Turkey and Foreign Investors

Over the past year, foreign investors have reacted in various ways to the situation in Turkey. Most of them sold off the Turkish assets they held in their portfolios and left the country. Turkey has put foreign investors in a tough spot and they are faced with the dilemma: to stay or go? The flight of so-called "hot" money—short-term investments in treasury bonds and stock market securities—reached an unprecedented level in Turkish history.

Faik Oztrak, former Deputy Undersecretary of Treasury, stated that in 2015, foreign-held portfolios had shown a net outflow of capital of $9.4 bn. This amount exceeded the volume of assets sold during the financial crises of 2001 to 2008. The capital flight in 2001 amounting to $7 bn was particularly painful, as Turkey’s exchange reserves were very low at that time.

Oztrak said that, according to Central Bank statistics, the sale of foreign-held assets in the past year reached a record high. He also warned that “In 2016, global conditions remain uncertain. An unfavorable move by the US Federal Reserve, for instance, could lead to a repetition of what happened in 2015.”

Economic trends, however, are by no means a "one-way street." In contrast to the flight of short-term investments, foreign direct investment (FDI) in the Turkish economy amounted to $16.75 bn in the past year. In 2007, FDI reached a record high since 2000, topping off at $22 bn, with FDI amounting to $19.7 bn in 2008, before the country experienced the effect of the crisis.

In 2009 and 2010, FDI plummeted (in comparison with 2007) to $8.6 bn and $9 bn respectively, and then started climbing up reaching $16 bn in 2011. In 2012, FDI dropped to $13.28 bn, and in 2013—was down to $12.38 bn. Then it showed some improvement rising to $12.52 bn in 2014. Growth of FDI in 2015 by $4.2 bn had instilled a fragile hope of returning to the pre-crisis level.

Acquisition of immovable property emerged as a significant share of the FDI. FDI amounted to $2 bn in 2011, $2.6 bn in 2012, and $3 bn in 2013, having exceeded $4 bn in 2014 and 2015. Although immovable property is said to be a “dead investment,” not contributing to the economic growth in any way, Turkish government masquerades FDI as a “driving force” in attracting foreign investors to Turkey.

Will the FDI growth trend continue this year and reach the pre-crisis level of $22 bn? So far, figures for January 2016 are the only ones to have been released ($620 million). This is apparently not nearly enough to reinforce optimism. This number is noticeably lower than $1.73 bn invested in January 2015. What’s more, over a third of these funds ($250 million) were invested in real estate.

The Turkish economy's failure to show a growth rate adequate to the growth rate of FDI is another compelling problem. According to Turkish Minister of Economy Mustafa Elitas, the country had attracted $165 bn in FDIs since 2002, when Justice and Development Party came to power.
In the period from 1950 to 2002, Turkish economy was showing an average annual growth of 5.1%, despite a series of economic crises and military coups, while FDI amounted only to $5.1 bn. In the period from 2002 to 2014, FDI amounted to $148.2 bn, while average growth remained at 4.7%. According to the 2015 statistics, the volume of investments in FDI in 2015 amounted to $16.75 bn and the country’s economy growth rate was at 4%, i.e., the gap between these two indicators had been apparently widening.

Why then was the rate of economic growth under the AKP below the average rate of the pre-AKP period, despite a multifold increase in FDI? Mahfi Egilmez, former Deputy Undersecretary of Treasury, offered the following explanation saying that "An important part of the foreign capital inflow since 2003 went towards the purchase of existing plants and companies rather than new investments. Hence, it did not create new production capacity to contribute to growth. Another part [of FDI] went towards the construction sector, which meant one-off contributions to growth."

Meanwhile, the flight of "hot" money has depleted Central Bank's reserves. "We've eaten away at stocks. The Central Bank reserves are down," told Durmus Yilmaz, former Governor of Turkish Central Bank, to Al-Monitor. He stressed that the current account deficit—$32 bn at the end of December last year—was offset with $7.5 bn from FDIs, $8.4 bn from inflows of unexplained origin and $16 bn from Central Bank reserves.

Yilmaz believes that both economic and political factors will trigger an outflow of foreign investments from Turkey in the forthcoming period. "The coordination glitches in management of the economy and the regression and uncertainty in the rule of law, human rights and property rights seen in recent years will all play a major role in determining capital flows," said Yilmaz.

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