Turkish Economic Outlook Under Recent Exchange Regimes And Alternative Bussiness Models For Foreign Companies

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First and foremost, we would like to express our gratitude, for giving us the opportunity to present to distinguished Foreigner firms in Türkiye on the subject of the *"Turkish Economic Outlook under recent Exchange Regimes and alternative bussiness models for Foreign Companies."*

The primary reason behind assigning us this presentation is to address the challenges posed by the depreciation of the Turkish lira, particularly due to its sharp decline against the U.S. dollar, which has resulted in significant cost increases. This issue, especially affecting the foreign countries industrial sector, is part of a broader foreign currency problem faced by the entire manufacturing industry. It is important to highlight that the main cause of the Turkish lira's pressure against foreign currencies is the severe impact of even minor fluctuations in exchange rates on consumer prices, which in turn drives inflation to levels far beyond normal market conditions.

To mitigate this, the government has introduced the HIT-30 Investment Incentive Program, specifically designed to alleviate these pressures, particularly in industrial investments. I believe that this program is of particular interest to Foreign firms due to its focus on high technology. The HIT-30 Program provides comprehensive support and incentives for specialized projects in priority technology areas, offering tailor-made solutions to meet specific needs.

Additionally, the government has launched a medium-term program aimed at returning inflation to its normal levels. One of the key measures in this program is the Domestic Minimum Corporate Tax regulation, which will come into effect in the first quarter of 2025. This regulation seeks to prevent excessive tax deductions and exemptions by establishing a minimum corporate tax base, thus ensuring tax fairness and contributing to inflation control by 2025.

In summary, the foreign currency issue is a temporary challenge. In this presentation, we aim to provide Foreign firms with concrete proposals on how to invest and pursue economic policies independent of foreign exchange rates. Specifically, we will present potential business models that can be implemented without being affected by exchange rate fluctuations. It is worth noting that over the past decade, Turkey's industrial production growth rate has hovered around 4-5%.

Furthermore, according to Orhan Güvenen's study which was held in 2001 titled *"Capital Flows and Sudden Stops in the Turkish Economy,"* the consumer income index was reported as $3,000 based on normal data, while the actual consumer index stood at $8,000. If we apply a similar assumption today, the $10,000 consumer index is likely no less than $20,000, and when taking the informal economy into account, this figure is estimated to be around $25,000. We believe that the current issues related to foreign currency are temporary and solvable.

This is an important indicator for Turkey's industrial sector. From January to December 2023, Turkey's exports reached $255.809 billion, reflecting a 0.64% increase compared to the same period last year. Meanwhile, imports decreased by 0.51% to $361.847 billion. Consequently, the total foreign trade volume amounted to $617.656 billion, showing a slight decline of 0.04%. Additionally, Turkey's tourism revenues were $54.3 billion in 2023. In this context, Turkey's total income (exports plus tourism revenue) reached $310.102 billion, while its imports totaled $361.847 billion. Therefore, Turkey's foreign trade deficit is not as high as it is often perceived. This illustrates that currency crises are temporary under normal financial conditions. These indicators underscore the economic security Turkey offers, making it an attractive investment destination for foreign firms. Furthermore, it should be noted that Turkey's underground economy will eventually be recorded.

In my opinion, one of Turkey's major economic challenges is a debt of approximately $400 billion to Western countries, mainly arising from industrial goods and intermediate products. Foreign, with its advanced technology, excels in areas where Turkey is both progressing and reliant on imports, such as steel, plastics, and industrial manufacturing. A 'Local Placement' policy could be pursued by combining Türkiye's products, which have significant export deficits and are among the most imported, with Foreign's advanced technology. Through this policy, approximately $200 billion of Türkiye's identified $400 billion deficit could be replaced, establishing a mutually beneficial relationship. It should be noted that Türkiye also offers incredible advantages for advanced technology investments under the HIT-30 project. In this context, I present business models that can be adopted and lead to profitability. Therefore, it is highly beneficial for Foreign to take an interest in HIT-30, localization policies, and the other business models we will discuss below, as collaboration with Foreign as a strategic economic partner could yield remarkable returns.

Historical Economic Policies and Exchange Rate Regimes

I will present a comprehensive overview of the key opportunities for South Foreign investment and collaboration with Turkey, starting with a look at Turkey's economic evolution and historical context, and highlighting the strategic areas where both nations can mutually benefit from growth and development.

Following the 1960 military coup, Turkey shifted towards a planned economy, which defined much of its economic direction, including the development of crucial infrastructure like **TELEKOM**. In 1973, Turkey, under its planned economy, achieved a significant milestone as exports outpaced imports, resulting in a favorable balance of payments. During that period Mr. Krueger stated as follows *"In 1973, Turkey became the world champion in export growth, and in 1974, the country had a budget surplus. I believe it is no coincidence that the Cyprus operation occurred in this year from an economic development perspective. An economy with a budget surplus, operating within a planned growth strategy, creates the potential to fully comprehend the industrialization process and secure its economic future."*

According to the industrial developments regarding planned eceonomy In 1978, the European Union extended an invitation to Turkey, which was rejected by Prime Minister Ecevit on the grounds that the Turkish lira was strong and inflation was low. At that time, I was working in the European Union's Factory and Business and Labor Relations Office. Another factor behind the offer was the existence of dictatorial regimes in Greece, Spain, and Portugal and EU wants to notify these countries.

When a cash shortage occurred due to highly densified planned investments, the 1980 coup took place, and the flexible exchange rate system was adopted. The most significant turning point was Turkey's transition to the Customs Union in 1995 without becoming a member of the European Union.

When the Customs Union was accepted in 1995, our auto parts imports were valued at $1.5 billion USD. By 1996, this figure had doubled to $3 billion USD, further widening the trade deficit. The Customs Union (CU) agreement led to a substantial rise in Turkey's trade deficit with the EU, surging by **237%** between 1996 and 2000, to a staggering **$56 billion USD**. Industrialists were unable to compete with this situation and ended up exploiting the banks. Due to the Customs Union, industrialists, under competitive pressure, saw the only solution as taking out loans from banks to make their industrial goods competitive.

When the loans were not repaid, the 2001 crisis occurred. Later, a flexible regime was adopted, and stability was restored.

The 2001 financial crisis, which led to the collapse of major Turkish banks, was driven largely by unsustainable external debt, inflation, and the deepening trade deficit with the EU. This crisis prompted the IMF's intervention, bringing about a significant restructuring of Turkey's economic policies. Despite the recovery efforts, the legacy of the crisis and the currency's volatility persisted into the early 2000s.Between 2001 and 2003, Turkey witnessed the seizure of **Interbank.** During this process, I successfully recovered $1 billion USD from abroad on behalf of the government.

At that time, the dollarization policy, which was clearly flawed, emerged. Argentina went bankrupt due to this policy, and for this reason, Turkey did not implement it.

Around the same time, other countries were grappling with their own economic crises—Mexico, Asia, Russia, Brazil, and Argentina were particularly affected. Brazil's decision to let the Real float freely undermined Argentina's competitiveness. During this period, I conducted research in Argentina and met with Steve Hanke, a professor at Johns Hopkins University, who was instrumental in shifting Argentina to a dollarization system, famously proclaiming ***"1 dollar = 1 peso."*** Especially during this period, Turkey did not implement this policy due to the disaster in Argentina. I remember asking Hanke in Washington why his project was not successful, to which he responded, "*I didn't account for corruption."*

1. The Free Trade Agreement (FTA) Between Turkey and Foreign

As is well known, The Free Trade Agreement (FTA) between Turkey and Foreign, implemented in 2013, marked a significant milestone in enhancing economic relations between the two nations. This agreement facilitated increased trade and investment, particularly in industries like automotive, electronics, and chemicals. South Foreign companies leveraged Turkey's strategic geographical position to access markets in Europe, the Middle East, and North Africa.This could be one of the recommendable way for the Foreign companies.

Foreign companies have been able to leverage the FTA to access the Turkish market, especially in industries like automotive, electronics, and chemicals. The agreement also opened the door for increased trade in both directions, with South Foreign firms benefiting from Turkey's strategic location as a gateway to Europe, the Middle East, and North Africa. **Half of Turkey's foreign trade deficit could be closed by combining Turkey's advantages with Foreign technology to address the import gap.**

However, Turkish policies to control imports may pose potential challenges, with anti-dumping measures similar to those used against China possibly being applied to Foreign products, thus complicating access to the Turkish market.

2. The Inward Processing Regime (IPR) in Turkey

Turkey's **Inward Processing Regime (IPR)** offers significant advantages for foreign companies, including those from Foreign, by providing exemptions from customs duties and VAT for raw materials, intermediate goods, and inputs imported into Turkey for the purpose of re-exporting them. This regime is particularly beneficial for manufacturers seeking to reduce production costs and enhance their competitive position in global markets.

By importing raw materials at zero or reduced customs duties, companies can process these materials in Turkey and then export the finished products to various markets, including Europe and the Middle East. Around 45% of Turkey’s exports consist of products that are imported under the IPR, processed domestically, and then re-exported. This system allows Foreign companies, even for products not listed in the FTA, to enter European and other markets at a lower cost, taking advantage of Turkey’s favorable geographical location.

Additionally, Turkey's **Inward Processing Regime (IPR)**, which allows companies to import raw materials without customs duties for re-export, became an attractive feature for international manufacturers, including those from Foreign. **45% of Turkey’s exports** benefit from this regime, helping companies reduce production costs and increase global competitiveness.

The **IPR** is widely recognized for helping firms enhance their competitiveness on an international scale, and it plays a crucial role in Turkey’s industrial and trade strategy. In this context, **Japanese companies** have also successfully harnessed this regime to boost their production and export activities in Turkey, providing a model for how South Foreign businesses can similarly benefit from this system. Recently, a Chinese company conducted market research in Turkey with the aim of **purchasing phosphate from Serbia,** processing it at its Adana Yumurtalık facility for export, and we facilitated the establishment of this relationship by providing consultancy services.

The fact that TAFE, the third-largest tractor factory in the world, has managed to produce 100% domestically made tractors that comply with EU environmental standards in the Manisa Organized Industrial Zone supports our view.

3. Backward and Forward Participation Model

The **Backward and Forward Participation Model** is a key concept for global value chain involvement, which can provide substantial benefits for South Foreign companies operating in Turkey. This model involves participation at various stages of the supply chain to optimize costs, control quality, and improve market access.

Backward participation refers to a company's involvement in the earlier stages of production, such as procuring raw materials or intermediate products. By sourcing materials from Turkish suppliers or establishing production facilities in Turkey, South Foreign firms can take advantage of lower labor costs, geographical proximity to key markets, and tax incentives. For instance, Foreign electronics or automotive manufacturers can collaborate with Turkish producers or establish local operations, thereby reducing logistics costs and improving supply chain stability.

Forward participation, on the other hand, focuses on the distribution and sale of finished products. South Foreign companies can develop their own sales and distribution networks in Turkey to reach not only the Turkish market but also Europe, the Middle East, and North Africa. For example, a Foreign car manufacturer could produce vehicles in Turkey and sell them directly through its own retail outlets or partner with local distributors to maximize market penetration.

This participation model has been successfully implemented by various international companies, such as **India's Mahindra**, which acquired a tractor factory in Turkey. By using Turkey as both a production base and a distribution hub, Mahindra has reduced costs and expanded its market reach. Similarly, **South Foreign firms** can apply the backward and forward participation model to maximize their investments in Turkey, leveraging the country's strategic location and favorable economic conditions to access new markets and improve profitability.

According to the report prepared by the Istanbul Development Agency, the top six products that:

TOP SIX IMPORTED PRODUCTS BY TURKEY	1.Iron and Steel	2.Plastics	3.Machinery	4.Electrical Machinery & Equipment	5.Automotive	6.Food

The table below illustrates the sectors with the highest trade deficits:

SECTOR	**EXPORTS (USD)**	**IMPORTS (USD)**	**DEFICIT (USD)**
Mineral Fuels	4.325.262	37.194.822	-32.869.560
Machinery	13.830.708	27.164.856	-13.334.148
Electrical Machinery & Equipment	8.097.223	21.152.053	-13.054.830
Iron and Steel	8.238.262	16.761.986	-8.523.725
Plastics and Plastic Products	5.476.514	13.265.042	-7.788.528
Precious Stones and Metals	10.879.079	17.443.554	-6.564.475
Organic Chemical Products	657.067	5.387.647	-4.730.580

SECTOR	EXPORTS (USD)	IMPORTS (USD)	DEFICIT (USD)
Optical, Photo, Cinema, Measurement Equipment	810.833	4.999.048	-4.188.215
Pharmaceutical Products	875.480	4.449.099	-3.573.619
Copper and Copper Articles	1.441.815	3.326.548	-1.884.732

Year	Export (M USD)	Export Change (%)	Import (M USD)	Import Change (%)	Trade Volume (M USD)	Trade Balance (M USD)
2013	500	-	6,358	-	6,858	-5,858
2014	513	2.7	7,732	21.6	8,245	-7,218
2015	616	20.1	7,247	-6.3	7,863	-6,631
2016	553	-10.2	6,468	-10.7	7,022	-5,915
2017	621	12.3	6,823	5.5	7,444	-6,201
2018	982	58.1	6,638	-2.7	7,621	-5,656
2019	944	-3.9	5,777	-13.0	6,721	-4,833
2020	1,104	16.9	5,734	-0.7	6,838	-4,630
2021	996	-9.8	7,597	32.5	8,593	-6,601

2022	1,052	5.6	9,004	18.5	10,056	-7,952
2023	1,042	-1.0	9,479	5.3	10,521	-8,437

Despite currency fluctuations in Turkey, Foreign firms can make strategic, long-term investments, leveraging the incentives offered by the Turkish government. These incentives, including tax exemptions, customs duty relief, and investment credits, reduce operational costs and create a favorable environment for stable returns on investments. By capitalizing on these advantages, Foreign firms can mitigate the risks associated with currency volatility and position themselves as strong players in Turkey's strategic markets.

Turkey's business environment, supported by investment incentives, offers opportunities for foreign investors, including Foreign firms, to engage in **backward and forward participation** models. These involve integrating supply chains through sourcing raw materials in Turkey or using the country as a production base for goods destined for nearby markets.

Moreover, Turkey presents opportunities for investment in high-tech industries such as **semiconductors and microchip production**, where South Foreign expertise can play a pivotal role in boosting Turkey's local production capacity and technological development.

Advantages of Collaboration

Foreign investors have a successful history of investing in Central and Eastern Europe, including Poland, the Czech Republic, and Hungary, to access the EU market. However, Türkiye offers a more robust R&D and innovation ecosystem. With 104 technoparks supporting over 10,800 technology companies and 1,600 R&D centers, Türkiye provides a well-established infrastructure for investors, making it particularly attractive to Foreign firms in sectors like automotive, electronics, and semiconductors.

While Foreign companies like Hyundai and Kia have manufacturing plants in the Czech Republic and Slovakia, labor costs in these regions are rising. In contrast, Türkiye offers lower labor costs and a young, growing workforce, with an average age of 32, providing sustainable long-term potential for high-tech manufacturing.

Foreign investments in Central and Eastern Europe often rely on government incentives, and Türkiye offers similar advantages. The Türkiye Tech Visa Program fast-tracks residency and work permits for tech professionals, while the $30 billion HİT-30 high-tech investment program presents attractive options for Foreign companies focused on R&D-intensive sectors. Additionally, Türkiye's venture capital investment funds enhance access to capital for startups and foreign investors.

Türkiye's growing presence in high-tech industries makes it a prime destination for Foreign companies. Investments in renewable energy, electric vehicles, semiconductors, and hyper-scale data centers align well with Foreign expertise in these fields. Türkiye's large domestic market for electric vehicles and strategic location provide direct access to fast-growing regional markets.

For Foreign companies with operations in Southeast Asia and the Middle East, Türkiye offers a culturally compatible and business-friendly environment, unlike countries like Poland and Hungary, which have faced anti-immigrant sentiment that complicates attracting foreign talent.

On the fiscal front, one key measure is the **Domestic Minimum Corporate Tax regulation**, Under this rule, companies will be required to pay at least 10% of their corporate income, ensuring both tax equity and fiscal stability.

Complementing this domestic reform is the **Global Minimum Tax** regulation, which will be implemented in 2024 as part of the OECD's global initiative. Multinational corporations with a turnover exceeding 750 million euros will be required to pay a minimum of 15% tax, preventing the shifting of profits to low-tax jurisdictions and promoting international tax fairness. This global measure is designed to curb tax evasion by large corporations, ensuring they contribute fairly to the countries in which they operate.

In addition, Turkey is tightening its regulations regarding **VAT Refunds**. Going forward, refund claims will only be processed after tax audits, with reports from certified public accountants considered during the process. This change enhances the oversight mechanism, ensuring that VAT refunds are handled with greater precision and transparency, thereby reinforcing the integrity of the tax system. Together, these reforms represent a comprehensive effort to align Turkey's tax policies with global standards while bolstering investor confidence and fiscal sustainability.

Additionally, the defense sector represents another promising area for collaboration. Investing in military electronics, unmanned aerial vehicles (UAVs), and armored vehicles can strengthen defense ties between Foreign and Turkey. The synergy between Foreign’s technological expertise and Turkey’s growing military production capacity can elevate both nations' defense capabilities.

In the rapidly growing electric vehicle market, joint ventures between South Foreign and Turkish companies could offer substantial long-term benefits, aligning with both countries' goals for sustainable transportation. Similarly, partnerships in shipbuilding, focusing on large-scale vessels, could leverage Foreign’s advanced shipbuilding technology and Turkey’s strategic location, enhancing industrial collaboration and global competitiveness.

The energy and chemical sectors, where Turkey has significant needs, also present investment opportunities. Foreign’s advanced petrochemical technology can address these needs, fostering technological exchange and boosting economic growth.

The HIT-30 Project is a key initiative for both countries. This collaborative space and satellite technology program aims to combine Turkish and Arab expertise with South Foreign technological capabilities. By facilitating joint research and development in space exploration and satellite science, the HIT-30 Project can enhance technological innovation and capacity, offering significant benefits to Turkey, Foreign, and the broader region.

Our respectful recommendation regarding what the State could undertake on this matter;

Just as certain measures are taken by the private sector, States can also come together to manage and navigate the process. I would like to share my invention, which I proposed as a solution at the time and was widely accepted.

As Austria’s *"Lawyer of Trust,"* I previously brought together Austrian and Turkish **Eximbank** officials. *In the aftermath of the 2008 financial crisis, the importance of utilizing and evaluating capital became apparent, leading to discussions on joint investment efforts by combining the capacities of both Eximbanks. The updated economic and program-related achievements specific to the crisis period should be initiated as soon as possible, both politically and economically. Economic security has also been identified as a fundamental goal. Since information technology has not been lost, it will be possible to restart new investment processes by planning resource allocations.* In this context, the Foreign and Turkish Eximbanks could reach an agreement to facilitate a merger.

By 1985, the exchange rate surged to 574 TL per dollar, and by the late 1980s, Turkey experienced a severe economic downturn with the exchange rate surpassing 1,000 TL per dollar. These challenges were compounded by government efforts to keep the currency competitive for export purposes.This phenomenon further weakened the role of the Turkish lira in the economy during this period.

The current reason for keeping the currency under pressure is the visibility of the extreme impact of devaluation on consumers.

A detailed explanation regarding inflation accounting and exchange rates will be provided by Mr. Elvan İnanlı.

I would like to express my gratitude to Mr. Tamer Taşkın, the former president of the Chamber of Industry, for providing us with data on various industrial products and for his contributions while preparing this work. I would also like to add that he indicated that they can always host Foreign companies at the Aegean Chamber of Industry and offer all kinds of support.

Additionally, we would like to extend our gratitude to Mr. Çağatay Özden from the Ministry of Trade, whose valuable insights we benefited from by participating in his previous presentations on Foreign.

KIND REGARDS,

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