Can Turkey achieve economic growth without foreign investment?

Eser Karakas

July 2, 2019

The answer to this question is simple: No, it is not possible in the short and medium term, while in the long run, as economist John Maynard Keynes put it, we will all be dead.

The United States has for a long time been the country that attracts the highest share of foreign direct investment. According to the Cato institute, as of 2018, the level of foreign investment stock in the United States was nearly $4 trillion, which is equal to one-quarter of the total accumulated foreign investment in the world.

Before 2000, the United States' share was at 37 percent so the growing competition to attract foreign direct investments should be a crucial issue for emerging markets like Turkey.

Hong Kong follows the United States with a 6-percent share in global foreign direct investment stock. The United Kingdom and China share third place with 5 percent each.

In the United States, foreign companies that have invested in the country have a 5.5-percent share in employment and 17-percent share in research and development activities. They pay 17 percent of federal corporate taxes and have 23.5-percent share in U.S. exports.

Let us look at Europe.

The United Kingdom is the most successful country in Europe in terms of attracting foreign direct investment, but its future is bleak due to Brexit. For investors, the country was ideal with its qualified human capital and strong infrastructure to export their goods and services to EU countries without customs and tariffs. How Britain's position will change after Brexit remains to be seen.

Meanwhile, Turkey has had a customs union with the European Union since 1996, but has not managed to attract substantial inflows of foreign direct investment as it fails to ensure the rule of law and due to its poor human capital. In other words, Turkey's performance indicates an absolute state failure.

Turkey could have increased its share of foreign investment following Brexit, but there is no indication of an increase in investment inflows, while France has stepped up its efforts to position itself as an alternative destination for investment after Britain's exit from the EU.

France ranked second in Europe in 2018 with 1,027 foreign direct investments - nearly $55 billion - leaving Germany behind. Some 144 of those investments were research and development oriented.

The prospect of Brexit is an important factor in the increase of foreign direct investment inflows to France, but it probably is not the only one.

France’s education system produces a qualified labour force. In terms of average quality of higher education, France seems to have a better performance compared to the United States and Britain.

Moreover, France is also a success in continental Europe in terms establishing the rule of law. Its judiciary is totally independent and neutral, and the principle of the separation of powers has been effectively institutionalised.

The world in the near future will experience a huge competition among countries to attract foreign direct investment. The quality of human capital, therefore the quality of education, the rule of law, and infrastructure will play a central role in this competition. Only countries that have better performance in all those areas will attract more direct investment and as a result will have higher and sustainable growth rates.

Turkey should aim to attract at least $50 billion of foreign direct investment annually. But Treasury and Finance Ministry figures, updated on weekly basis, do not look promising.

According to the OECD’s 2018 report, Turkey’s share in $1.6 trillion foreign direct investments in the world is only $10 billion, that is 0.6 percent.

This means that Turkey is substantially behind other countries in the global competition to attract foreign direct investment. Given that Turkey’s domestic savings rate is also very low, it is impossible for the country to achieve sustainable growth.

The level of foreign direct investment in Turkey is also falling; it was $21 billion in 2008. While the total volume of global foreign direct investment has remained almost the same in the last decade, Turkey’s share dropped by around 50 percent.

Turkey needs foreign direct investments as it lacks own resources. To attract that investment it has to solve two important problems: establishing the rule of law and increasing quality in education. Unless radical steps are taken to address these issues, Turkey is destined to lose out.