

FDI in Turkey – Opportunities and Challenges

June 2017



European Bank
for Reconstruction and Development



- Turkey's fundamentals as a destination for FDI
- FDI flows to Turkey
- Structural impediments
- Competitiveness and productivity
- What to do
- How EBRD is helping

Turkey – an attractive destination for FDI?



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Turkey as a destination
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FDI flows in Turkey

Structural impediments

Competitiveness and
productivity

What to do/how EBRD
is helping

- **Positives:**

- Fast growing, young population
- Large and growing middle class
- Attractive geographical situation – links with EU (1995 Customs Union agreement), and close to Asia, Middle East.

- **Challenges:**

- Geopolitical risk
- Economic volatility
- Competitiveness issues

FDI flows to Turkey



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Turkey as a destination
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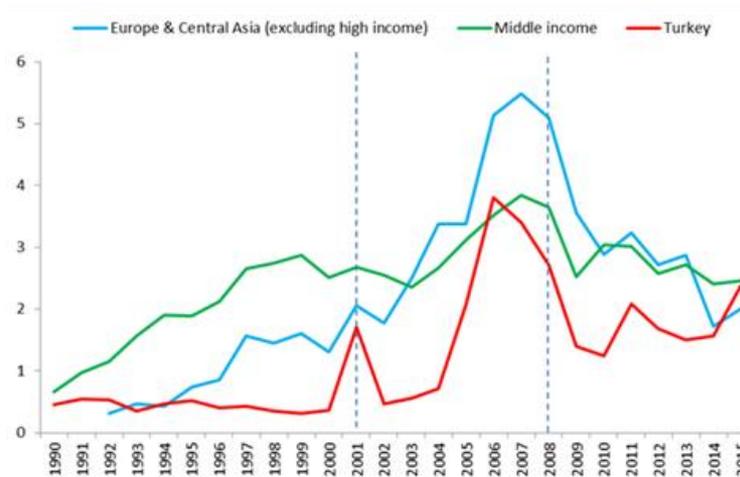
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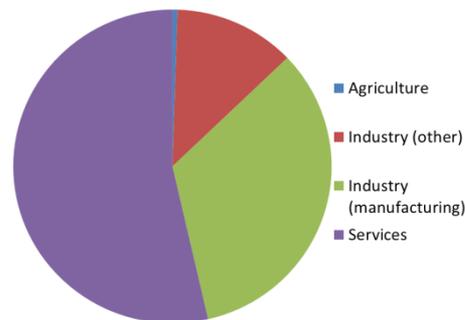
- FDI net inflows



- Slowdown since GFC partly due to timing as GFC impaired balance sheets of banks and NFCs
- Also due to slowdown in EU, Turkey's main source of FDI
- Diminished prospects of EU membership?



- Most FDI following the 2001 reforms was into non-tradables, financial intermediation more specifically.



- Studies show that FDI into nontradables may cause economic volatility by fuelling domestic demand booms and boost imports, resulting in trade deficits and increasing internal and external imbalances. It also drives up domestic inflation.
- Furthermore, it creates few opportunities for technology transfer.
- The composition of Turkey's FDI helps explain the continued trade deficit and high inflation rates which act as deterrents to investment.

Structural impediments to FDI



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- Structural impediments include
- Economic volatility. Heavy investment in financial intermediation following the reforms of 2001 was beneficial in terms of promoting financial deepening , but it worsened external and internal imbalances which increased economic volatility. In such circumstances investors prefer short term portfolio investment to FDI.
- Turkey's competitiveness. In turn this is dependent on productivity. Competitiveness is key to making a country attractive to investors, and Turkey faces a number of issues in this regard.

Turkey's competitiveness (I)



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- Around one third of the country's exports are low to medium tech products, which are generally final products rather than inputs, and their import content is low. As such the country is not integrated into global value chains.
- A lack of innovation and R&D – the country ranks 103/138 in terms of the quality of scientific research institutions – has held the country back from moving into higher value, higher technology products.
- Persistent high inflation has eroded the country's competitiveness, countering the effect of the depreciation in nominal exchange rates in recent years.
- The undifferentiated nature of exports means they have a high price elasticity of demand, which in turn means that price competition is important for exporters. However, inflation keeps the REER overvalued.
- Furthermore, inflation has increased input (particularly labour) costs.

Turkey's competitiveness (II)



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- On top of this, the labour market suffers from inflexibility, faced with high severance costs and minimum wages. There is also a significant skills gap. Labour market efficiency it ranks 126/138 in the GCR. This has two effects:
 - Hampers firms' ability to adjust to technological and market changes that require labour reallocation, pushing down on productivity.
 - Disincentivises formal employment.
- Further competitiveness-related issues include weak institutions. Notably, Turkey ranks 1707/138 in terms of judicial independence . This is important as studies show that the strength of institutions is seen as the most important factor in attracting FDI.

Measures to increase Turkey's attractiveness for FDI



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What to do/how EBRD is helping

- Turkey has good economic fundamentals, making it an attractive destination for FDI.
- Some structural changes are required to fully exploit the possibilities.
 - Currently employees trapped in low productivity informal or semi-formal firms. Need to shift to better performing firms. Requires...
 - Rebalance economy from domestic to external sources of demand. Need to focus on attracting FDI into non-tradables. Will help address external imbalances and increase technology transfer.
 - Having successfully moved from low to medium technology production, the goal should now be to move into the high technology sphere, and integrating Turkish firms into global value chains. This will...

EBRD activities to help improve the Turkish investment environment

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What to do?

Inclusive

- Enhance the engagement of the private sector in updating and improving (vocational) skills standards and work based learning policies through direct engagement with local and national education authorities.
 - Partnership agreement with the European Training Foundation
 - MoU with the Turkish Ministry for National Education
 - Public and Private Sector Steering Group established

Competitive

- Initiate the rationalisation of incentives measures provided to agricultural sector
 - Mapping and benchmarking studies on existing support measures in agricultural sub-sectors

Integrated

- Liberalisation of the railway sector by finalising the approval of secondary legislation
 - The Bank has engaged with Turkish National Railways under an advisory approach