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Foreign investment in producer services

The Turkish experience in the post-1980 period

Since 1980, Turkey has been changing its growth strategy from protectionist import substitution to one more market-oriented and outward looking. As the restructuring has unfolded, the domestic market has opened up to foreigners. This paper discusses the increasing involvement in the economy of producer service firms with foreign capital. We describe 278 such firms: when they entered the Turkish market, their countries of origin (mostly European Community countries), industry groups and ownership structure. The most popular choice of location has been Istanbul.

Introduction

Since 1980, Turkey has been pursuing a market-oriented and outward-looking growth strategy which encourages foreign firms to establish a footing in the country. During the late 1980s and early 1990s, as private firms adjusted themselves to the new conditions, there was a dramatic increase in the number of branches of multinational companies and in the number of partnerships of foreign firms with Turkish corporations. This was partly because of the introduction of a more encouraging framework for foreign capital, and partly because Turkey would be entering a customs union with the European Union in 1996. The dismantling of trade barriers and the opening up of the domestic market to foreigners would give Turkish companies with foreign alliances a competitive edge over those without such alliances. The result has been that

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practically all major corporations, in a wide range of industries from manufacturing to services, have engaged in talks with foreign concerns either to form franchising relationships or to develop joint ventures. The increasing involvement in the economy, since 1985, of producer service firms with foreign capital should be understood within this broader context.

Producer services¹ are those services used in productive activities as inputs, instead of final consumption. The common property of producer services is that they provide their products mainly to other business establishments and government agencies rather than to individuals. The businesses they serve may be in any sector: agriculture (such as seed research), manufacturing (such as research and development), or other services (such as insurance).

This paper explores the recent growth of producer services in the context of the changing policy environment and economy and documents up-to-date information about foreign involvement in the sector. The purpose is to provide information about the scale, scope and character of international producer service firms in a developing economy. The first section summarises the transformation of the Turkish economy in the post-1980 period; the second is concerned with two main concepts: producer services and foreign direct investment (FDI).² First, we discuss the producer services and the recent overwhelming growth of producer services in advanced economies. Here we stress that producer services are also rapidly growing in developing countries (Noyelle, 1991). Secondly, we discuss FDI and review the pronounced transformation in the composition of foreign investment in the world economy.

In the main part of the paper, we bring the two principal concepts together in the context of Turkey and document information on 278 producer service firms that have received some FDI. Using official data, provided by the Foreign Investment Directorate of the Undersecretariat of Treasury and Foreign Trade, we establish that initial entries occurred in the 1955–1980 period, increased in the 1981–1984 period and surged remarkably after 1985. The empirical data indicate the overwhelming dominance of finance and consultancy services as industry groups, and that of the European Community countries as the countries of origin. According to the data, foreign investors have a clear preference for majority ownership. The evidence also demonstrates that the surge in the

1 Our definition of producer services refers to distributive infrastructure, such as banking and property; and it includes both primary and secondary business services, such as non-banking financial services, research and development, advertising, insurance and legal, fiscal, technical and professional consulting on the one hand and security, catering and cleaning on the other.

2 Here FDI is defined as any foreign investment made to acquire a lasting interest in productive enterprises, excluding only investment in financial instruments, i.e. portfolio investments. Our data refer to all the direct investments made in producer services with some foreign involvement, regardless of the degree of involvement (majority, minority or equal shares). Different relationships (e.g. subsidiaries, joint ventures or partnerships) have not been differentiated owing to the lack of systematic data on specific forms.

number of producer services has reinforced the historical dominance of the Istanbul region over the rest of the country.

We then discuss the degree to which the growth can contribute to the economic development of the country and to the well-being of Istanbul. Many observers of the Turkish economy do not expect a significant contribution from foreign investors to services, in part explaining the concentration of foreign investors on services by their hesitation to invest in producing areas such as manufacturing. They call attention to the tendency of foreign investors to invest in not-so-productive, 'non-basic', 'easy-money' service industries where fixed investment requirements are low and profits high. We do not altogether challenge this perspective, but we raise some doubts about its view of the service industries as one broad category. We believe that we shall not have a realistic idea of the problems and merits of the recent increase in the number of producer service firms with foreign involvement unless the analysis of the services category and its consequent differentiation, especially between consumer and producer services, is taken seriously. Moreover, at the global level, the importance of FDI in services is growing; this is part of a pronounced transformation in the composition of foreign investment. We emphasise the link between national and international trends in the development of producer services, as well as in the composition of foreign involvement.

This paper is a necessary first step towards such a project. Accordingly, in the final section we raise some questions to begin a more thorough investigation of the degree to which producer services can contribute to Turkey's economic development and to the well-being of Istanbul. So far, the possibility that Istanbul could be a locus for branches of multinational producer-service corporations has not been considered. It is an open question whether Istanbul can be a regional gateway for several countries in the geographical area, and how the trends in the production and delivery of producer services might shape the future development of the city.

The transformation of the economy after 1980, producer services and foreign investment

Since 1980, Turkey has been experiencing a fundamental change from its previous protectionist, import-substitution growth strategy towards an economy more market-oriented and outward looking. The belief behind the change has been that the country's development was becoming severely constrained by the inefficiencies of the domestic economy. In the late 1970s, domestic production and investment were heavily dependent on imports whose prices kept increasing. Exports remained stagnant and the government was unable to raise sufficient foreign finance without resorting to borrowing. Consequently, Turkey faced a serious balance of payments and foreign debt crisis.

Accordingly, the policy makers of the post-1980 period introduced a framework encouraging foreign investment, simplified bureaucratic formalities for application procedures and, in fact, improved the country's foreign investment environment significantly (Hewin and O'Brien, 1988; Balkır, 1993;

Balasubramanyam, 1996).³ Government policy has clear expectations: greater foreign participation in all sectors of the economy is supposed to secure financial inflows into Turkey without creating debt and to accelerate economic growth and development. Consequently, the number of foreign companies active in the economy increased from 78 in 1980 to 1856 in 1990, and to 3161 in 1995. The total amount of FDI reached US\$6.2 billion in 1990 and US\$10 billion in 1995 (Foreign Investment Directorate, 1996). This growth seems attributable to the change in the country's development policy.

Given the government's open encouragement and support, FDI is usually considered to have been slow between 1980 and 1990. A number of reasons (given different weight by different authors) have been put forward to explain the low levels of investment. These included investors' caution about the health of the economy, political stability, administrative delays and bottlenecks in response to foreign investment applications, the lack of supportive legislation despite the broad encouragement (such as on patents, trademarks and copyrights to protect intellectual property), continued high inflation, periodic currency crises and relatively high wage rates. There were wage increases, especially by the end of the 1980s and the beginning of the 1990s, which were considered quite high by observers such as Balasubramanyam (1996) when labour productivity was taken into account. However, it now appears that foreign investment has finally grown, although there are still concerns about macro-economic stability, the credibility of the new liberalisation programme, the government's inability to control inflation, and relatively high wages (Balasubramanyam, 1996).

Permits to bring in foreign capital rose by 63.2 per cent, reaching US\$2.9 billion in 1995, compared with US\$1.4 billion in 1994. According to the Treasury, foreign capital entries amounted to US\$1.1 billion in 1995, compared with US\$830 million in 1994 (Foreign Investment Directorate, 1996). When these increases occurred, Turkey had a reasonable place (somewhere between Brazil and Mexico) in the rankings for global economic projection, thanks to the high expectation of its economic performance (22nd highest expected change in economic performance between 1995 and 1996, among 84 countries); its ranking for 'political risk' was not so high. Good economic performance projections

³ More specifically, the post-1980 foreign investment legislation liberalised the capital flows from foreign sources by rewriting the main investment law, Law No. 6224, which had been introduced in 1954. The amendments simplified the procedures for the approval of FDI proposals and eliminated much of the bureaucracy. In addition, several incentives applying to domestic investment were made available to foreign investors. There are no local content requirements (such as domestic sourcing of raw materials), no employment regulations and no limits to the amount of equity foreign firms can own. Foreign firms in possession of investment certificates are eligible for generous exemptions from corporate taxes ranging from 30 to 100 per cent, depending on the location, the sector and the value of investments. Moreover, at the end of 1992, four free-trade zones were established, offering foreign investors full exemption from corporate and income taxes for unlimited periods (Balkır, 1993; Hewin and O'Brien, 1988; Balasubramanyam, 1996). Attempts at further encouragement seem to be continuing. Nowadays there are discussions about whether the investment permit might be eliminated altogether (*Cumhuriyet*, 8 March 1997).

seemed to compensate for the uncertainty that characterised the country (see *Euromoney* (1995) for a complete list of country risk and economic performance rankings).

However, many observers are still disappointed by Turkey's share in the world stock of FDI (Balasubramanyam, 1996). Moreover, there are concerns about the nature of FDI. First, there are claims that the share of new investments seems to be decreasing: since 1990, foreign investment has been mostly directed to maintenance and expansion (*Dünya*, 8 January 1997). Secondly, it has moved towards those service areas characterised by fewer fixed investment requirements and higher profits (Balkır, 1993). Thirdly, there are signs that Turkey's supportive policies on FDI may be too generous to allow foreign investments to benefit local economies, and that foreign investors may be transferring their earnings abroad instead of reinvesting them locally (Balasubramanyam, 1996). Fourthly, some so-called foreign investors are suspected of being arms of domestic corporations that open branches abroad under foreign names in order then to invest in Turkey, hence benefiting from the generous incentives and use some other loopholes, such as transfer pricing (Sönmez, 1992, 100–01).

The government seems to prefer operations that maintain some degree of Turkish involvement and anticipates that foreign investment will contribute technology, training, and employment to the Turkish economy.⁴ However, no sectors of the economy are banned from foreign ownership or participation; there are no limits to the amount of equity foreign firms can own; and there are no regulations to ensure the expected benefits, such as local content requirements or employment regulations (Balasubramanyam, 1996).

Before 1980, foreign companies were mostly investing in manufacturing. After 1980, foreign investment shifted away from manufacturing into the service sector. Thus investment in manufacturing as a proportion of all investment dropped from 91.5 per cent in 1980 to 65.2 per cent in 1990 and 68 per cent in 1995, while services rose from 8.5 per cent in 1980 to 28.7 per cent in 1990 and 28.9 per cent in 1995 (Foreign Investment Directorate, 1996). According to the same source, the 1996 data indicate an enormous increase in the service sector (81 per cent). This change is believed to be due to the hesitation of foreigners to invest in manufacturing industries after 1980 and their tendency to invest in sectors characterised by low productivity and a lower economic value than that of manufacturing. In fact, almost all investors—domestic and foreign—have tended to invest in less productive areas since the 1980s (Sönmez, 1992; Balkır, 1993). Many blame high inflation, high depreciation and the high interest rate environment for the preference (see Conway, 1990; Boratav, 1990). As expected,

4 The preference is clear when certain legal provisions that impose joint venture agreements with Turkish partners on foreign investors are taken into account (Berksoy et al., 1989, cited in Buğra, 1994). Also, complicated rules and regulations governing business–government activities make it difficult for foreigners to function alone in the country, and force them to form partnerships with Turkish firms (Buğra, 1994).

foreign capital has also preferred non-manufacturing areas, such as tourism, and producer services, such as consultancy, banking and insurance. Non-banking financial services have also attracted multinational corporations (e.g. Price Waterhouse, Arthur Andersen, Cooper & Lybrand, Peat Marwick, Ernst & Whinney, Arthur Young) to information services (e.g. Zet-Nielsen, Information Resources Inc.) and to other sectors.

If the economic environment were characterised by low inflation, low depreciation and a low nominal interest rate, manufacturing might also have been a preferred area for investment. However, the service sector should not be spoken of as one sub-category of non-manufacturing activities. As we shall substantiate in the following sections, one group of service activities deserves to be addressed separately: the increasing participation of service multinationals in producer service areas such as finance, insurance, consulting and software should be of interest in its own right.

The growing number of firms investing in producer services in Turkey, at various degrees, and the increasing proportion of FDI going to services indicate that this trend might not be temporary. If this is the case, the usual treatment of the service industries as one broad category (less productive, 'non-basic', 'easy-money') may no longer be sufficient. Elsewhere, owing to the elaboration of the services category and its consequent differentiation, especially between consumer and producer services, services are being taken much more seriously (Illeris, 1996; Felli et al., 1995; Lanvin, 1993; Daniels, 1993; Daniels and Moulaert, 1991). In advanced economies, producer services are considered an essential infrastructure for economic development. Their innovative activities emphasise the human factor again, and provide invaluable employment opportunities. Moreover, although most of the consumer service activities and many of the producer services still have low productivity rates and remain 'non-basic', some producer services have already become basic activities—directly (by selling important parts of their service outside their own regions) or indirectly (by improving the competitiveness of a region's basic firms)—with reasonable increases in productivity. Therefore, such services can be the targets of national and regional development policies in both advanced and developing countries (see Illeris (1996) for a discussion about 'basic' and 'non-basic', and Grubel (1995) and the rest of Felli et al. (1995) for discussions about low productivity).

The following section about the two main concepts (producer services and FDI) suggests why and how producer services should be taken more seriously, and how producer services have led to the emergence of new motivations and incentives for FDI.

The two principal concepts

Neglected for a long time, partly because of the traditional characteristics attributed to it (that it is unproductive, not transportable, cannot be stocked or warehoused, is not subject to accumulation or export), the service sector is now a major area of interest for scholars (Sassen, 1991; Daniels and Moulaert, 1991;

Daniels, 1993; Lanvin, 1993; Felli et al., 1995; Illeris, 1996). From urban economic analysts to international development theorists, quite a large number of scholars emphasise the distinctiveness of the service sector and analyse the differences among service industries. The differentiation between consumer and producer services has resulted in a re-evaluation of the characteristics attributed to services and their productivity, tradability and exportability.

Unlike other service industries, some producer services (such as communications, consultancy, data processing and finance) have recently increased their productivity greatly (Grubel, 1995) and their tradability too (Lanvin, 1993). The export role of producer services has recently been demonstrated in a study covering 300 consultancy firms in six European countries. Data have shown that approximately 38 per cent of their total turnover originates from clients outside their home regions, and 8 per cent of it from transactions with international clients (Daniels et al., 1991, cited in Daniels, 1991). In sum, producer services are an important part of the services category: they are productive, tradable and can even be exported outside their home regions. Therefore, a recognition is growing that producer services are becoming basic activities, with significant potential for contributing to the economic development of countries and regions.

Today we recognise not only that producer services are important for production processes, but also that producer services are becoming a central component of the world economy. In advanced economies, the widely acclaimed recent increase in the importance of the service economy has primarily reflected the growth and development of producer services. Producer services are increasingly contributing to the GNP and employment in such economies. Producer services account for about 6 per cent of European Community GNP and 14 per cent of the value added for all market sectors (Commission of the European Communities, 1990, cited in Daniels, 1991). In the US metropolitan counties, over the 1980–1988 period, employment in the producer service sector expanded by 50.6 per cent; this represented 4.65 million new jobs (Goe, 1996).

More importantly, from this paper's point of view, international and inter-regional markets for producer services have expanded. An important aspect of the continuing integration of economic activity, the international tradability of producer services is growing (O'Farrell et al., 1996). As a result, producer services are also rapidly growing in those developing countries (Noyelle, 1991) where the internationalisation of industrial production through trade and FDI is creating a demand for support activities in areas such as finance, accounting, consultancy, data processing, market research and law.

For a number of developing countries, the expansion of international producer services has been considered a source of substantial economic benefits. For example, the Cayman Islands, Singapore, Hong Kong, the Bahamas and the Philippines have recently accounted for up to one-fifth of global Euromarket finance activity. Similarly, the software services industry is rapidly growing in countries such as Brazil, China, India, South Korea, Mexico, Singapore and Taiwan (Lanvin, 1993). Less obviously, some countries have also started finding their own niches: Kuwait, for example, is now involved in the development of Arabic computerised script for export to other Arabic-speaking

countries (Daniels, 1993). The most critical resource in services is brain power, and many developing countries have more university graduates than they have been able to absorb into their manufacturing industries and government. Some people believe that even the poorest countries might be able to develop market niches at appropriate levels of skill.

Producer services are usually located in primate cities or capital regions. Therefore, the importance of producer services for whole countries may not be too obvious. For example, in OECD countries less than 10 per cent of total urban employment in cities outside the capital regions is created by producer services (Lambooy and Moulaert, 1996). However, their growth, especially in large metropolitan cities, has been noteworthy. Ten US producer service companies (in banking, telecommunications, construction, insurance and related services) are reported to have created 48 000 jobs in fifteen developing countries, 99 per cent of jobs and 83 per cent of management positions being held by host country nationals (CSI, 1989, cited in Daniels, 1993). The transfer of technology and access to information networks are other advantages that developing countries can enjoy through such companies.

In developing countries, especially initially, many providers of producer services were established by industrial transnational corporations; later, multinational service enterprises joined them. Recently, even small and medium-sized producer service companies have become engaged in international business in a significant way (O'Farrell et al., 1996).

Transnational firms are central to the internationalisation of services. For such firms, FDI seems to be the most preferred way to maintain competitive advantage across national boundaries. Thus, since the late 1980s a growing number of companies have been expanding across borders by making foreign acquisitions, merging with competitors and investing in more and more countries, either by themselves or through joint ventures (Daniel, 1993; Noyelle, 1991). Although there are differences between particular producer service industries (see Daniels, 1993, 92–93), producer service firms mostly provide their services through foreign investment, rather than by cross-border trade (i.e. by providing services via business letters, reports, transfers of electronic information, etc.) or by selling services to customers where the firms are located (Noyelle, 1991). This makes FDI a pivotal concept in any discussion about producer services.

Since the 1980s, there has been a pronounced transformation in the composition of FDI. Its flow in services has grown more rapidly than its flow in manufacturing and extractive industries. Also, FDI in services has become the fastest-growing component of overall FDI flows (Sassen, 1991). By the mid-1980s, about 40 per cent of the world's total foreign investment stock was in services, compared with about 25 per cent in the early 1970s and less than 20 per cent in the early 1950s (Sassen, 1991). Regardless of the degree and type of participation in international finance markets, all investments that include foreign capital emphasise two important and newly recognised characteristics of producer services: they are tradable and even exportable. Advantages provided by liberalised FDI rules in many less developed and developing countries have certainly encouraged the internationalisation of services (see Erden (1997) for the

Turkish case); but the fact that FDI in services is growing faster than other kinds of FDI indicates a trend that transcends what is happening in particular countries.

The literature certainly calls attention to the importance of the internationalisation of producer services in developing economies (see Lanvin, 1993, 291–316). However, empirical studies are scarce; for example, there is not enough information on the nature of international producer service firms in developing economies. The following analysis aims to fill the gap to a certain degree.

Evidence on the Turkish experience

The analysis in this paper was conducted at firm level. The official data used were provided by the Foreign Investment Directorate of the Undersecretariat of Treasury and Foreign Trade. In its raw form, it consisted of a comprehensive list of all the firms associated with FDI, in all sectors, during the period 1954–1995 (Foreign Investment Directorate, 1995). We compiled the final list by selecting firms associated with the producer services category. Among several classifications used for producer services in the literature, our classification relies on the one proposed by Martinelli (1991). The definition excludes social infrastructure services (such as health, education and social security) and consumer services (such as retail sales and personal services), and includes only distributive infrastructures (such as banking and property services) and business services (such as research and development, non-banking financial service and insurance). More specifically, our taxonomy includes the following services: banking and non-banking financial services, property services, R&D, all types of consultancy (technical, professional, organisational, legal and fiscal), advertising and marketing, printing and paper processing, management, insurance, transport, electronic data processing, communication, and related services: training, security, catering and cleaning.

One problem with classification is that it is difficult to distinguish between those activities of a specific firm that mostly or exclusively serve other businesses and government organisations and those that cater to a much larger public. We have included all the firms that can be associated with producer services, even when we have thought that they may simultaneously be producing consumer products and social infrastructure services: our 278 firms are those involved in the production of business services in one degree or another, with or without additional involvement in consumer services.

Another difficulty is that producer service activities can conceivably be internalised by firms; businesses do not have to buy these services on the market. In addition to independent or at least separate producer service firms, non-productive activities within manufacturing firms also represent the producer service sector. For practical purposes, however, we have completely ignored the latter group of activities. In the literature, some producer services are taken into account even when they are carried out within manufacturing firms. Hansen (1990), for example, in his US-based study, includes manufacturing firms, by using their non-production payrolls. However, this would be beyond the scope of our own study, because data about manufacturing firms in Turkey lack the

level of detail required for such an analysis. Only a field survey could have provided the necessary information in this regard.

WHEN DID THE FIRMS ENTER THE TURKISH MARKET?

As Table 1 illustrates, of the 278 producer service firms established through FDI, only six were established before 1980, and only 10 between 1981 and 1984. The remaining 262 (almost 95 per cent of the total) were established after 1984, the two-year period 1989–1990 being the peak (with more than 25 per cent of the total).

Table 1 *Years of entry into the Turkish market*

<i>Year</i>	<i>No. of firms</i>	<i>%</i>
1955–1980	6	2.16
1981–1984	10	3.60
1985	27	9.71
1986	13	4.68
1987	20	7.19
1988	25	8.99
1989	35	12.59
1990	39	14.03
1991	22	7.91
1992	26	9.35
1993	23	8.27
1994	14	5.04
1995	18	6.47
TOTAL	278	100

COUNTRY OF ORIGIN

As Table 2 illustrates, between 1985 and 1995 the European Community countries dominated as countries of origin. Overall, more than half of the producer firms analysed have originated from these countries. The USA has consistently been the second most important place of origin for every year of the decade. The UK and Germany lead with 30 and 29 firms respectively, followed by France and the Netherlands with 25 and 17. The distribution does not indicate any clear dominance by any one country, although the UK seems to be consistently involved in a wide range of areas, including not only producer services but also defence, electric power, consumer products and basic urban

Table 2 *Producer firms by country of origin, 1985–1995*

	<i>No. of firms</i>	<i>%</i>
European Community countries	149	53.60
USA	69	24.82
Others	39	14.03
Mixed	21	7.55
TOTAL	278	100

infrastructure (*Cumhuriyet*, 22 January 1997). In addition to these countries, Belgium seems to be considering telecommunications as a potential investment area in Turkey (*Cumhuriyet*, 14 March 1997).

INDUSTRY GROUPS

Over other industry groups, the dominance of finance (especially in Istanbul) and consultancy services (again mostly in Istanbul, but also in Ankara) is clear in almost every year. Table 3 shows the analysis over the decade.

Table 3 *Producer firms by industry group*

	<i>No. of firms</i>	<i>%</i>
Consultancy	70	25.18
Banking and property services	42	15.12
Non-banking financial services	22	7.91
Insurance	24	8.63
Advertising, R&D, management	59	21.22
Data processing, telecommunications	36	12.95
Other related services	25	8.99
TOTAL	278	100

OWNERSHIP STRUCTURE

The data on the share foreign and domestic partners have in the firms of producer services seem to indicate that majority ownership is preferred by foreign partners,⁵ which is also the case for manufacturing firms associated with FDI. While the percentage of majority ownership is 50 per cent in manufacturing firms (see Erden, 1997), for producer services the share is higher—69.43 per cent. However, local partnerships are very important, and in more than 30 per cent of the cases foreign firms either have equal shares or a minority of the shares. See Table 4.

CHOICE OF LOCATION

The evidence demonstrates that the surge in the number of producer services has reinforced the historic dominance of the Istanbul region over the rest of the country. Ankara has been a distant second, while the rest of the country has been poorly represented. In contrast, FDI in manufacturing industries has been expanding all over the country (Seçkin, 1997), indicating a different pattern. This supports the observation that the internationalisation of producer services is an especially uneven process, some cities participating in it more prominently than others. See Table 5.

⁵ It is believed in the business community that in Turkey minority shareholders are poorly protected (*Euromoney*, 1995).

Table 4 *Ownership structure*

	<i>No. of firms</i>	<i>%</i>
FDI share above 50%	193	69.43
FDI share below 50%	62	22.30
Equal shares	23	8.27
TOTAL	278	100

Table 5 *Producer firms by choice of location*

	<i>No. of firms</i>	<i>%</i>
Istanbul	208	74.82
Ankara	47	16.91
Others	23	8.27
TOTAL	278	100

An evaluation of the empirical evidence

Since 1985 the increasing involvement in the economy of producer service firms with foreign capital is an indication that international producer services are becoming an important component of contemporary metropolitan growth and economic differentiation in Turkey. It is not a coincidence that almost 95 per cent of the producer service firms receiving foreign capital were established after 1984, and that 1989–1990 was the peak period, more than 25 per cent of our 278 firms being established within this two-year period. The introduction of a more encouraging framework for foreign capital was an important component of the country's more market-oriented and outward-looking development strategy. Turkey had first introduced legislation to encourage foreign investments in 1954. However, because other favourable conditions were absent, such as legislation on patents, trademarks and copyrights to protect intellectual property, and guarantees for interest and profit remittances, there was no significant introduction of foreign capital into the economy. Turkey's policies to encourage foreign capital, ranging from the removal of restrictions on foreign ownership and foreign staff to generous tax exemptions, were introduced through the decrees and bills of 1980, 1986, 1994 and 1995. The growth of the producer services sector with foreign involvement has been a clear response to these recent policy changes.⁶

⁶ Foreign banks were first authorised to open branches in 1980; regulations concerning profits, capital transfers and the reinvestment of funds by foreign citizens were eased in 1986; foreign investors were first admitted to the Turkish capital market in 1988; foreign investment funds were first allowed in 1989 (Togan, 1994). In 1994 several other significant changes were made, including to the commercial law, which made the enforcement of judgments against state institutions and enterprises easier; and bills were introduced covering anti-cartel issues and intellectual property rights (*Financial Times*, 1994; OECD, 1995).

So far, the greatest momentum has come from the European Union countries. This can be explained partly by the fact that Turkey entered a customs union with the European Union in 1996. The consensus in the business community has been that the customs union would reshape the country's economy, and that Turkish firms with alliances with foreign companies would be more competitive, while those with no outside links would suffer. Forming joint ventures with major European companies has been considered a good precaution.

It is an open question whether the growth of producer services with foreign capital involvement represents a distinct phase in the transformation of the Turkish economy. The degree to which the growth can contribute to the country's economic development and to the well-being of the cities in which they are concentrated is also open to discussion. Our findings about industry groups and ownership patterns provide some clues, but not answers.

The term 'producer services' is not commonly used by those who write specifically on Turkey. Our impression is that Turkish scholars regard all service activities as one residual category, next to agriculture and manufacturing. There is an interest in the broad performance of the sector. However, the service sector consists of such a diverse range of activities (from the smallest retail shop to the most technologically advanced research and development facility) that indicators to the general performance of the sector are not very meaningful.⁷ Also, the perspective that services perform, at best, a supporting and, at worst, a parasitic role in economic development seems to be common in Turkey. As non-basic activities, they do not contribute through 'exports' to the economic well-being of cities, regions or nations. For example, the treatment of all service activities as one broad category is obvious among those who explain the recent shift of FDI from manufacturing to services by the reluctance of foreigners to invest in productive industry. The complaint seems to be that foreign investors, rather than invest in productive manufacturing, invest in less productive, 'easy-money' services, for which fixed investment requirements are low and profits high (Balkır, 1993).

Those who recognise that producer and consumer service activities are very different and that producer services are very important for production processes would take issue with this perspective. The alternative view recognises that producer services are becoming a central component of the world economy and emphasises their productive contributions. According to this position, the economic vitality of places, that is their competitiveness and ability to adjust to changing economic circumstances, is built upon a close relation between goods production and services, as well as upon the export of service industries' output (Daniels, 1991). Producer services provide essential inputs to manufacturing; their forward and backward linkages make them central to economic planning

7 There are indicators concerning the sector's performance: between 1950 and 1992, as a proportion of all industries, services' share in the country's GNP increased from 43.7 to 57.1 per cent, agriculture's fell from 41.7 to 16.0 per cent and manufacturing's rose from 14.6 to 26.9 per cent (Togan, 1994).

(Daniels, 1993). From this perspective, it is less justifiable to look down on some services (producer services) and more questionable to interpret the shift from manufacturing to services as necessarily a negative development.

Turkey is not a country with an established policy to offer advantages to services, certainly when it is compared with the advanced economies, but also when compared with countries such as India (which is very competitive in the provision of computer software services (Daniels, 1991; Daniels, 1993)), Singapore, Barbados and Jamaica (Lanvin, 1993). Thus, for a country such as Turkey, the reality should be somewhere in between. The shift towards services probably reflects the general global trend towards the increasing importance of producer services only to a certain extent; and the attitude of not bothering with productive areas and escaping towards easy-money making possibilities is also part of the story. Unless the analysis of the services category and its consequent differentiation, especially between consumer and producer services, is taken seriously and the nature of producer services thoroughly explored, we shall not understand why the recent increase in the number of producer services firms with foreign involvement is so important.

The nature of the producer services sector is crucial for understanding the sector's potential for any country. For example, in some countries participation in international credit and capital markets may have important implications for their economies; in others financial markets may be so 'shallow' that international operations must be confined to the financing of their foreign trade.⁸ Similarly, the mere existence of producer service firms in a country does not tell us whether they are the providers or simply their users. For example, some computer firms may simply be involved in software retailing without providing any real technical help or consultancy. Also, within the producer services category, some sectors may have domestic components sufficiently prepared to benefit from internationalisation; the internationalisation of other sectors may only bring suffering to their domestic components. Each sector deserves to be evaluated separately, something we could not accomplish here.

This study has not told us what contribution producer services might make to economic development, because of the limitations inherent in its methodology and data. But at least it has raised reasonable doubts about the oversimplified treatment of the services category and the consequent interpretation that investing in services will not contribute to the economic well-being of a city, region or country.

In the light of the limited background information on the Turkish economy, and especially on the nature of the Turkish producer services sector, it is not easy to discuss the propensity of producer services to export and their possible

⁸ According to Sönmez (1992, 78), foreign investments in finance have serious problems in Turkey. When their numbers are taken into account, it seems likely that for foreign banks Istanbul is going to replace Beirut's position before its civil war. However, when the nature of the investments is considered, the operations may be confined to the financing of Turkey's foreign trade and the monitoring of the credits provided to traders.

contributions to economic development. But the increasing involvement in the economy since 1985 of producer service firms with foreign capital is an indication of a change, while it can also be characterised as a continuity. More specifically, by change we mean the increasing integration of the Turkish economy in the world market, as a consequence of the fundamental shift in the country's development strategy. We argue that the recent surge in the number of such firms is an important aspect of the ongoing integration of economic activity at the international and inter-regional levels. Therefore, it should be of interest in its own right. By continuity, on the other hand, we mean to call attention to the unchallenged dominance of Istanbul over the rest of the country. The economy may have a new dimension because of a new level of interaction with the outside world, but the geographical concentration of economic activities in the primate city still remains powerful. The preference of many producer service firms for this central location supports the view that producer services are not uniformly distributed.

According to Daniels (1991), the geographical outcomes of the behaviour of producer services are more far-reaching than those of the behaviour of consumer services. The distribution of producer services is determined by the spatial pattern of intermediate demand; the distribution of other services, such as retailing or health services, is determined by the spatial pattern of final demand, which can be measured by such variables as population distribution or patterns of income. Therefore, the location of producer services is related more to the distribution of employment than to the distribution of population. The Istanbul region not only offers unrivalled scope for growth and specialisation through the concentration of corporate functions, but also presents greater opportunities for the further division of labour based on networking and sub-contracting. Not only is the demand for producer services more sophisticated in Istanbul, owing to the corporate geography of the country, but also there we find a heavy concentration of highly educated and experienced people, forming a basis for the producer service expertise. The education level of active people in Istanbul is well above the country's average; university graduates comprise 10.2 per cent of active people in Istanbul, compared with the national average of 5.2 (Sönmez, 1996). In addition to the staffing requirements of producer firms, the needs for access to clients and to advanced telecommunications networks make Istanbul the most popular location for producer services. (For particularities about Istanbul and international interdependencies see Keyder and Öncü (1993) and Aksoy and Robins (1993).) Ankara, on the other hand, offers unique opportunities through its concentration of central government departments and agencies, which are obviously somewhat less attractive to international producer services.

One local impact of the geographical concentration of producer services in Istanbul will be an increasingly intense competition for office space in its central business district. The development of the city as the locus for branches of multinational corporations has not been studied so far. Most office space in the city is currently converted residential accommodation, and there is a shortage of modern office space. It is certain that in the near future Istanbul will experience

an even stronger demand for office space from new multinational tenants and from the expanding producer services sector. How all this will change the relatively immature commercial property investment market is another open question. More generally, we need to investigate further how the trends in producer services will shape the city's development. How constraints on local planning, built form and developers may increase or inhibit the ability of the city to accommodate the sector is part of the same question.

Suggestions for further research

This study represents the opening of an important research area, and by raising interesting questions it aims to encourage subsequent work. This section recognises the limitations of our research and further elaborates the questions about further research that we find meaningful.

There are several important areas it has not been possible to consider in this paper. First, there is a need for further investigation into the qualitative characteristics of individual producer service sectors and firms. Peculiar characteristics of particular sectors within the category should be taken into consideration. For some sectors, Turkey may have every reason to be concerned about the participation of multinationals, because access to markets might ultimately allow them to become monopoly suppliers of specialist services. Since market concentration is considerable among international producer service firms, that could mean an increased concentration and monopolisation within the economy. For example, the top eight accounting firms have a 40 per cent share of the industry's world-wide revenues. The situation is similar in advertising, software/data processing, research and development, and management consulting (Noyelle, 1991).

On the other hand, in some sectors domestic components might be sufficiently prepared to benefit from internationalisation. One such sector seems to be construction engineering services, which already exports substantially. Emerging after 1980 as a new force in the Middle East and North African markets, construction companies from Turkey are now involved in producer service activities such as management consultancy (see Kaynak and Dalgıç, 1992).

An investigation into the qualitative characteristics of particular producer service sectors and firms would use an in-depth interview survey and investigate the organisational, client and behavioural structures of the firms. More specifically, their mode of entry into the market (as joint-ventures, as partnerships or through the establishment of sales offices or subsidiaries) and their degree of independence (independent enterprises, autonomous subsidiaries of conglomerates, subsidiaries of conglomerates, etc.) should provide valuable information about their organisational structures.

What clients do the firms serve? Domestic conglomerates, multinational corporations, small or medium-sized businesses? Also, their reasons for entering the market should throw light on the workings of the business environment. To what extent have they appeared in the market because of the changing business

practices of large domestic conglomerates and their demands? To what extent have they exclusively served the newcomers (multinationals) by helping them deal with country-specific conditions and problems? To what extent do they export their services, that is to what extent can they function as basic activities?

Little is known about the performances and potentials of foreign investment in producer services. Sit (1993) analyses various forms of foreign investment in developing countries and examines its impacts on the economies of host countries. However, almost no information exists that describes or measures the impact of foreign investment specifically in producer services on the metropolitan economies and on the national economy. Among the many subjects needing further illumination are the virtues and problems of foreign investments in the producer services. More specifically, do they change the business environment? If so, how? Do they help those they serve to increase their productivity? For whom do they enhance the attractiveness of the business environment? Do they change the organisation of firms and industries?

Of course, a more fundamental question is whether the growth of the producer services sector with foreign involvement can contribute to Turkey's economic development and to the well-being of Istanbul. There are strong claims that the supportive policies for FDI in Turkey might be so generous that foreign investments cannot be beneficial for the local economy, and that foreign investors might be transferring their earnings abroad instead of reinvesting them locally (Balasubramanyam, 1996; *Cumhuriyet*, 9 April 1997). Foreign investors can be beneficial to local economies only when they reinvest their earnings locally. Repatriation of funds, on the other hand, might further depress the economy.

The effects of the FDIs in producer services on the metropolitan and the national economy are obviously worth studying in greater detail, with an extensive examination of the facts and relevant data. Concerning the effects, the following areas deserve special attention: economic effects (employment creation, technology transfer, market development and interlinkages, balance of payments and business practice); political implications concerning state and local policies; social and cultural implications concerning new lifestyles; and finally, spatial impacts on the cities.

The local context 'in which larger global forces are filtered, challenged, manipulated, ignored and embraced by the constituent social, political and economic forces within each local setting' (Douglass, 1995) should also be understood better. The peculiar characteristics of Istanbul should be taken into consideration. Some of these characteristics are mentioned in other studies (Ercan, 1996; Buldam, 1993; Köksal, 1993), but there is still a need for a more thorough investigation.

Conclusion

Since the 1950s, world-wide employment in and output from producer services have expanded at rates markedly higher than employment in and output from the world economy as a whole. While the growth of producer services was at first

overwhelmingly concentrated in advanced economies, there is now considerable evidence that producer services are also rapidly growing in developing countries (Noyelle, 1991).

We have shown that since the late 1980s international producer service firms have been appearing even in low-profile countries like Turkey. This is the first substantial effort to take producer services seriously in the context of the Turkish economy, and it has documented up-to-date and precise information about foreign involvement in the sector. Our paper has explored the recent growth of producer services in the context of Turkey's changing policy environment and economy and has shown that the growth of the producer services sector with foreign involvement has been a clear response to some specific policy changes.

We have documented information on 278 producer service firms that have received some degree of FDI. Using official data, we have established that such foreign investments were first made in the 1955–1980 period, increased between 1981 and 1984 and surged remarkably after 1984. The empirical data indicate the overwhelming dominance of finance and consultancy services as industry groups, and that of the European Union countries as the countries of origin. Foreign investors have a clear preference for majority ownership. The evidence also demonstrates that the great increase in the number of producer services has served to reinforce the historic dominance of the Istanbul region over the rest of the country. We have also raised doubts about the oversimplified treatment of the services category by Turkish scholars and about the consequent interpretation that investing in services will not contribute to the economic well-being of the cities, the regions or the country.

We believe that there is a need for a more thorough understanding of the distinctiveness of the services sector. The differentiation between consumer and producer services should result in a re-evaluation of the perceived characteristics of services—their productivity, tradability and exportability. This would in turn encourage a more detailed investigation of the degree to which producer services can contribute to Turkey's economic development and to the well-being of Istanbul. So far, the possibility that Istanbul might be a locus for branches of multinational producer-service corporations has not been considered. There are two open questions. Can Istanbul play the role of a regional gateway for several countries in its geographical area? How might the trends in the production and provision of producer services shape the future development of the city? Unless the analysis of the services category and its consequent differentiation, especially between consumer and producer services, are taken seriously and the nature of producer services is thoroughly explored, we shall not recognise the importance of the recent increase in producer service firms with foreign involvement.

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