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EU Foreign Direct Investment Policy and Its Implications for Future Turkey - EU Relations

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Abstract

Following World War II, regionalism – which was usually state-led and impacted by altering international politics – emerged as a reaction to the economic challenges of globalization. Regional trade agreements (RTAs), which provide a way for adjacent nations to seize possibilities and difficulties presented by globalization, have increased as a result of global economic integration. However, in order to participate in some form of integration with other sovereign states, a state must give up a portion of its sovereignty. The desire for politically and militarily stronger member states, economic cooperation, confidence-building, security concerns, RTA as a negotiation tool are some examples of economic drivers for joining an RTA. In the modern global economy, employment, technical development, and economic growth are all significantly influenced by foreign direct investment (FDI). Using historical and comparative analytical methods we present Turkey's success in FDI attraction. The results demonstrate that strategic location, educated workforce, and liberalized investment environment have made Turkey an attractive destination for FDI. Factors such as relative economic stability, market size, labour costs, infrastructure, and natural resources influence the decision to invest in Turkey. Furthermore, research verify that the FDI has contributed to job creation, employment opportunities, and facilitated the transfer of technology, knowledge, and managerial skills. Turkey is also one of the six largest trading partners of the EU and has a close relationship with the EU. FDI has played a crucial role in upgrading Turkey's industrial base, boosting its export capacity, and bolstering its diplomatic influence. Policy recommendations based on conducted study encourage political and economic autonomy. Turkey should prioritize strengthening its foreign connections and expanding trade rather than enlarging its membership in the EU. It should enhance alliances with the Middle East and Russia as well, especially in the field of energy. The EU remains a desirable investor and destination for Turkish capital, but it is important to avoid relying solely on one primary source.

Keywords: Economic Sovereignty, EU FDI Screening regulation, Foreign direct investments (FDI), Multinational corporations (MNC), Regional trade agreements (RTA), Regionalism, EU – Turkey relations
Jel codes: F13, F15, F59

1. Introduction

After the WWII most of the countries in Europe, and somewhat later in the rest of the World, realised that their economic interests in the current era of Globalization would best be served by establishing some sort of regional economic integration; be it something as simple as a free trade area or something as complicated as an economic union. With the rise of Globalisation from 1960s onwards, this trend only intensified. If we define Globalization as “the integration of world economy” (Gilpin, 2001, 364) then we can also understand regionalism as a response to economic complexities of Globalization. According to Stefanova “Regionalism is a multilayer phenomenon embedded in the shifting nature of global politics and the intensification of globalization” (Stefanova, 2018, 6). It is often state lead and as Schultz et al. point out ‘Regionalism’ represents a general phenomenon, denoting formal and often state-led projects and processes and a body of norms, values, objectives, ideas and a type of international order or society” (Schulz et al., 2001, 5).

The global environment is too insecure for the individual states (especially small or medium states) to handle alone. Because of Globalization other actors appeared on the international scene that have some sort of “new” economic and politic powers (multinational corporations - MNCs, international institutions like WTO, IMF, World Bank), which were previously sole prerogatives of state. Ergo, states are no longer key and only players in the arena of international political and economic relations. States respond differently to globalizing pressures. Drahkuopil points out that common pressure like globalization” influence macroeconomic outcomes as they produce comparative institutional and structural advantages, which in turn shape the nature of international exposure and integration of a given economic space” (Drahokuopil, 2009, 13). Majority of the scholarship on regionalism is concentrated on explaining the factors which deal with the emergence of regional political-economic formations (like custom unions, free trade areas, EU etc) and their impact on the economy (occasionally politics as well) of member countries or on the global arena the most common feature of economic sovereignty is the ability of state to lead independent monetary, fiscal and trade policies limited only by the exogenous factors. Selleslaghs and Van Langenhove point out the classical types of regional integration which depend on the scope of activities and loss of sovereignty, namely: “regional cooperation, regional harmonization and truly regional integration. Whereas regional cooperation is a rather “issue-focused arrangement” and related to knowledge and best practice sharing, regional harmonization goes a little further as it is more intended to address inconsistency in policy content and approaches. Integration finally implies a loss of sovereignty, and also tends to apply to a broader scope of policy areas” (Selleslaghs & Langenhove, 2020, 152).

Limitation to economic and political sovereignty start when state enters custom union since it must give up its own trade policy and transfer this sovereign prerogative to custom union. The only example of common market and economic union in the World is European Union. Membership in EU limits states sovereignty in many ways. First, state must bring its own legal system in accordance with EU law and EU law is always superior do domestic law. Also, all the member states, apart from Denmark (TEU,1992) must introduce EURO as a common currency so the member states of EU lose the ability to wage their own monetary policies. Under the Stability and growth pact the fiscal policies of Euro area members have been subjected to monetary policy conducted by European Central Bank. And finally, with the membership in EU state loses power to conduct independent trade policy since trade policy under the auspices of article 207 TEU is the sole prerogative of the EU and commission of EU acts on behalf of all member states in negotiating trade agreements with third countries or within WTO (Consolidated version of the TEU - PART FIVE - Article 207 (ex Article 133 TEC), 2008).

The purpose of this paper is to analyse Turkey’s achievements in FDI attraction. The implemented methodology utilises historical and comparative analytical methods. The paper examines implications for future Turkey – EU relations and stipulates policy recommendations. It is organised as follows, following the introduction, the paper provides short overview of the FDI theoretical framework. Section three is focused on the role of the FDI in the EU, while section four discusses Turkey - EU relations, spotlighting the foreign direct investment attraction in Turkey. Section five concludes and proposes policy recommendations for enhancement of Turkey’s FDI competitiveness.

1. Foreign Direct Investments - FDI

One of the main reasons why countries decide to enter Regional Trade Associations is to attract more Foreign Direct Investments. Adam Smith famously observed in the Wealth of Nations that “The... proprietor of stock is properly the citizen of the world and is not necessarily attached to any particular country. He would be apt to abandon the country in which he is exposed to vexatious inquisition, in order to be assessed burdensome tax, and would remove his stock to some secure country, where he could either carry on his business or enjoy his fortune at his ease. A tax that tended to drive away stock from a particular country would so far tend to dry up every source of revenue, both to the sovereign and the society. Not only the profits of stock, but the rent of land and the wages of labour, would necessarily be diminished by its removal” (Smith, 2003, 848-849). This definition points out that bar the imposition of capital controls capital has historically been seen as a “very” mobile factor of production, which puts certain restraints on economic policies of countries. OECD gives the following definition of FDI: “FDI reflects the objective of obtaining a lasting interest by a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor (direct investment enterprise)” (in Neuhaus, 2006, 42). Nayak, for example, points the simple fact that “FDI depends upon two key agents, namely a firm that desires to invest in another country, i.e. investing foreign firm, and a country open to foreign investment, i.e. the host country” (Nayak, 2008, 6).

Gilpin makes an interesting observation about the FDI: “in the ideal world of the neoclassical economist firms would not invest abroad (Gilpin, 2001, 279). According to neoclassical theory the firm operates solely on the market signals and it doesn`t matter whether its production is located in its home country or abroad (ibid).

Cohen and Barbić point out the three main characteristics of the MNC: “firstly, have an unlimited life that allows them to continue even though owners and managers come and go, secondly, allow easy transferability of ownership interests by shares of stock that can be transferred from one owner to another quickly and easily, and thirdly, have limited liability. Owners’ losses are limited to the funds they invested in the corporation, that is, owners cannot be assessed to cover corporate deficits or obligations (Cohen, 2007, 28; similar in Barbić, 2020, 7-16.).

First of all, the MNC in the form of the company or the limited trade partnership is a legal fiction, which allows it to exist in the World of Law and allows it to enter legal contracts (as an active or a passive party, according to the Civil and Trade Law) and to own property (according to the civil law). Its “legal existence” is totally different from the legal existences of its employees (stockholders) or its owners (shareholders). This is important not only from the point of the trade, corporate and civil law, but also from the point of penal law, which under some circumstances allows for the criminal prosecution of the corporation (almost always in the case of the environment pollution).

These are the basic legal definitions of corporation. Beyond these simple definitions other definitions of corporation tend to be overly ideological. Historically speaking company was one of the essential ingredients of the Western success, since other cultures did not have the same legal solutions for the economic activity of enterprise (similar in Micklethwaith & Wooldridge, 2003, XX-XXI) .

Finally, there are three channels through which FDI has impact on economic growth: “1) Direct Transmission (through “Greenfield Investments”), 2) Indirect Transmission (through “Ownership Participation”) and 3) Second-Round Transmission (through “Technology Spill overs”) (Neuhaus, 2006, 43-44).

2. The role of FDI in EU

FDI is very important for European economic growth, innovation and employment. EU is the main global destination for FDI, amounting to 7 trillion EUR in 2019 and delivering 16 million jobs directly (European Commission, EU foreign investment screening mechanism becomes fully operational, Brussels, 9 October 2020) & (European Commission, Statement by Executive Vice-President Margrethe Vestager on the Commission's proposal for a new Regulation to address distortions caused by foreign subsidies in the Single Market, Brussels, 5 May 2021). European Union is one of the most open economies of the world, building its competitiveness on open trade and investment. In 2017, the EU28 accounted for 1/3 of global investments with over 100.000 foreign owned companies (European Commission, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, Brussels, 5.5.2021 COM(2021) 223 final 2021/0114 (COD), p. 1). FDI is a part of the common EU commercial policy. After the global financial crisis 2007/08, the global trends were moving towards uplifting protectionism across national borders. “The EU is and will remain open to foreign investment. But this openness is not unconditional. To respond to today's economic challenges, safeguard key European assets and protect collective security, EU Member States and the Commission need to be working closely together. If we want to achieve an open strategic autonomy, having an efficient EU-wide investment screening cooperation is essential.” (Dombrovskis, 2020, p. 1).

The COVID-19 pandemic has fast-forward policy actions of protecting “national champions” against foreign takeovers. Some EU Member States have already announced they will be taking actions to protect national companies from foreign takeovers, including recapitalization, buying shares and even nationalizing strategic companies (e.g. France, Italy, Spain) (Baker McKenzie, 2020). In the light of the COVID-19 pandemic, the Commission published a Guidance to the Member States concerning FDI from third countries with an aim to protect and preserve EU companies, primarily (although not exclusively) in health industry. “The Commission urges Member States to be particularly vigilant to avoid that the current health crisis does not result in a sell-off of Europe’s business and industrial actors, including SMEs.” (European Commission, Communication from the Commission Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe’s strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation) (2020/C 99 25 March 2020, p. 1).

Although free movement of capital is guaranteed by the art. 63 of the Treaty on the functioning of the European Union (TFEU) within the EU as well with third countries, it can be subject to exemption justified on grounds of public policy or public security (art. 65 TFEU). The Commission points that movement of capital to and from third countries "takes place in a different legal context compared to restrictions to intra-EU capital movement", therefore, justification for restrictions of foreign FDI may be acceptable and permissible in more broad terms when it comes to third countries. (European Commission, Communication from the Commission Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation) (2020/C 99 I/01), Brussels, 25 March 2020, p. 4-5).

This is not a solitary European policy. Other advanced economies have, over the past years, also introduced more restrictive approach and safeguard regulations with regard to FDI, e.g. the USA, Australia. They include measures such as mandatory notification and declaration requirements along with penalties for failures to apply rules as well as possible government intervention for strategic industries (Baker McKenzie, 2019).

In spring 2020, Margrethe Vestager, the EU competition commissioner and executive vice-president of the European Commission, cautioned that COVID-19 pandemic could make European companies susceptible to foreign takeovers. She warned that such takeovers could transpire distortive effect on competition in the EU market caused by foreign subsidies, i.e. from the non-EU state-backed companies, namely from China (Financial Times, 2020). In June 2020, the European Commission published a White Paper on levelling the playing field as regards foreign subsidies (European Commission, White Paper on levelling the playing field as regards foreign subsidies, Brussels, 17.6.2020 COM(2020) 253) The White Paper points to the gap in the EU State aid rules, which do not apply to subsidies granted by non-EU governments associated with acquisition of EU companies. Stressing the possible detrimental effect of the unfair competition on the Single Market, it proposes new powers to the Commission and national authorities to assess the impact of foreign companies and impose "repressive measures" to remedy the distortions instigated by foreign subsidy (European Commission, White Paper on levelling the playing field as regards foreign subsidies, Brussels, 17.6.2020 COM(2020).

In May 2021, the European Commission published a Proposal for a Regulation on foreign subsidies distorting the internal market (European Commission, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, Brussels, 5.5.2021 COM(2021) 223 final 2021/0114). Along with the new Industrial Strategy, it aims to provide legal mechanisms and tools to address and intervene in takeovers of EU companies that are backed up by foreign subsidies. Financial Times cautions it will take years before this proposal becomes law (Financial Times, 2021). Nevertheless, the EU has a helpful complementary regulation, the EU FDI Screening Regulation, that aims to safeguard European security and pubic order through screening foreign investments in the EU.

3. Turkey - EU relations and Foreign Direct Investment attraction

3.1. FDI in Turkey

With its strategic location bridging Europe and Asia, a young, educated and dynamic workforce, population over 80 million inhabitants and liberalized investment environment Turkey has become an attractive destination for FDI. Several policy reforms implemented by the Turkish government have contributed to the attractiveness of the country for foreign investors. Among them the removal of bureaucratic hurdles, the establishment of Special Economic Zones, and the introduction of investment incentives have played a pivotal role in attracting FDI. These reforms aimed to enhance the investment climate, promote economic growth, and increase the country's integration into the global economy. According to the Turkish Statistical Institute, the country attracted significant FDI inflows, surpassing $200 billion between 2000 and 2020. Until 2002, total FDI inflow was USD 15 billion, while it attracted around USD 240 billion of FDI during the 2003-2021 period (Presidency of the Republic of Turkey, 2022).

The rising middle class and increasing consumer demand have fuelled FDI across various sectors, such as retail, telecommunications, and automotive. The country's proximity to major markets provides access to over 1.7 billion consumers, creating opportunities for companies to establish regional headquarters and distribution centres. Over the past two decades, Turkey has made substantial investments in infrastructure development. Projects such as airports, highways, railways, and ports have not only enhanced connectivity within the country but also improved its logistics capabilities, attracting FDI in sectors like transportation, logistics, and energy.

United Nations Conference on Trade and Development (UNCTAD) data shows that FDI inflows to Turkey have witnessed significant growth in recent years (UNCTAD, 2012). According to a report by the Central Bank of the Republic of Turkey (2022), in the 2003-2021. period financial sector received 31,6% of FDI inflows, manufacturing sector accounted for second largest share of FDI (24,2%), followed by energy sector (10,6%) that was driven by investments in renewable energy projects and natural gas infrastructure, while ICT services received 8.8%, wholesale and retail trade 8,4%, transport and storage 4,7% and construction 3,2% of FDI. Top foreign investors in aforementioned period were from the Netherlands 15.7%, USA 8.1%, United Kingdom 7,5%, Gulf Countries 7,1%, Austria 6,2%, Germany 6,2%, Luxembourg 6%, Spain 5,6%, Belgium 5.2%, France 4,4%, Azerbaijan 4,2% and Greece 4% (Central Bank of the Republic of Turkey, 2021). "As of mid-2022, the number of companies with international capital in Turkey hit 78,257, up from 5,600 in 2002." (Presidency of the Republic of Turkey, 2022).

Numerous factors influence the decision of MNC's to invest in Turkey: geography, demography, economic factors, market factors, policy factors, and institutional factors. Economic stability, market size, labour costs, infrastructure, and natural resources are among the key economic factors. Additionally, trade openness, investment incentives, and the legal framework are crucial policy factors that shape the investment climate in Turkey. FDI has contributed to job creation and employment opportunities, particularly in sectors such as manufacturing, services, and construction, as well as it has facilitated the transfer of technology and know-how, fostering innovation and productivity improvements. FDI inflows have supported export-oriented activities, leading to increased export competitiveness and the diversification of Turkish exports.

3.2. Turkey – EU relations

According to Eurostat (2023) Turkey is one of the six biggest EU trading partners (after USA, China, UK, Switzerland and Russia). The Ankara Agreement between Turkey and the EEC, signed in 1963, represents the beginning of construction of institutional framework of cooperation, after that important first step, Turkey was officially recognized as a candidate country in 1999. The negotiations started in October 2005, in addition, Turkey and the EU signed a Customs Union Agreement in 1995. Today, Turkey is the only non-member country that has a customs union agreement with the EU. Turkey would stand apart from previous EU enlargements in terms of population, size, geographical position, economic, security, and military capability, as well as cultural and religious traits, and these qualities would give Turkey the ability to contribute to international and regional stability (Lejour and de Mooij, 2004). The aforementioned elements play a crucial part in the negotiating processes and may have significant effects, such as changes in the structure of shared EU policies and institutional structures. In most cases, membership in the EU has been considered as a method of bolstering and solidifying political and economic changes. During the negotiating process, Turkey is expected to adjust its political and economic institutions to EU standards and accept acquis communautaire (Elveren & Kar, 2005).

Turkey's relationship with Europe is based on a number of issues; domestic politics in all nations involved influence their political and economic relations, while challenges at Turkey's borders have ramifications for the country's security and migratory flows into the EU, as well as Ankara's strengthened ties with Russia and Iran. Despite rising differences between Turkey and its traditional European and other Western partners, neither side can afford to neglect political, economic, and security ties. This is especially true in the EU-Turkey economic relationship, where trade, FDI, and technology transfers play crucial roles in both directions (Pierini, 2019).

At the moment, the modernisation and further development of already existing relations in the EU-Turkey customs union is the most plausible and the most probable option for extending this partnership. With new technology and massive advances in service commerce, it is time to update existing trade agreement, which was signed more than two decades ago. An increase of its scope would be desirable, not only to include different services as well as agriculture, but also various subsidies and state assistance monitoring and a more functioning dispute-resolution system, which is critical in resolving the growing number of disputes about how the regime operates.

The fundamental question is if Turkey is willing to move through with reforming the customs union despite the huge impact on the country's economy (Pierini, 2019). FDI has played a crucial role in upgrading Turkey's industrial base. Investments in advanced manufacturing technologies, research and development, and innovation have led to the emergence of globally competitive Turkish companies in sectors such as automotive, electronics, and textiles. FDI has played a crucial role in boosting Turkey's export capacity. Foreign investors have leveraged Turkey's skilled labour force and competitive production costs to establish export-oriented industries. As a result, Turkish exports have diversified and expanded, contributing to a favourable trade balance and strengthening Turkey's position in global value chains.

Turkish FDI has not only transformed the domestic economy but has also bolstered the country's diplomatic influence. Investments in neighbouring countries and beyond have helped forge closer political and economic ties, contributing to Turkey's role as a regional power and increased its global influence. Turkey as an EU candidate country has better economic indicators, especially GDP growth rate in comparison to other European competitors. Despite its attractiveness to foreign investors, Turkey also faces certain challenges in attracting and retaining FDI. These challenges include political uncertainties, regional conflicts, volatility in the currency, bureaucratic hurdles, and occasional unpredictive changes in economic policy.

4. Conclusion

Although membership with the EU is beneficial for attracting FDI, the restrictions imposed recently in the field of FDI, limiting Asian countries in accessing the EU market, as well as various non-economic, and actually political, and ideological conditions, often masked in indeterminate system of the so-called "Western" and "European" values, as well as the possibility of an extensive interpretation of these screening regulations by the EU, i.e. individual member states, suggest that in order to preserve the economic sovereignty of Turkey, it would be better not to hurry with joining the EU and focus on developing economic relations and intensifying international exchange, as well as the attraction of capital from certain other interested European and Asian countries, BRICS countries, CIS members, while at the same time they can, along with the Balkan countries where Turkish investments, culture, and even political influence are traditionally present, be a desirable destination for Turkish FDI.

Due to the armed conflicts in Ukraine, the EU and Russia, each in their own way, are affected by the recently introduced sanctions from which they suffer economic consequences, as well as China, whose work on the OBOR (One Belt One Road) initiative - The modern Silk Road and China's economic and political influence towards those in the West of them, is temporarily physically interrupted and questionable, at least in the part that includes communication with the EU via Russia. On the other hand, the military, economic and political influence of the USA is strengthening, and America is slowly regaining its old glory and the role it played at the global level in the last century. Also new and old armed conflicts in the Middle East are always threat to political stability and economic relations in the region. For this reason, the economic and political cooperation of countries outside the sphere of influence of the EU, NATO and the USA is intensifying, primarily within the framework of BRICS (3.3 million inhabitants) and the Shanghai Organization for cooperation (SCO).

Since Turkey is also interested in joining in that regional cooperation, it all together shifts the centre of gravity towards the overly rich Caspian Basin with oil, gas and drinking water, while infrastructurally, politically and communicatively it bypasses the EU, and reminds of some initial bloc grouping according to the present day perception of economic and political relations in the world, in order to ensure its own economic prosperity and to maintain the current internal socio-political structure of the member countries to whom the values propagated by the USA and the EU are not entirely acceptable.

The recent example of EU relations with Russia indicates the danger of relying on only one primary source, be it the supply of energy or the inflow or destination of FDI. Therefore, it is good that Turkey equally develops partnership with Russia and Middle Eastern counties, especially related to the supply of energy products. The EU certainly remains a desirable investor and destination for Turkish capital, but it would be dangerous if any country and economic-political grouping of countries became key, the only or the main one, because the greater the exposure to one, the more leverage it has over you, economically and politically, which calls into question the possibility of conducting an economic policy motivated by sovereign national interests, as well as any other form of sovereign state policy.

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