enforcement, are generally weak in most developing countries. Bribery and corruption are obviously more invasive in emerging markets than advanced economies. It is generally less difficult to enact and develop various laws, but political, social, historical or cultural factors often impede the implementation and enforcement of these laws. The roles of law and judicial systems differ among countries. The gap between the law on the books and the law in practice can be vast. Legal standards tend to be ideals, not necessarily achievable.

Then, what new or strengthened institutions will increase the attractiveness of an economy to FDI inflows? Which political institutions provide FDI to attract higher levels of FDI flow?

Recently, Turkey has made considerable progress in modernizing its business legislation. In the first half of the 1980s there were major reforms, and a second wave that began in the mid-1990s is still underway. While there are some gaps in the body of laws and regulations, poor implementation of existing legislation is the main problem. Missing implementing rules and administrative guidelines, inconsistent application of laws, incompetent bureaucrats in charge, and lack of judicial enforcement are the main problems.

In order to increase the quality of institutions in order to enjoy high economic growth rates and receive high levels of FDI inflows the state should adopt several policies such as introduction of independent regulatory agencies in various fields such as competition, banking, and telecommunications; adoption of modern legislation to protect industrial property rights; invitation of all relevant business association to comment on draft legislation.

Therefore, institutional reform –adapting institutions to perform new roles and functions in harmony with social needs – is a key ingredient of successful reform for developing countries, including Turkey.

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