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Foreign Direct Investment in Turkey

"A sector based empirical analysis on the Turkish Case"

BY: N.Saygın Sungur

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SOSYAL BİLİMLER ENSTİTÜSÜ MÜDÜRLÜĞÜ'NE,

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Yrd. Doç. Dr. Çağatay AKARÇAY (Danışman)
Yeditepe Ü., İşletme Bölüm

Yrd. Doç. Dr. Gaye GENCER
Yeditepe Ü., İşletme Bölüm

Yrd.Doç.Dr. Can Tansel KAYA
Yeditepe Ü., İşletme Bölümü

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ABSTRACT

During the last two decades it is certain that with the recent developments in the local policies and the global determinants related with Turkish and world politics and economics, has given a significant change in the economical framework of Turkey. It is certain that even the start of our European dream in 1963 with the signing of the Ankara treaty to be a part of the European family (which we always have seen ourselves a part of) had been an ignition point for Turkish policies for certain economic development. One of the main pillars that the Turkish economy stands on can be counted as the foreign direct investment schemes that flow through certain programs both from public and private sector. These FDI schemes have been a discussion point both in academic world and also in the business sector seeking the answers to the questions; What is the FDI structure in Turkey?, Does it contribute to growth or Is it just an urban legend and lastly what kind of constraints do we have for FDI and what are the possible remedies for a better and more stable inflow of FDI? Although the above questions seem to be just a few sentences, in it unfortunately a huge issue exist to fully comprehend the situation. In this thesis thus, I am going to focus on mainly a piece of the big cake which I will look for the possible relationship of FDI inflows through the Turkish economy with the Turkish growth and derive a possible correlation (if there is any). Here the statement will be on empirical evidence and in the conclusion part I will try to sum up by trying also to say a few sentences on the constraint and remedies part in our way to the EU membership.

Key Words: Foreign Direct Investment, European Union membership, Foreign Direct Investment in Turkey

ÖZET

Son yirmi yılda yaşanan yerel ve küresel gelişmeler, Türkiye'nin ekonomik çevresinin değişme ve gelişmesinde önemli bir rol oynamıştır. 1963 yılında imzalanan ve Türk Avrupa Birliği adaylık rüyasının başlangıcı olan Ankara antlaşması, bu bağlamda bir kıvılcım noktası oluşturmuş ve değişimlerin başlamasına ön ayak olmuştur. Türk Ekonomik sisteminin en önemli dayanaklarından bir tanesi çeşitli şekil ve programlar ile Türkiye'ye akan doğrudan dış yatırım hareketleridir. Akademik aratırmaların önemli bir konusu olan yatırım hareketleri; "Türkiye'de doğrudan dış yatırım şekilleri" , " Türkiye'de doğrudan dış yatırımın ekonomik büyümeye etkileri", "Doğrudan dış yatırımın arttırılması için iyileştirme yöntemleri" gibi araştırma konularına hayat vermiştir. Her ne kadar yukarıdaki konular birer küçük cümle gibi gözüksede temellerinde öenmli araştırma kaynakları barındırmaktadır. Bu tezde yapılmak istenen bu araştırmalara bir nebze katkıda bulunmak amacıyla bu doprudan dış yatırım hareketlerinin büyümeye olan katkısının önemli sektörel kırılımlar üzerinden ölçmektir. Burda vurgu ampirik verilere dayandırılmaya çalışılmış son kısımda ise Türkiyenin Avrupa birliği süreci açısından dış yatırım hareketliliği özetlenmeye çalışılmıştır.

Anahtar Kelimeler: Doğrudan Dış Yatırım Hareketleri, Avrupa Birliği Üyeliği, Türkiye'de Doğrudan Dış Yatırım Hareketleri

LIST OF ABBREVIATIONS

FDI (Foreign Direct Investment)

MNCs (Multinational Enterprises)

OECD (Organization for Economic Cooperation and Development)

UN (United Nations)

UNCTAD (United Nations Conference on Trade and Development)

IMF (International Monetary Fund)

EU (European Union)

CU (Customs Union)

WTO (World Trade Organization)

BDDK (Turkish Banking Regulation and Supervision Agency)

TUSIAD (Turkish Industrialists' and Businessmen's Association)

YASED (Foreign Investors Association Turkey)

DEIK (Foreign Economic Relations Board)

USD (United States Dollar)

TL (Turkish Lira)

GDP (Gross Domestic Product)

CEECs (Central and Eastern European Countries)

IMD (International Institute for Management Development)

TUBITAK (The Scientific and Technical Research Council of Turkey)

GDFI (General Directorate of Foreign Investment Turkey)

M&A (Mergers and Acquisitions)

ICI (Istanbul Chamber of Industry)

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1. Introduction

Foreign Direct Investment (mainly known as the FDI) has become one of the main pillars of the global economy in the post-world war period which witnessed the reconstruction of a new global world, interlinking the emerging economies with the developed ones. To give a first step to my research efforts, there can be no debate on the fact that FDI has several effects on the economy of a host country who is receiving the inflow. With the direct investments breaching through the country several key economical factors such as production outcomes, employment schemes, balance of payments, economical growth (which will be the main focal point of this thesis) and general welfare of the country witness important changes. What is more important here can be stated as, the flows of FDI from industrialized and developed countries to the less developed or emerging economies contribute highly towards a strong global political economy. The world economy has seen that during the last two decades the amount of FDI to the developing countries (not all of them in reality) has risen significantly and in terms of statistics given it now accounts nearly 40% of the global FDI given by the figures. This sharp increase in the last decade depends on several factors such as the liberalization movements in the markets through certain events such as the European Union accession talks in terms of the Eastern European new members or the transposition of the FDI laws into ones that fairly exist and govern the FDI activities in the developed countries. The rapid pace in these transposition and liberalization activities has contributed fairly to the figures what came out today.

So, an issue to be discussed here is that where Turkey stands in this marathon for Foreign Direct Investment which we explain as the harbinger of welfare to emerging markets. Our ignition point for the Turkish FDI issue may start with the point that most of the FDI emitted through the Turkish borders has found body in the last two decades which can be proved with above argument of the rapid increase in the global FDI movements in the last two decades through certain harmonization and liberalization schemes. One of the main considerations here is the lack of sufficient research in the Turkish FDI literature for both the explanations of the low levels of FDI that is attracted and also coming to a conclusion for the correlation of economical activity and FDI in terms of several key factors such as growth, employment and welfare. It is rather sad that most of the research in this field has been conducted by foreign academicians, and even in the progress reports of the European

commission the poor performance of Turkish FDI has been given as advice to the Turkish government. (Commission progress reports on the Turkish accession)[1]

It is rather important to notice that although the poor performance of the Turkish FDI attractiveness has become a major discussion in the literature still in the recent years compared with the years of import substitution of 1980's there has been a significant increase in the FDI figures. The import substitution policies were seen as the primary causes for the low level of investment climate and thus starting with 1980's (when also the export led economy was chosen and also the privatization movements started) the Turkish governments systematically have started to take necessary remedies to attract more FDI into the country. These remedies included the creation of free market economy, less interventionist state policies and lastly efforts for the full integration of Turkish economy into the Global world economy. (The Customs Union agreement, IMF agreements and so on can be counted among these efforts) It can clearly be seen that the amount of FDI which was only 228 million $ in 1980 has increased significantly over the years. In 1999 the amount of authorizations for FDI amounted 25,050 million $ (GDFI, 1999 figure)[2] and with its uprooting trend it amounted 21.3 billion $ in 2007 (2007 figure, Turkish Treasury 2008 FDI report)

In terms of FDI activity, 1999 has been an important year for Turkey.[3]With the EU recognition decision in Helsinki a breakthrough in the relations between the EU and Turkey occurred. The decision meant an interconnection with the single market, a transposition to the European acquis communautaire and also the Economical Union which embodies itself under the pillar of Economic and Monetary Union. Thus all of the above has direct connection with the FDI issue as in most of the negotiation cases the accession countries were the ones to receive high amount of direct investments. The best example for this can be shown as the accession of the 8 Eastern European countries with Hungary and Poland pulled high amount of direct investments inside and thus benefited highly from the inflows of FDI.[4] On the other hand the FDI received within Turkish borders seem to increase less that its ancestors and the increase after the accession decision can be concluded less.

[1] The Commssion progress reports can be obtained from the commissions web site. http://ec.europa.eu/enlargement/press_corner/key-documents/index_en.htm

[2] The recent figures can be obtained from the following Turkish FDI authorizations table.

[3] The EU Helsinki Summit on 10-11 December was the date when Turkey was officially recognized as a candidate country fort he accession to European Union. Since the 1963 Ankara treaty this was the first milestone for Turkish full membership to the European Club.

[4] Poland, Czech Republic and Hungary combined received nearly 71 billion $ whereas Turkey has only received 5.1 billion $ during years 1995-2000 which means a 14 times difference in the amounts. (Source eurostat data)

Several key factors for the poor performance of Turkish FDI attractiveness can be counted. Turkey being a capital scarce economy is really in need of injections of foreign direct investments to increase its productive capacity and for giving its economy a boost to grow and compete in the world economy. Recent developments in the legislation and activities that are targeting potential foreign investors are at bay for a better performance or at least to catch near what is desired in terms of outcome. Thinking that FDI is different than the portfolio investments or loans[5] in terms of stability[6], there are several advantages to attract FDI into the country.

In this thesis I chose to conduct a research on the correlation between the economical growth and Foreign Direct investments. There are key factors affecting economic growth of a country and in this paper there will be an investigation of a possible interconnection of FDI with these key factors. To follow up a suitable plan the thesis will start with the necessary literature review and background to light the idea of what FDI is, how it affects countries and mainly how the historical scheme of Turkish FDI has developed through the years. After the literature review I am going to deal with the methodological form of the study and formulation of the hypotheses will follow up. After the necessary empirical research with the secondary data gathered is conducted there will be an evaluation of the results and the testing of hypotheses will occur. In the last part, I will try to link my test results with the necessary remedies and possible outcomes of these remedies in terms of the poor performance of Turkish FDI attractiveness. As mentioned above the Turkish research literature in this area can be concluded as weak and thus I believe the study will help to fill a minor gap in the Turkish FDI literature.

[5] Unlike loans for example FDI ensures that most of the risks involved in the business are carried by the investor himself thus giving a more flexible level of playing field fort he governments.

[6] It is important to notice here that not every type of investment that comes through Turkey can be counted as a stable Foreign Direct Investment. The above mentioned types of investments such as loans are the types of investments that are not stable and since they are mostly ready to flee in an economic downturn it is not suitable to count them among real FDI inflows.

2. Theoretical Background & Literature Review

Before going further into the hypotheses formulation and empirical research, I believe it is best to dive into and explain what we are dealing with. I will try to divide this part of the thesis into mainly three sections with the first section trying to cover an extensive summary of what the FDI is, what are the basic forms of FDI and what the theories of Foreign Direct Investment exist in the literature. In the second part, I will try to extend the literature review into the Turkish case in which I will try to work on a brief history and a literature review on the Turkish FDI inflows. In the third part, my work will be focusing on the European accession effects on the FDI with extensive literature covering the transformation of Foreign Direct Investment schemes regarding to the negotiation talks.

2.1 Big money talks: The theories of FDI

A basic definition of FDI can be explained as follows;[7]

"Foreign Direct Investment (FDI) in its classic definition is defined as a company from one country making a physical investment into building a factory in another country. Its definition can be extended to include investments made to acquire lasting interest in enterprises operating outside of the economy of the investor. The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a Multinational Corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. The UN defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.**"**

2.1.1 The types of FDI

Direction	Target	Motive
Inward-Outward	Horizontal-Vertical	Resource Seeking Market Seeking Efficiency Seeking Strategic-asset Seeking

[7] Source: http://en.wikipedia.org/wiki/Foreign_direct_investment

On Direction Basis

The fist of the facets of FDI that is used for the differentiation can be on the direction basis of FDI which can be concluded as the way the FDI is received. Inward FDI here as easy to understand donates for the incoming of FDI flows through the borders of a country where as the outward FDI means the country's strategic investments that are tied to other countries abroad. The major discussion is usually is on this topic as lots of debate revolve around the effects of inward FDI on a country's growth. Usually with several spill over effects as the literature concludes, some academicians believe that inward FDI brings positive growth effects and some believe that there may be negative effects on the market with the high level of monopolistic tendency that is breached by the powerful multinational companies.

On Target Basis

When we come to the second fragmentation on the differentiating dimensions of foreign direct investment activities we have the separation of horizontal and vertical FDI issues. Horizontal FDI is the type of FDI where the multinational companies or countries themselves undertake the same production measures in multiple countries where they can produce with the least cost. That means it does exactly the same production activities in different countries but does not divide the stages in the production process to several fragments. On the other side vertical type of FDI is the division where multinational companies prefer to produce their goods and services with the method of separating the steps of production and locating these steps in the countries where they can obtain a certain cost advantage. Literature has shown that in the cases of uncertainty in the global economy the expected income form the vertical FDI reduces and the expected income form the horizontal FDI increases. That is mainly because of the fact that in these uncertain environments multinational companies do not want to spread their risks in more than a few countries since in an economic downturn it will be harder for them to liquidate their investments and flee form the countries they have inward investments. One last aspect of these two types of FDI can be concluded is the market preferences as because of the country fragmentation- cost advantage issue the vertical FDI seems to flow more in the emerging countries where there are certain cost advantages and horizontal FDI seems to flow in the mature markets where there will be higher volatility which mainly is a key reason for these markets to attract FDI.

On the Motive Basis

The last differentiation point can be concluded as the motive basis which mainly indicates the reason why the multinational companies invest in particular countries. This dimension is driven mainly by 4 types of motives which, as summarized in the above table, are market seeking FDI, resource seeking FDI, efficiency seeking FDI and strategic asset seeking FDI. The first of these motives, the market seeking FDI is driven by the motive of accession to different markets and their potential. Considering the emerging markets especially have a huge potential in their domestic markets it will be easy to understand why this type of FDI from multinationals flow to these countries. Market seeking FDI can be driven by local regulations and operational costs. Car manufacturers prefer this type of FDI mainly because they can sell the cars they produce in that country through the domestic markets. Second comes the resource seeking FDI which we can see mainly in the multinational companies that are doing business in sectors with natural or scarce resources. As this kind of investment is tied to certain resource extractions, the inward FDI movements are directed to countries where the extraction of these resources is lower in costs or higher in volumes. This type of FDI activities are the primary motivations of petroleum, natural gas and so on producing multinational companies such as the Royal Dutch Shell doing business in the Middle East or Exxon Mobil searching for petroleum in the North Sea.

Efficiency Seeking FDI as a third dimension is mainly the search for a lower cost structure. We can usually see this type of FDI as in the forms of off shoring or in the forms of services given to domestic customers through other countries. Siemens for example gives its US and European customers call center services through Turkey and transition county based call centers where they can benefit form the low wage and allowance considerations. As a last dimension to the FDI we can give the strategic asset seeking FDI which donates to the notion of multinational companies seeking for strategic assets in other countries that they can benefit in the long term through the obtaining of specific ownership and technological advantages from the assets they have acquired. Also that means an easy access to the new market horizons and a different view to the competiveness for the multinationals investing to strategic assets in different countries.

2.1.2 The theories on FDI

Mainly the notion of FDI developed itself and got its peak by the end of the Second World War. The reconstruction of a devastated Europe needed a huge amount of investment for a recovery and with several aid plans such as the Marshall Plan[8] a new era of investment climate has shown itself by the leading of US. From then on several theories on FDI have been developed to explain the models of FDI activities. These theories looked indepth the issue from different points such as technological transfers, the effects of FDI on financial markets and so on… In this paper on the other hand as the main focal point is the correlation (to test whether there is a correlation and in which direction it is) between the growth of Turkish economy and the nature of FDI that Turkey receives, only three of the best known models will be taken into account which are the internalization theory, the eclectic FDI theory of Dunning (Dunning 1990,1993) which is mainly based on the behavior of multinational companies in terms of FDI activities and lastly the well known theory of product life cycle theory adapted to the Foreign Direct Investment activities. The brief summary of the three theories will be guiding for us to use and understand the knowledge of FDI and to spill this information on the other theories and therefore come to a conclusion for the explanation of FDI behavior.

The first of the three theories is the internalization theory. According to this theory the MNC's set up their activities and subsidiaries abroad if they see licensing and carrying their activities through domestic firms is more difficult than penetrating through a host country via transfers of foreign direct investments. (Chen pp.231, 2004) Dunning states that, the MNCs seek alternative ways for their activities outside their national markets and give their investment decisions abroad if they see a comparative investment advantage exceeding their home market operation advantages and if it is beneficial to invest outside their national boundaries. (Dunning, 1993) In the Buckley&Casson's long-run theory of multinational enterprises (Buckley&Casson 1976, 1998b) there are four dimensional factors regarding the direction of FDI inflows for the host country choice. The authors state these factors as the industry specific factors shaping the nature of the market and the product nature, region specific factors which depend on the geographical and sociological nature of the country

[8] The Plan initiated by the U.S in 1947 named after secretary of state George Marshall. Several debates on this issue has shown itself in the academic literature with both camps wither saying Marshall Plan was not the saver of Europe or the plan itself was the igniter of a possible European recovery at the time.

receiving the FDI, nation specific factors such as the economical and political climate of the host country and last firm specific factors reflecting the managerial ability of the MNC to coordinate and effectively manage the inflow of FDI. (Buckley&Casson 1976, 1998b) Later discussions added to this argument are present stating that operational costs of the transactions are also considered in the FDI decisions and this is the main argument why firms rely more on investing abroad rather than licensing and managerial contracts. Also authors such as Henisz have extended the Buckley and Casson thesis stating that the third factor of political environment (in the Buckley and Casson article the finding is that effective cooperation with the host country governments is a success factor for MNCs in their investments) may also provide multinational firms with an advantage over their domestic counterparts. (Henisz pp.183, 2003)[9] The internalization argument covers the idea that foreign MNCs prefer making direct investments over giving licenses to domestic firms as certain benefits such as the elimination of high costs of foreign direct investment, and avoiding the high costs of using the market for technology. (Chen pp.243, 2004)[10]

The second theory is Dunning's eclectic theory which is also known as the OLI paradigm. In this OLI paradigm O stands for the ownership specific advantages, L stands for location specific advantages and I stand for internalization advantages. (Dunning, 1993) The eclectic theory suggests that specific assets should be owned by the MNCs in order to operate in foreign markets. Among these assets are both tangible assets such as scarce resources such as natural ones, capital and so on and also intangible ones such as technology and information. The ownership of these both tangible and intangible assets brings certain advantages to the firm investing and thus creates ownership-specific advantages. Location specific advantages are the ones that encourage a firm to invest in a certain host country because the assets or resources that give certain advantages to the MNC are tied to a certain location and the investment done in that location make it easier for the foreign firm to transfer and allocate the resources more effectively. The last of the factors the Internalization factor is given birth by the discussion that whether the firm should continue its activities abroad through the internalization of the investment with FDI or sales subsidiaries, or through arms-length contracts and so on… Oxelheim et al. here argues that for the decision of whether to undertake the necessary investment measures the firm should have developed firm-specific

[9] Henisz, Witold J " The Power of the Buckley and Casson thesis: the ability to manage institutional idiosyncrasies" Journal of International Business Studies (2003) 34 173-184

[10] Chen Shih-Fen S "Extending internalization theory: a new perspective on internalization technology transfer and its generalization" Journal of International Business Studies (2005) 36 231-245

characteristics that enable it to be competitive in the home market, typical of these characteristics include economies of scale and scope, high technology derived from heavy R&D activities, differentiated products and lastly excellence in managerial and marketing expertise. (Oxelheim et al. pp.7, 2001) Oxelheim et al (2001) Chen (1998) and Dunning have concluded on the OLI paradigm that the behavioral direction to the FDI decision is highly linked with where to locate the FDI which is the L factor in this theory. The internalization factor according to the literature is also an important factor. Considering the fact that without the ownership of foreign subsidiaries the transaction costs would be higher, Dunning (1993.1998) Oxelheim et al. 2001) conclude that internalization of some of the FDI activities highly affects the outcome of the FDI.

The last of the three theories that I am going to focus on this thesis is the Product-Life Cycle theory of Vernon. This theory in reality was developed for the understanding of International Trade; however it can also be used to understand how the FDI works in the International Arena. According to Vernon (1966)[11] the MNCs first start the investment process first by exporting their products to different host countries and from then after when the product moves through its product life cycle they start to invest across national boundaries enjoying different benefits in the host country. This argument foresees three stages of the product which are the new, maturing and standardized. As the product starts to mature, the conditions also start to change. A certain degree of standardization takes place and the demand of the products will start to appear elsewhere. As the demand starts to increase, the overseas markets then start producing for themselves generally at a cheaper labor and overall cost. Czinkota argues here that in the first stage of the cycle the product may not be standardized due to the need of innovation, great research and highly qualified labor thus the manufacturing costs are usually high. In the second stage the exporting procedure starts with the combination of advantages of the home market and host market. (Czinkota et al. 2002)[12] The expansion of he production over the national borders create an advantage in terms of declining production costs and increasing demands in the combination of several markets. Vernon and Czinkota expands the argument here that, the investing company here has a critical choice in terms of FDI for whether to lose market share against the companies which have lower transaction costs of to invest outside the home country, where certain competitive advantage reigns.

[11] Vernon, R. "International Investment and International Trade in the Product Life-Cycle" Quarterly Journal of Economics. 1966, 80:190-207

[12] CZINKOTA, M; RIVOLI, P. and RONKAINEN, I. International Business. 2nd Ed. New York: The Dryden Press, 1992.

(Vernon 1966, Czinkota et al 1992) Entering through the last stage brings the standardization of the product and the decline in the R&D activities and certain transaction costs. The standardization lowers the need for skilled labor also. The Product Life Cycle Theory when adapted to the FDI is a way of explanation why although most of the products innovated in the developed countries are preferred to be produced in lower cost emerging markets and thus in terms of establishing this manufacturing process why the FDI flows through these markets. Czinkota et al. here concludes as an important point that only products that are going through manufacturing processes may be adapted to this theory as resource based products and service sector are harder to categorize in this theory's stages of life cycle. (Czinkota et al 1992)

2.1.3 FDI literature on Economic growth

FDI being an important vehicle for most of the developing economies in terms of transfer of technology, creation of human capital and thus economic growth, has been discussed exclusively by the academic literature considering different dimensions. Some find evidence that FDI compared to domestic investment results to be more productive. This is because of the fact that although the domestic firm has a better knowledge of the domestic market, it is clear that with several benefits such as enjoying lower costs and higher productive efficiency (in terms of better managerial skills and the more modern technology), the FDI excels in the productivity measure compared to domestic investment. (Borensztein E., Gregorio J.De, Lee J-W p.133, 1998) This also links an important notion of a correlation between the effects of FDI on economic growth with the level of human capital of a host country receiving the inflow of foreign direct investment. The qualitative formation of human capital strongly effects the direction of FDI and thus economical growth also this educational attainment correlation is not the same in the domestic investment since the foreign firms or MNC's investing in the host country try to maximize the efficiency derived form the human capital for better performances whereas the domestic one rely more on the knowledge of domestic markets. (Borensztein E., Gregorio J.De, Lee J-W p.133, 1998) Also the usage of technological innovation through this human capital has an important add-on effect to the productivity level of the foreign firm investment that the domestic ones.[13]

[13] Most of the difference in the usage of human capital results because of technological nature since most of the FDI receiving countries usually tends to be less developed in terms of technology than the home country of the investing foreign firm. As a result, this brings a gap in the effective usage of the human capital and changes the level of productivity growth. However the technology brought by the MNC's to the host country also helps the domestic firms since this competition creates the transfer of technology to local markets in the host country and creates a tendency towards technological R&D activities and thus innovation.

Alfaro et al. finds evidence for this add-on of technology to the growth discussion stating that the introduction of the new technologies to the host country by the foreign investing companies help domestic firms to benefit from accelerated diffusion of new technology and also from the labor turnover with domestic employees spilling into the foreign firms. The combination of these key factors with the necessary capital financing creates a modernization in the national economy and thus promotes the economical growth. (Alfaro et al. pp.90, 2004)[14] Blömström et al. supports this technology transfer argument by stating that FDI is one of the important channels of technology transfer through the exports of machinery. The article defends the idea that technology diffusion is an important side-effect of foreign direct investment as a major percent of the developing countries are dependent on the Research and Development activities of the developed countries through FDI inflows in their countries to access the modern technological developments. (Blömström et al. pp.11 1992) Alfaro supported this argument by stating that FDI may be a valuable technology and know-how transfer method fostering the linkages with local firms and thus become a jumpstart in the economic growth. That is mainly one of the primary reasons why most of the countries establish incentives to encourage the flow of FDI through their borders. (Alfaro pp.1,2003) One negative debate on this tech spill-over issue is that as Alfaro cites from Hirschman (1958)[15] there is a limitation in this growth technology relationship in terms of FDI as not all of the sectors have the same absorption capacity and thus do not have the same growth based effect. Hirschman suggests that sectors such as agriculture and mining draw less portions form the FDI technological spillovers and as a result mostly have a limited effect in the growth of an economy. (Alfaro, L pp.3, 2003)

FDI inflows in the world have increased significantly in the World in the last two decades. Gao (Gao, pp158 2005) here gives evidence that this inflow rose form 57 billion $ in 1982 to 1271 billion $ in 2000. The growth rate of the world FDI has exceeded the growth rates of GDP and world trade.[16] Policy making also changed according to this increase in the recent years and developing countries started a wave of liberalization in order to attract more FDI to their countries. The belief of the emerging markets that FDI inflows create more jobs

[14] For better understanding the effects of technological transfers by FDI inflows, see Wang J.Y "Growth technology transfer, and the long run theory of international capital movements" Journal of Economics 29. pp.255–271,1990

[15] Hirschman, A. "The Strategy of Economic Development New Haven: Yale University Press 1958

[16] The annual average FDI that flow into developing countries has risen from 13.1 billion $ annually during 1981-1985 to a stunning 240.1 billion in 2000 (UNCTAD, 1994-2001)

and prepare a remedy for the capital scarcity becomes a crucial factor in these liberalization movements.

An interesting debate appears in the discussions of Subramanian et al. (Subramanian et al pp.1, 2006)[17] There is a discussion in the paper stating that developing countries that have relied more on foreign finance have not grown faster in the long-run and have typically grown more slowly whereas surprisingly industrial countries that rely on foreign finance have grown faster than their counterparts. (Subramanian et al pp.1 2006) Possible explanations for this debate as the authors conclude can be given in two ways. First, in the less financially developed countries the positive correlation between the account balances and the economic growth is stronger which restricts the profitable ratio of investment possibilities and thus investments are financed through domestic savings. Secondly, to prevent overvaluation at the host country's exchange currency, the host country prefer not to absorb too much foreign capital actively also making sure that some of the country's sectors (especially the manufacturing sectors) keep themselves competitive and thus there is an augmentation in the economic growth rate. (Subramanian pp.1, 2006)

One of the important factors that are discussed in the literature is about the growth effect of FDI through productivity spillovers. Lipsey argues that (Lipsey R.E, 2002) productivity spillovers from foreign-owned firms to domestic firms is a way of understanding the effects of inward FDI to the growth (Lipsey pp.54, 2002) However he also argues that "if the higher productivity of the foreign firms are at the expense of lower productivity in domestic firms, there might be no implications for aggregate output or growth." (Lipsey pp.54, 2002) Görg and Greenaway[18] (Görg and Greenaway, 2003) have conducted an extensive research of this productivity spillover issue and from the 35 articles[19] and they have reached certain conclusions that most of the cases in terms of this productivity spillover show no or nearly too low evidence that there is a positive effect of FDI on the productivity and thus a positive effect on growth through this increase in productivity of domestic firms. They conclude that this is because of specific reasons. One of the main reasons is that foreign firms are cunning enough to protect their tech advantage form a positive spillover to the domestic

[17] Subramanian A , Prasad E, Raghuram R, "Foreign Capital and Economic Growth" IMF Research Paper August 2006

[18] Görg, H and Greeaway, D. "Much Ado About Nothing: Do Domestic Firms Really Benefit From Foreign Direct Investment?" Research Paper 2001/37 Globalization and Labor markets Program, Nottingham.

[19] Among the articles they have conducted researches on 15 of them were on developing countries, 14 of them were on developed countries and 6 of them were on the transition countries.

firms and as a result there is little help of the transferred technology. A second factor according to Görg and Greeaway is that the competition created because of the entrance of multinational players restricts the level of playing field for the domestic ones and thus reduces productivity. (Görg and Greenaway, pp.6-9 2003)

Another important factor discussed in the literature can be extracted as the wage spillover effect of FDI on economic growth. Görg and Greeaway conclude that on the presence of productivity spillovers mostly this is due to the increase in labor productivity. The competition created with the entrance of foreign players cause an upturn in the labor market as the foreign firms pay higher wages in order to control the market due to their size and sectoral characteristics. (Görg and Greenaway, pp.12 2003) However this will cause the domestic players to reconsider their wages and make an increase if the foreign and domestic ones share the same labor market. The conclusion is that mostly the direction of the productivity spillover of Foreign Direct Investment usually determines the direction of the Wage spillovers and thus the effect of wages and labor supply on the economic growth. However in most of the cases as Görg and Greeaway find evidence this direction is negative.

Export spillovers are a debate issue in the FDI literature in terms of economic growth. Considering the point that export of a country is an important determinant for the growth and GDP level, this notion is an important one. Aitken, Hanson, Harrison[20] (cited by Görg and Gateway pp.13, 2003) find evidence in their study that "export activities of MNCs have positive effects on the market" On this issue Görg and Greenaway conclude that certain factors such as export information externalities, demonstration effects, competition on home and foreign markets affect the domestic firms export activities however the conclusion is that (both in the Aitken et al and Görg paper) these factors only positively affect the probability of a domestic firm to become a successful exporter but usually have no evidence of increasing the export ratios. As a result, it is not certain whether the export spillovers have a positive effect on the economic growth.

[20] Aitken,B.; Hanson, G.H; Harrison A.E "Spillovers, foreign investment and export behavior" Journal of International Economics Vol.43 pp.103-132

An interesting debate on the effects of FDI on a country's growth has been shown by Alfaro et al. (Alfaro et al. pp.107, 2004)[21] The authors find evidence that despite the fact that from the FDI investor country's perspective FDI is only a way of investment from the perspective of the host country accepting the inflow it means the gathering of important side effects such as the introduction of new processes to the market, the training of labor force and other positive spillovers. However policy making has become an important determinant in the positive effects of FDI meaning that if these fiscal and financial incentives are not regulated with the right policy measures then FDI would not go further from the capital it accumulates and wage generation effects which in turn means no growth for a country. (Alfaro et al. pp.107, 2004) Another key point in the analysis of Alfaro suggests that FDI has a positive growth effect with a crucial factor of the level of development of local financial markets. The lack of a well developed financial intermediation in a host country would certainly limit the level of benefits that a country would enjoy form the FDI inflows. This argument is both valid for short-term capital flows as well as long-term stable investments and none of the two alternatives would work in the "in the absence of well-functioning financial markets." (Alfaro et al. pp.108, 2004) This proposition stems from the discussion; Goldsmith argues (Goldsmith 1969 cited from Lipsey 2002)[22] local firms would be unable to take advantage of various kinds of knowledge that gain from the presence of the foreign firms in case of a lack of a stable financial market system.[23] Alfaro et al. also suggests here that education also plays an important role in the FDI and economic growth relationship (Alfaro et al. 2003)

Trade policies have also been researched exclusive in terms of FDI and growth relationship. Bhagwati (Bhagwati, 1978)[24] has argued that trade policies and trade based incentives play an important role on the FDI effects being either favorable or unfavorable for the host country. [25]His argument stated that countries using export promotion policies has better results and while others using import substitution policies decreased their chances of

[21] Alfaro, L. Chanda A. ; Kalemli-Ozcan, S. ;Sayek S. "FDI and economic growth: the role of financial markets" Journal of International Economics Volume:64 2004 pp.89-112

[22] The original discussion can be found in the book of Goldsmith. Goldsmith Raymond W. "Financial Structure and Development" New Haven, Yale University Press 1969

[23] In the next chapter while I will be dealing with the Turkish FDI literature and also in the mid section when I will construct my hypotheses on the Turkish case, I will try to show this argument seems to be valid for Turkey. The lack of a well established and stable financial system in Turkey is one of the key explanations of why Turkey has difficulties in attracting and benefiting the FDI inflows and lack highly behind countries like Poland, Hungary and other transition countries.

[24] Bhagwati J.N. "Anatomy and consequences of Exchange control regimes" 1978 Cambridge, Ballinger.

[25] Balasubramanyam V.N, Salisu M, Sapsford D, " Foreign Direct Investment and Growth in the EP and IS Countries" Economic Journal Vol.106 pp.92-105

enjoying these benefits. In the later literature Balasubramanyam et al (1996) tested this hypothesis by using data from several developing countries and using their data finding evidence whether this trade policy argument was valid. The authors found significant and persuading results as in most of the developing countries using export promotion policies, the effect of FDI on economic growth was positive and significant. However the interesting point was the lack of evidence for a proof for the other developing countries that the usage of import substitution policies for them was a reason for a negative correlation between FDI and the economic growth.[26]

The incentives given to the foreign firms for attracting FDI has been questioned in the literature a lot since there is yet no conclusive evidence proving that there are positive spillovers for host countries receiving this foreign capital. Most of the literature on the developing countries have weak conclusions and rather do not support this positive spillover theory. (Alfaro pp.1 2003) Some literature even states a negative effect cycle of FDI on the host country. Gorg and Greenaway conclude in this issue that although it is acceptable that FDI is a key driver of economic growth and economic development, still there is far more research to be completed to comprehend the full effects of FDI on the economic growth through certain factors such as spillovers, technology and know how transfers and so on. (Gorg and Greeaway pp.18-19 2003) Another important conclusion drawn was by Alfaro stating that different sectors of the economy attracting FDI has different effects on economic growth (Alfaro pp.13, 2003) FDI inflows in the primary sectors tend to give negative empirical results whereas FDI inflows in the manufacturing sector has a positive one. Service sector has no convincing result so it is ambiguous.

One last remark on the growth and FDI relationship has been emphasized by Carkovic and Levine (Carkovic&Levine 2002) The authors found that solely FDI does not seem to be consistent as a determinant on the economic growth. They have concluded that the policy measures combined with the FDI and its incentives may influence growth but there are not enough empirical evidence proving that FDI is an important catalyst for the economic growth of a country. (Carkovic&Levine pp.219 2002)[27]

[26] Another key factor to be investigated in terms of Turkish FDI could be related to this argument. The rapid increase in the FDI inflow has shown itself during the years after the switch of Turkish trade policy. The start of the increase in the stock of foreign investments seems to increase after Turkish policy shift from import substitution to export promotion. Later in this thesis I am going to delve into this issue.

[27] For the in depth results of the sensitivity analysis and other empirical tests see; Carkovic M, Levine R; "Does Foreign Direct investment Accelerate Economic Growth" Working Paper University of Minnesota 2002

After dealing with the economic growth literature, in the next chapter of the thesis I am going to look in depth to the history and development of the Turkish FDI case and try to look through the literature (although there are certain limitations as there is a lack of research especially in Turkey) This in fact will give a brief insight to us before forming our hypotheses and testing the Turkish FDI-Economic Growth Case.

2.1.4 Literature on Turkish Foreign Direct Investment

The lack of extensive literature is one of the biggest problems in conducting research on the FDI activities in Turkey. Although some sources have been guiding in the research process like reports form organizations such as TUSIAD or bulletin from the Turkish treasury, it is really precious if you can find empirical studies on the issue.

Perhaps the first and the most obvious argument that the Turkish FDI literature emphasizes is that in spite of being the largest economy in the Black Sea basin, the Balkans and in the Eastern Europe and also the 6th biggest trading partner of EU, Turkey compared with the other candidate and new member countries such as Hungary, Poland, and so on it has a very low attractiveness and ratio in terms pf FDI inflows. Basar and Tosunoglu gives evidence here that evaluating the key FDI figures of some of the biggest countries in the newcomers and comparing them with each other the result shows sadly that the FDI inflows in Poland are 4.3 times higher, Hungary 2.1 times higher and Czech Republic 3.1 times higher that the Turkish FDI figures. (Basar&Tosunoglu pp.120, 2006) Turkey's FDI inflows reaching rarely $1 billion in any of the tracked years in the last two decades means the FDI received can be concluded as a fraction level of the countries of the same comparable size such as Argentina and Mexico. Dutz, Us and Yılmaz find this notion as one of the most important FDI challenges Turkey has to face. (Dutz,Us and Yılmaz pp. 24, 2004) According to them the main question to be answered should be why the FDI levels are so low and what the remedies to correct this situation are. Erdal and Tatoğlu support this argument by stating that; although the transformation of the economic system to the free-market economy has created a surge in the foreign direct investment inflows still Turkey has a relatively poor record of FDI compared to Latin American and Central Eastern European Countries. (Erdal and Tatoğlu pp.5,2002) They have found that policy implications play an important role on the direction of FDI in Turkey.On the other hand Loewendahl&Loewendahl adds to this

argument that Turkey has performed far worse in the privatization related FDI and with its present condition with several barriers in front of such FDI inflows, they have concluded that it is unlikely for Turkey to improve its condition in the long-term relative to its competitors.(Loewendahl&Loewendahl pp.15, 2001) The removal of obstacles before the FDI inflows accelerating the privatization program[28] according to the literature is an important step in narrowing down the gap in terms of FDI between Turkey and the other transition economies. In the next few pages in the light of the discussions above in terms of Turkey's low performance of FDI, it is essential to delve into the literature of key possible factors and possible offered remedies for the issue. This literature review gains importance in the path to form our methodology for the investigation and forming of our key hypotheses question of whether the FDI has a positive or negative effect on the Turkish economic growth in the recent years.

Several explanations for the FDI performance of Turkey have been discussed in the literature. It is obvious that Turkey has both advantages and disadvantages for attracting high volumes of foreign direct investment. According to the Institutional Investor Americas, 1999 (cited from Loewendahl&Loewendahl, 2001)

"Turkey has many advantages to offer foreign investors: a domestic market of 64 million people, proximity to the huge markets of Europe, the Commonwealth of Independent States, the Middle East and North Africa, low labor costs, a well educated managerial class, state or art telecommunications networks, and modern infrastructure. Foreign investors can freely move capital goods, capital, profits and dividends in and out of the country, and have the same rights, exemptions and privileges as Turkish investors."

On the other hand despite the above statement, it is paradoxical to see that still Turkey suffers from a very low performance for the attractiveness of FDI through its borders. One of the main arguments in this issue is about the locational determinants is the foreign capital movements through Turkey. Going back to the Dunning's OLI paradigm[29] in the previous section of this study the theory is a way for understanding the underlying motive but not

[28] January 2000 comprehensive program of structural reforms to eliminate double-digit inflation and restructure banking, agriculture and backward state owned-enterprises has become a major step in this path to the liberalization of policies and a certain remedy for encouraging the foreign countries to invest in a more stable environment.

[29] Reminder; **O**: Ownership Specific Advantages **L:** Location advantages **I:** Internalization advantages.

sufficient enough for understanding the key motivators behind the idea of why a firm has an motivation towards investing in a specific location preferring one location to the other even though the one that is left behind has certain other advantages. Loewendahl&Loewendahl here argue that here with the location specific advantages the country's attractiveness and the foreign investor's investment strategies play an important role in the determination a FDI decision. .(Loewendahl&Loewendahl pp.16, 2001) Erdal and Tatoglu classify location based determinants into two; 1) the Ricardian type endowments mainly comprise natural resources, labor and proximity to markets and 2) the environmental range of variables such as political, economic, legal and infrastructure factors of a host country. (Erdal and Tatoğlu pp.3, 2002) Balancing these two dimensions Turkey gains in the former and loses in the latter dimension. As Erdal and Tatoglu empirically conclude, while Turkey offers several locational advantages to the investors, the lack of the economical stability (in terms of several important key determinants such as inflation, exchange rate policies and so on…) and political instability (political upturns and downturns, the danger of coup d'etats and etc…) has widely hindered efforts to attract more FDI through the borders. (Erdal and Tatoğlu pp.6 2002) Loewendahl&Loewendahl suggests that as most of the FDI received by the developing countries can be counted as the market seeking type of FDI; main location factors in host countries such as Turkey can be counted as; (Loewendahl&Loewendahl pp.17, 2001)

- ✓ **Market size**: This factor is truly valid for the Turkish case since Turkey is the biggest economy among the CEECs and among its neighbors having an important and unsaturated market with 70 million people.
- ✓ **Market Growth**: recent growth rates have shown that despite fiscal imbalances and the economic downturn in the global financial markets still the Turkish GDP growth has been higher then the expectations. This in return causes an important environment for foreign capital movements.
- ✓ **Access to regional and global markets**: Turkey constituting a bridge between the two important old continents of the world has been an important trade center. Having an interconnection between both regional and global economic integrations such as European Union makes Turkey an important player in the international trade and investment scene.
- ✓ **Country specific consumer preferences**: Turkey has been an important market for most of the global brands with a huge percentage of young population. This in return gives high advantage to the global firms to bring their investments and products to Turkey with high and better profit margins than they have in their home countries.

- ✓ **Structure of Markets**: Turkey offers faster market access and a stronger competitive position as a location for FDI in its regional location with a blend of a dynamic market structure and large population with the mid-level per-capita income. Thus as Loewendahl&Loewendahl (2001), Tatoglu and Glaister (1998) and Erdilek (1982) argues the Turkish market seems to give clues of being converging rather than an emerging market.

Besides the location based advantages Turkey has in terms of FDI attractiveness certain other advantages have been discussed in the literature. Basar and Tosunoğlu (2006) have emphasized the fact that the population and the workforce are the main advantages of Turkey for the luring of foreign investors to bring capital into Turkish borders. (Basar and Tosunoğlu pp.121, 2006) The authors conclude that the advantage here is, by 2015 the size of the potential workforce is expected to increase at a constant level in contrast to both western and eastern European countries. As a result of this projected workforce increase, Turkish business climate is attractive to the investors with the advantage of lower labor costs. The TUSIAD report on Turkish FDI attractiveness (TUSIAD, pp. 6 February 2004) supports this labor argument with much evidence in different dimensions. The report suggests that Turkey scores higher in availability of skilled labor compared with the CEECs and even higher than Ireland[30]. According to the report for example Turkey ranks 8th in the world in terms of availability of competent senior managers, well ahead of Hungary (31st) Poland (40th) and Czech Republic (46th) (TUSIAD, pp. 6 February 2004) The important remedy here as parallel with the other problem is the transposition of legal issues accordingly and removing the question marks in front of the foreign investors such as legal deductions on salaries.[31]

Political and economical stability are important determinants as stated in the literature on Foreign Direct investment. Chan and Gemayel (2004) find evidence that investment risk is higher in countries which have historically a higher level of instability. Empirically they have concluded that more than half of the senior executives of the global MNCs believe that government regulations, political disturbance and economical crises and similar key factors

[30] This is important since Ireland with both its growth numbers and FDI attractiveness has been one of the most successful countries in the EU in terms of FDI inflows.
[31] High income taxes deduced form the salaries create an important burden on both the investors and employees. The higher the income taxes get the lower the investors have to increase the salaries which makes Turkey an undesirable place as it creates higher labor costs.

are the main determinants of investment decisions. (Chan&Gemayel pp.6 and pp.15, 2004) [32] Considering the above argument, it is not surprising why Turkey is not so attractive in terms of political and economical instability. With several economic crises at hand which are quite destructive and with political uncertainty of several governments[33], there is a quick and easy explanation of why Turkey is not chosen as a host country for the foreign capital investments. Dutz&Us&Yılmaz conclude that "with its heavy dose of patronage relations and rent-seeking activities in the domestic politics never allowed the creation of a stable macroeconomic environment" (Dutz,Us and Yılmaz pp. 6, 2004) As a result of this political instability several key macroeconomic indicators showed weaknesses and this in return either discouraged the foreign investors from bringing in the capital or caused to flee with capital inflows back to their home countries.

Aside from the economic and political instabilities, the issue of administrative barriers in front of foreign investments create and important discouragement to the investors. According to Morriset&Neso (2002) Excessive regulation and paperwork with different dimensions such as entry approvals, land-site development & utility and lastly operational requirements varying form country to country may cause a disincentive for the foreign investors. (Morriset and Neso pp.6, 2002)[34] Turkey in this area has a very bad fame among the other transition countries. Observations have shown that Turkey has the longest administrative procedures and red-tape for the foreign investment compared to other countries in the Euro zone and the lack of a single entity that can manage all of the paperwork form a single source makes it harder for the foreign investors to cope up with such procedures. Morriset&Neso (2002) has found evidence that with 1106 business days (121 days for entry and 985 days for land-site) Turkey has the longest delay in terms of FDI (Morriset and Neso pp.11 2002) Corruption can be added importantly to these administrative barriers. Turkey which has an important fame in the corruption indexes has a great public administration disadvantage of high corruption and thus combined with the barriers above this makes the

[32] This result is the result of "a survey that was constructed using primary data from a proprietary survey administered to senior executives of the world's 1,000 largest corporations" For more empirical results of the study see Chen,Kitty K. And Edward R. Gemayel "Risk Instability and the Pattern of Foreign Direct Investment in the Middle East and North Africa Region" IMF Working Paper WP/04/139 August 2004

[33] In the last 13 years there have been 13 different governments (www..tbmm.gov.tr-2005) with most of them being coalition governments which make it harder to pass legislations and easing the transposition of the necessary regulations.

[34] For an extensive coverage of these three dimensions see Morriset J and Neso Lumenga O. "Administrative Barriers to Foreign Investment in Developing Countries", Foreign Investment Advisory Service and World Bank, Policy Research Working Paper 2848, May 2002

results graver than thought. One of the key EU effects is here in the corruption case since with the opening of accession negotiations the European Union requires dealing with the corruptive factors in the both private and public sector which mainly scares the foreign investors. Minimization of both the administrative procedures and corruption would definitely affect the volume of FDI received.

With Turkish FDI literature at hand one last part I want to go into is the findings and literature on the effects of European membership on new transition countries. This linkage is highly important to understand how these countries receive the high volume of FDI with the opening of negotiations and why Turkey still lags behind them. The formulation of our hypotheses will depend on mainly understanding the key points in the three parts of this literature review. In the next chapter I will try to briefly summarize key points in the effects of FDI on the transition countries[35] and try to figure out what is similar and what is not between us and them

2.1.5 Joining the Club: The effects of EU accession on FDI.

In this final part of the literature review, I will try to sum up with a small literature review of how the FDI has developed in countries which enjoyed the same accession period like Turkey and what the literature on this FDI- transition country relationship says. I believe this will be one of the crucial parts of the thesis, though not quite extensive as it is a large and totally other topic to wholly cover, since it is one of the main ways to understand the key pros and cons of the Turkish FDI attractiveness during the last decade mainly through the accession talks.

EU membership has become one of the important issues in the last fifty years for the whole European continent. Form the time Robert Schuman paved the way of an integrated Europe with the proposal of Coal and Steel Community in 1950[36] , the European Union managed to transform itself into an important entity in the World scene. With the collapse of

[35] What I count among the transition countries are grouped into three. 1)Central and Eastern European Countries (Albania, Bulgaria, Czech Republic, Croatia, Hungary, Macedonia, Slovak Republic, Slovenia, Romania, Poland),2)The Commonwealth of Independent States (Armenia, Azerbaijan, Belarus, Moldova, Ukraine, Russia, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan) and 3) The Baltic States (Estonia, Latvia, Lithuania).

[36] Coal and Steel community was the father of the European Union. With the help of its transformation in 1957 the treaty of Rome was signed with established the European Economic Communities which afterwards turned into the European Union with the treaty of Maastricht in 1993.

the Berlin Wall and more importantly the Soviet Union, a chance for the reintegration of former iron curtain (eastern European countries) into the capitalist west was given birth. FDI here became an important notion for most of these Eastern European countries since under the Soviet regime their markets were still in their infant stages and were unable to find the changes to develop under the planned economy. FDI on the other hand, brought the chances for accelerated growth, restructuring of their enterprises, technical innovation and with all of these enough capital to take a relief form the economic downturns. Bevan&Estrin here argues that "EU membership can be viewed as a determining element of the operating business environment which may be a direct factor on the rate of FDI inflows" (Bevan&Estrin pp.4, 2000) Recent literature on these transition economies have shown us that privatization and FDI movements have significantly increased with the first entrance of a possibility of an EU membership through the borders. Several important notions such as business environment, labour costs, and trade integration and so on have changed as Bevan&Estrin emphasizes that these political and economical factors have been the primary determinants of the allocation of FDI across the transition countries. (Bevan&Estrin pp.4, 2000)

According to Holland and Pain one of the most important effects of Foreign Direct Investment for the transition and emerging economies is the technology transfer argument. Supporting our previous literature survey on the growth part, it is argued that technology transfer to these countries via FDI provides a vital source of investment for the modernization of industrial infrastructure of these countries and act as the innovator of new and modern markets. (Holland and Pain pp.1, 1998) This also supports the idea that most of the FDI received in the eastern and central Europe can be counted as within the *market-seeking* type of FDI.

Empirical evidence on the relationship of transition country growth and FDI has not still reached on a consensus of whether the accelerated economic growth in the Eastern European countries is a result of an increase in the volume of FDI. As Gaisford et al. (2003) argue still in particular whether the FDI is given birth by the economic growth or the economic growth in these CEECs leads to FDI is a big question mark as there is not enough empirical evidence to fully persuade the economists in this area in either way. (Gaisford et al. pp.1, 2003) The important fact here is that up to date little economic research on the relationship of FDI and growth of these transition economies has been conducted and there is a huge gap in this area in the literature. The typical finding of literature on these transition

economies is that although they have the human capital the lacking parts are usually the market institutions and infrastructure. This is mainly the reason why the EU negotiation talks accelerate the FDI investments. By the transposition of the country legislation to the community acquis the governments take the necessary measures in order to fulfill the desired institutions thus creating a blend for the investment climate. Also along with this transformation the flow of technology by the FDI itself helps the recovery of the old fashioned models in the country.

One of the interesting arguments I have found in the literature is the accession announcement theory by Bevan and Estrin. The authors claimed to identify that the accession announcements fort he candidate countries have a direct effect on the FDI itself rather than the credit ratings and etc… as previously thought. The findings in the paper cover the result that, there is an interesting mechanism whereby these accession announcements first have an impact on the FDI and with one period lag have an impact on the credit ratings.(Bevan and Estrin pp.26, 2000) This according to them may cause long-delayed countries to have grave consequences in terms of FDI since the lengthening of the accession period may causes the FDI to decrease and start a demotion in the credit ratings of the country which will harden to achieve economic stability. This can be an explanation in the Turkish accession case where Turkey receives lower FDI than its competitors at the front door of the EU.

An important part of the FDI literature has shown evidence that one of the main reasons of FDI attractiveness of these transition economies is the easy access to rich natural resource fields. Lyroudi & Papanastosiou & Vamvakidis (2004) have argued that especially the CIS has attracted large amounts of FDI to the extracting and mining sectors. (Lyroudi & Papanastosiou & Vamvakidis pp.102, 2004) Certain precious natural resources in these countries such as gold, oil, natural gas have drawn MNCs for the excavation and management of these natural resource sites and probably helped the acceleration of growth in these Ex-Soviet countries.

Still on the other hand, there is not enough empirical evidence in terms of these country's transformations and growth with a direct linkegae to increasing FDI inflows to these countries. It is undeniable that the FDI activities of foreign multinationals had an impact on the transition process but as Lyroudi & Papanastosiou & Vamvakidis point that in some periods some countries such as Croatia, Slovenia and Slovakia have enjoyed certain increasing growth statistics although no FDI inflow can be tracked in the given period. .

(Lyroudi & Papanastosiou & Vamvakidis pp.102-103, 2004) Also in these given periods, the positive spillover argument of technology and productivity seems to work in contrast creating negative spillovers in certain industries. Turkey seems to support this argument with the latest growth statistics. The announced growth rates have been better than expected although most of the FDI seems to flee away with the economical and political stability in the domestic arena and also with the global economical turmoil.[37] What I am going to work on is this notion since empirical evidence is needed to prove the above statement since we know that there are certain conditions that effect Turkish FDI and growth as discussed in the previous chapter.

Concluding the literature review, in the next chapter there will be the methodology and hypotheses formulation on the basis of what I have tracked form the FDI literature in the above three sub-chapters.

[37] The growth rates were better than the expected ratios with 4.9% expectation and 6.6% realized.

3. FDI IN THE EMERGING MARKETS: THE TURKISH CASE

3.1 History of Turkish Foreign Direct Investment

FDI has been throughout all of these years has been an important issue and crucial player in the Turkish economy. For nearly more than fifty years, Turkey preferred to follow inward oriented policies such as import substitution and thus was quite closed to the flows of FDI. However switching to outward oriented policies in the 1980's brought new frontiers to the Turkish economy and with the help of new incentives foreign capital started to move through Turkish borders. Helsinki summit which opened up the possibility of Turkish EU membership was a breakthrough in the EU-Turkey relations and even the start of negotiations brought important changes to the capital formations. However it still is sad that Turkey receives far less FDI than the other countries who also experienced the same procedures of transposition to the EU acquis communautaire and even though there are considerable efforts for the attraction of FDI still it seems that the gap between these countries (especially with bigger accession countries such as Hungary, Poland and so on…) does not narrow down.

In reality although we assume the 80s as the breaking point for Turkish FDI inflows, actually this is not the real case. The fact that the privatization and liberalization movements saw a tremendous transformation in the 80s (mainly starting from 1986) the knocking of foreign capital and investment on our door is not quite new. The foreign investment issue stems from the Ottoman Empire. In the 17th and 18th centuries the sickness of Ottoman treasury has caused incredible fiscal crises in the Empire. These financial worsening took its peak in the 19th century and thus for a possible remedy certain incentives to the foreign investors were given in order to provide the Ottoman treasury with the right amount of money supply.[38] The first of these FDI like activities took place when the first signs of privatization efforts showed itself with the so called "Malikane sistemi"[39] Starting from 1695 the system was composed of the transfer of ownership rights from government to certain entrepreneurs in exchange for an amount of money called "Muaccele" The foreign investors at the period have shown some interest in the system. However because the system had the drawback of having

[38] Continuous devaluation of the Ottoman coins (translated: Tahşiş) and increasing inflation has caused several downturns in the economy making it day by day harder for the treasury to pay its debts. As a result of this vicious cycle, control of several goods and sectors were given to the foreign investors. Some of the examples of these goods were cotton, tobacco and so on…

[39] Yavi E. "Bir Devlet Nasıl Batırılır" 1. Cilt pp.9

no inheritance right which resulted in the termination ownership of the Mukaata[40] when the buyer was deceased, it was unable to attract the right amount of interest. 1838 has been one of the important dates in the Turkish FDI history. The pact of Baltalimanı has opened new frontiers for foreign investors making new reforms for trade and investment in the Ottoman markets.[41] 6 October 1875 witnessed the bankruptcy of the Ottoman treasury and from this date on in order to attract the needed money supply more and more incentives were given to the foreign companies and empires. After the collapse of the Empire and the birth of the new Turkish Republic, because of the fiscal impediments at the time inward polices were preferred to be followed and thus FDI inflow seemed to fade away for a long period of time. The removal of the benefits given to the European empires under the name of "Kapitülasyonlar" and the starting of government interventionist policies had been major reasons for the decrease in this flow of capital.

The years between 1923-1932 and 1933-1939 saw little to none investment of the foreign companies as most the investment was to be done at the hands of state itself. With the start of the Second World War and the coming of a protectionist wave of market policies to the whole European scene, up to the first regulatory movements of Turkish government for direct investments of the foreign companies and states this little investment climate continued. 1950 legislations on the foreign capital gave an incentive as transfer of money was guaranteed within a framework. On the other hand the milestone in the history of Foreign Direct Investment in Turkey can be counted as the legislative ruling of 6224 "Yabancı Sermayeyi Teşvik Kanunu" which is still valid today. Within this framework, along with the ruling of 6224, the foreign capital was managed also with the rulings of 6326 "Petrol Kanunu" ve 1567 "Türk Parasının Kıymetini Koruma Kanunu" until 1980's. Although starting with 1954 a liberalization process had been taken into consideration, as a result of the barriers and impediments of the legislative rulings the desired increase in the investments couldn't be achieved.

[40] The sold rights were called "mukaata" which were a part of the Ottoman treasury. (Hazine-i Amire)

[41] This pact had been one of the most discussed pacts in the history of the Ottoman Empire. It is widely debated that with this pact the Empire, giving more and more incentives to the foreign empires have paved its way to a bigger collapse as the domestic markets took bigger wounds by high differences in the taxes and so… This gap has caused the domestic manufacturers of key sectors such as textiles a loss of comparative advantage and thus certain domestic economic indicators which the Empire's economy depended on worsened.

Table 2: Sector breakdown of FDI during 1990-2003 (%-Percentage of FDI)

Years	Manufacturing	Services	Agriculture	Mining and N.R
1980-1989	61	37	1	1
1990	65	29	3	3
1991	56	41	1	2
1992	70	27	2	1
1993	76	22	1	1
1994	75	23	1	1
1995	68	29	1	2
1996	17	81	1	1
1997	52	46	1	1
1998	61	37	1	1
1999	66	32	1	1
2000	36	61	2	1
2001	46	48	5	1
2002	40	58	1	1
2003	59	30	1	10
Total 1990-2003	53	44	2	1

The stability decisions of 24 January 1980 have been a major turnover for the Turkish FDI. With the help of liberalization movements in the removal of barriers in front of foreign capital and the positive trend globally in the World for the flows of FDI have caused a solid increase in the amount of investments received. (Saatcioğlu pp.3) However the FDI in the period was only limited to specific sectors counting manufacturing and services sectors with agriculture, mining and similar sectors seeing no signs of foreign investment because of limited governmental regulations and incentives to encourage investors. This weakness can be seen form the given sector breakdown table showing the figures in the period 1990-2001. The following table is helpful in the evaluation of foreign capital inflows received during the periods 1980-1989 and 1990-2003.

Table 3: Monthly amount of FDI received during periods 1980-1990 and 1991-2002 (millions of $)

MONTHS	1980-1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	TOTAL 1991-2001
JANUARY	**270**	**76**	**133**	**35**	**65**	**126**	**100**	**196**	**84**	**37**	**7**	**92**	**244**	**1.195**
FEBRUARY	458	116	204	78	66	235	57	57	218	109	38	252	88	**1.518**
MARCH	**458**	**113**	**158**	**144**	**90**	**199**	**161**	**126**	**137**	**284**	**452**	**268**	**207**	**2.339**
APRIL	436	175	158	157	235	123	231	133	185	308	66	121	321	**2.213**
MAY	**401**	**261**	**79**	**109**	**65**	**95**	**81**	**100**	**72**	**62**	**360**	**276**	**99**	**1.659**
JUNE	615	230	138	110	157	451	128	174	243	133	244	175	44	**2.227**
JULY	**458**	**84**	**191**	**157**	**194**	**98**	**126**	**138**	**99**	**232**	**288**	**145**	**94**	**1.846**
AUGUST	413	394	92	102	36	119	150	79	22	24	339	206	308	**1.871**
SEPTEMBER	**566**	**61**	**163**	**162**	**78**	**193**	**67**	**74**	**162**	**65**	**147**	**607**	**119**	**1.898**
OCTOBER	450	124	69	38	96	67	45	82	98	122	647	166	228	**1.782**
NOVEMBER	**544**	**154**	**150**	**140**	**189**	**151**	**54**	**179**	**21**	**138**	**82**	**80**	**171**	**1.509**
DECEMBER	1.354	179	284	831	206	1.080	2.635	340	306	186	807	338	320	**7.512**

Source: Central Bank of the Republic of Turkey (Table from www.treasury.gov.tr)

As seen from the table above the FDI volume has nearly increased 6 times during 1991-2003 compared to the amount in 1980-1990. According to Saatçioğlu the interesting figure here is that the percentage realization of investment authorizations issued has increased from %39 (1980-1989 figure) to %48.9 which shows that there has been an important reform in the FDI process in terms of red-tape, bureaucratic barriers, legislative procedures and so on that encourages the investors to realize their authorizations. (Saatçioğlu pp.3) On the other hand there is a crucial point here that should be stressed is that although there is a considerable increase in the FDI received comparing the results with the overall global FDI figures gives up the point that Turkey is not as successful as the other emerging economies to attract investment. Evaluating the table below on the global FDI movements during the years 1989-2000 and adding the columns the Turkish case, unfortunately shows that the overall percentage of FDI in the global share has decreased from a %0.35 in 1989-1994 periods to a %0.07 in 2000 with 982 million $. This certainly gives enough evidence of a weakness of Turkey in terms of attraction of FDI and is an explanation of Turkey lagging behind the other Central and Eastern European (Hungary, Poland, Czech Republic etc…) and Commonwealth of Independent States countries (Azerbaijan, Kazakhstan etc…)

Table 4: World FDI movements and Turkish FDI during 1989-2000 (million $)

Years	World FDI	Emerging Countries	Turkey
1989-1994	200.145	59.578	708
1995	331.068	113.338	885
1996	384.910	152.493	722
1997	477.918	187.352	805
1998	692.544	188.371	940
1999	1.075.049	222.010	783
2000	1.270.764	240.167	982

Turkish FDI struggle has considerable improved itself in the recent years the investment report of UNCTAD has shown that Turkey has improved its rank of 57th in 2003 to 35th in 2004. This is mainly because of the policy climate changes that are established to remove the negative barrier in front of the foreign capital inflows. As mentioned above the transposition of Turkish FDI regulations with the EU acquis has brought an important impact on the volume and quality of the FDI breaching through our borders. However there is a two dimensional nature of the investment climate with the above improvements mentioned on one hand and negative impediments such as economic instability, weakness of legal framework, insufficient administrative system and corruption on the other hand. Along with these macroeconomic impediments, the lack of compliance with the international accounting systems and also transparency carry along the flag for the low attractiveness of Turkey in terms of Foreign Direct Investment. EU membership process requires reforms in important areas linked with this FDI issue such as purchasing power parity, openness, demographic dynamism and so on which Turkey needs to develop in order to maintain a policy of sustainable FDI. In the next part I am going to try to have a brief literature survey of to have an insight of how the facts have developed on the issue of Turkish Foreign Direct Investment and what are the dynamics of the following table.

3.1 Dynamics of Turkish Foreign Direct Investment

In this chapter I will be dealing with the main dynamics of Turkish FDI inflows and why we lag behind looking at the attractiveness table below. Mainly there will be 7 dynamics explaining the rationale behind the investments coming to Turkey and under subchapters each dedicated for these 7 dynamics, I am going to delve into a brief summary in order for us to come up a conclusion for the Turkish FDI issue and in combination with the extensive literature review to form our methodological framework and conduct our empirical research on the basis of this chapter's findings.

Table 5: FDI Attractiveness Scores (Scores lying between 0.001-1.00)

Rank	Countries	FDI Score Index
1.	Ireland	67,53
2.	Malaysia	63,46
3.	Czech Republic	62,07
4.	Germany	60,50
5.	Estonia	56,56
6.	Hungary	56,56
7.	Slovenia	54,18
8.	Slovak Republic	52,46
9.	Portugal	51,33
10.	China	48,90
11.	Brazil	48,46
12.	Russia	42,45
13.	Poland	42,34
14.	India	41,16
15.	**TURKEY**	**37,23**
16.	Argentina	37,23

Source: World Bank-World Development Indicators (2003)

3.1.1 General Macroeconomic Sustainability

It is well known that one of the main indicators affecting the volume of FDI in Turkey is the Economic Stability which sadly Turkey for many years had to struggle with. Because of the lack of a sustainable trend of economic stability, the climate of foreign capital usually changed course and thus left Turkey with unpredictable schemes of foreign direct investment. The annual report published by the General Directorate of Foreign Investment of the Undersecretariat to the Turkish Treasury has showed a deficiency in terms of foreign investment.

Table 6: International direct Investment (Inflows) to Turkey (million $)

	2003	2004	2005	2006	2007	January-April	
						2007	2008
International Direct Investment Total (Net)	1.751	2.785	10.031	19.989	22.029	10.158	5.336
International Direct Investment	753	1.442	8.190	17.067	19.077	9.063	4.420
Equity Investment (Net)	737	1.092	8.134	16.982	18.526	8.855	4.369
Inflows	745	1.190	8.535	17.639	19.269	8.857	4.377
Liquidiation Outflows	-8	-98	-401	-657	-743	-2	-8
Intra Company Loans	16	350	56	85	551	208	51
Real Estate (Net)	998	1.343	1.841	2.922	2.952	1.095	916

Source: Central Bank of the Republic of Turkey (Table from www.treasury.gov.tr)

From the table above this deficiency can be clearly tracked if looked at the increase percentages of FDI inflows during this period. According to table above, Turkey's total net FDI increased by 54 percent during 2002-2003, 59 percent during 2003-2004, 260 percent during 2004-2005, 99 percent during 2005-2006 and 10 percent during 2006-2007. Until this year, these extraordinary rates of increase, evidencing an FDI surge, significantly exceeded those in the corresponding total global FDI flows. By attracting $22.03 billion FDI in 2007 -- its highest-ever total -- Turkey ranked among the top five developing countries and the top 16 countries in the world. In 2007, close to 60 percent of the FDI flows, two-thirds of the total originating in the European Union, was recorded in the financial intermediation sector through the full or partial foreign acquisition of Turkish financial firms such as Akbank, Oyak Bank. The manufacturing sector accounted for about 22 percent of FDI flows. In 2007, no

IFDI flows were recorded as a result of privatization, unlike in 2004, 2005 and 2006. However the bad part here is that in the first quarter of this year Turkish total net FDI decreased by 47 percent relative to the first quarter of last year, suggesting that the IFDI surge since 2002 might be ending in the current year. What makes this significant drop in FDI flows something to be concerned about is that during this year's first quarter, the current account deficit widened to $16.9 billion from $12.5 billion, an increase of 35 percent compared to last year's first quarter. It is certain that the global financial crisis had a great impact on the FDI inflows since most of the FDI received are supplied by the big multinationals who are in the recent period are at the stake of dealing with huge quarterly losses.[42] Another important factor could be counted as the political stability caused by the latest political surge about the closure case about the Justice and Development Party (AKP) which has a tremendous impact on the economy as people are scared to do anything in case of a political gap in the case of a ruling for the possible closure of the party. However this is mainly the topic of the next section and in this section I am going to delve into the main dynamics of the Turkish economy that affects the FDI inflows and the FDI decisions of the foreign investors.

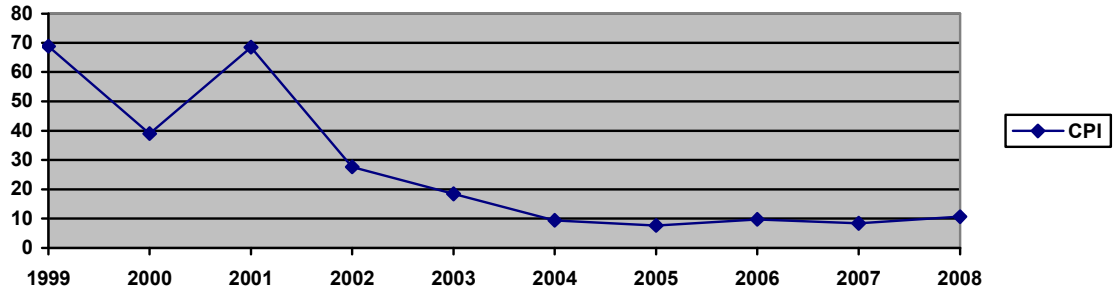
The general outlook of the Turkish Economy has mostly been gloomy in the last decades with the exception of recent years. The macroeconomic pillars were in decomposing state with high public debt originating form the macroeconomic crisis results such as the recapitalizing of the catastrophe in the banking system, weakness in the fiscal measures and chronic hyperinflation. More or less in all economic outlook reports issued by several organizations, this macroeconomic scene has been emphasized as one of the main concern why Turkey has troubles in realizing its full potential in the economic growth. Compared with the other transition economies, the lack of faster accumulation of physical capital, greater degree of sustainable macroeconomic policies, and heavy investment in the human capital, has left Turkey lagging behind these emerging markets. Structural reforms in order to combat with the dense public debt burden, chronic inflation and especially banking sector difficulties with a high and extensive state intervention were needed.

[42] The recent mortgage crisis has especially caused important investment banks such as Citigroup to write down huge quarterly losses which importantly affected the global financial system. In the recent terms important multinational companies such as Starbucks have chosen to close down several of its branches and kick-off nealy 12.000 employees (Business Week Turkey 04.07.2008). This is an important sign of a global recession which also has an important effect on the Turkish economy narrowing down the FDI volume.

Having a glance at the growth rates Turkey witnesses in the last two decades there seems a high volatility in the growth figures. Since Turkey had deep fluctuations with serious recessions after the financial crisis it is not surprising to have such a growth figure. The Average growth rate calculated during the period 1983-1993 with the help of policy shift to export orientation was around %5 whereas it decreased to the %2.7 during 1993-12003 due to certain imbalances in the public debt stock and financial impediments in the Turkish market. Also in this period Global financial crisis environment had a deep impact on the Turkish macroeconomic sustainability. Starting with the accession negotiations in 2005 there has been a better macroeconomic climate and the growth rates reflect this with over %5 in 2005. Recent years have shown similar growth perceptions with the exception of this year as there is a global turbulence especially with the deep mortgage crisis in US.

Chronic inflation has been a major handicap for FDI and macroeconomic stability as with all of the countries. Throughout the last decade however there has been a considerable improvement in the rehabilitation the inflation figures since in the 1990s Turkey was struggling with inflation over %70 which was a major barrier for the FDI investments. The following table shows this rehabilitation in the inflation figures. Especially the deletion of six digits from the Turkish Lira combined with the motive to counter the increase in the prices have led to a strong determination in the stability of inflation and attainment of the price stability thus paving its way to a stronger economy.

Figure 1: Consumer Price Indexes (1999-2008)



Source: TUIK Provisional Data

Of all the macroeconomic pressures on the attractiveness of the Turkish FDI case, no other factor can be more effective than the real interest rates. Deriving form high chronic inflation rates, the sharp increases in the interest rates have caused a certain decline in the investment climate. It is not surprising that the investors find it more profitable to invest their money in these guaranteed yield interest schemes other than dealing with real investment projects and wait for the harvesting of their desired profit margins. This in fact explains why in the first two quarters of 2008 there has been a major decline in the investment figures compared to the previous years as the Central Bank upgraded the interest figure to nearly %20 percent which is a desirable rate of return without any major risks in terms of foreign investors considering the fact that the interest rate returns in Turkey are nearly 5 times high than the EU average.

However despite above macroeconomic weakness indicators, there is considerable effort in the rehabilitation of the economy in the recent years. There has been considerable improvement in the GNP per capita measures, combat against higher inflation and decline in the public debt. These achievements excluding the recent government upturn has been a positive factor for the investor side for bringing foreign capital. On the other hand still Turkey among the macroeconomic ranking of emerging markets comes in the last places which may be the reasoning why it lags behind. Certain remedies in terms of economic policies should be added to the government basket for the rehabilitation of the FDI attractiveness and these policies should place Turkey in the rank it deserves when compared to young transition countries with only 20 years of free market experience.

Table 7: Structural reform and Macroeconomic Policy achievements (2003-2007)

	2003	**2004**	**2005**	**2006**	**2007**	**2008**
USD Rate	1,5	1,4	1,3	1,4	1,3	1,48
Inflation (CPI)	18,4	9,4	7,7	9,7	8,4	10.477
Interest Rates	46	24.7	16.3	18.1	18.4	
Unemployment	10.5	10.3	10.3	9.9		
% Growth	5.3	9.4	8.4	6.9	4.5	3,5
Public Debt %of GDP	-8.9	-5.2	-1.5	-0.7	-1.7	
Current Account (% of GDP)	-2,5	-3,67	-4,6	-6,00	-5,7	-6,52

Source: TUIK Provisional Data and IMF Staff Calculations

3.1.2 Political Environment and Public Governance

Political stability is a crucial actor in the determination of a country's fate in receiving FDI movements. Counting FDI as a capital investment activity based on the future prospects of the return of investment and the confidence in the host country that should be easily predicted and foreseeable by the international investors, the political climate in the host country in terms of stability has an impact on the investment behavior of the foreign investors since a typical strategy for the adaptation of foreign capital to the host countries in the transformation of FDI is the minimization of risks. Political upturns and instability is a part of this minimization since in case of political fluctuations that disrupt the general political climate increase the risk of investment and country risk premiums which in return cause the foreign capital to flee from the country yet to invest. Different dimensions of political stability and public governance can be counted factors on the determination of FDI decisions given by the MNCs or states. Among the factors that this thesis delves into can be counted as general political climate, legal and administrative framework, bureaucratic procedures and the existing of red-tape, corruption and bribery, and lastly the laws and incentives encouraging the FDI.

Table 8: Calculated weights for Turkish FDI dynamics (Total %100)

Dynamics	**Weighted Average**
General Macroeconomic Conditions	19%
Political Stability and Public Governance	25%
Labor	17%
Energy	8%
Taxes and Incentives	17%
Infrastructure for Transportation & Telecom.	12%
Research & Development	2%
TOTAL	**100%**

Source: www.yased.org

According to the proper FDI literature one common conclusion is given as most of the global players having the lion's share of capital believe that public governance, political and social disturbance that cause important fluctuations in the economy (such as currency and financial risks) bear a tremendous impact on the investment decision of a specific host country. Political Stability has always been a headache for turkey since history of Turkish

politics have witnessed several downturns and these always had disastrous effects on the political climate thus creating a negative effect on the FDI investment volumes. Continuous and often change of governments, especially in the last two decades with several coalition governments of poor performance, has caused the investors to take a cautious approach and perceive Turkey as a highly volatile political and economic system open to immediate political shocks. Unfortunately this is due to the incapable policies of the coalition governments popular to 1990s with poor and populist policies creating large public debts with excessive public expenditures and maintaining high country risk premiums in return. Another important and unfortunate case is the coups in the history of Turkey. With several coups in the political history and military take over, the foreign investors are wary of the military for a sudden change in the political stability.

Due to the opening of the accession negotiations, closure of several acquis chapters and a period of one party government have brought a mild climate in political stability. However recent crisis in the government with a closure case of the ruling Justice and Development Party (AKP) this mild climate has left its place an uncertainty environment. Investors keep an eye on the case closely calculating the risks and trying to foresee the impediments of a possible ruling for the closure of the party and banning of several important members form politics for years. An important explanation of a sharp decrease in the FDI inflows in the first quarter compared to the increasing trend in the latest years can be concluded as the uncertainty created by this political downturn. Combined with the weakness of political institutions established in the state and public governance lacking important competencies compared to several FDI attracting countries, this political instability negatively spillover and contaminates several other dynamics of Turkish FDI such as the macroeconomic stability, labor and human capital, and so on…

Legal and administrative framework is also a questionable impediment on the development of FDI volume in Turkey. With slow and inefficient public institutions the administrative framework has become a discouraging burden on the foreign investors thus discouraging them form bringing higher volumes of capital inside. In terms of FDI facilitation, the lack of inadequate application of competition law and a better legal system with proper usage of intellectual property rights have transformed the investment process into a cumbersome, time consuming and expensive one. As Morriset and Neso conclude several administrative procedures varying from country to country deriving form factors such as lack

of transparency and strong public institutions are important disincentives in the investment decisions of the foreign MNCs. (Morriset and Neso ,2002) The study of the authors in the evaluation of several countries administrative performance have showed evidence that Turkey turned out to have the longest process, considering the time and cost of administrative procedures, compared to the other EU countries even among the less developed ones. Recent work has been conducted on the rehabilitation of administrative procedures and a new FDI law in 2003 was enacted[43], bringing international FDI standard to the Turkish case such as guarantee of capital transfers, employment of expatriates , easy procurement of real estates and land for the necessary business activities. Following the enforcement of the enacted FDI law, a new institutional body of "Coordination Committee for the Improvement of Investment Climate" (YOIIK) was formed for the removal of administrative and regulatory barriers for foreign investors. Aside from the remedies above still the desired outcome is yet far from reached and the decreasing volumes of FDI still breach into the country FDI reports.

Bribery and communication linked with the administrative procedures and the lack of strong public administration have caused the Turkish case great difficulty. The first and may be the most important of this contagious cycle is the combination of corruptive public administration with the political instability. The Turkish political tradition of governments assigning their own officials in the important administrative bodies thus creating fear for existing bureaucrats to lose their posts have paved the way for political inefficiency and corruption in the political system. Due to the sad point of personal interests versus public interest clash major policy measures take hit and thus in return cause the political environment to be unpredictable.

[43] For the full text of this 2003 FDI law see Appendix.

Table 9: Country Corruption Perceptions Index (2007)

2007 CORRUPTION PERCEPTIONS INDEX		
COUNTRY RANK	**COUNTRY**	**2007 CPI score**
27	Slovenia	6.6
28	Portugal	6.5
33	Malta	5.8
39	Cyprus	5.3
39	Hungary	5.3
41	Czech Republic	5.2
41	Italy	5.2
51	Latvia	4.8
51	Lithuania	4.8
56	Greece	4.6
61	Poland	4.2
64	Bulgaria	4.1
64	Croatia	4.1
64	**TURKEY**	**4.1**
69	Romania	3.7

Source: http://www.transparency.org/policy_research/surveys_indices/cpi/2007 (Link valid on 10/07/2008)

Corruption in the public sector, violating the nature of efficient administration, has main effects on several arenas that directly relate with the FDI dynamics. Among these effects; lower efficiency in the public sector, increase in public expenditures, reduced government credibility, and increase of country risk can be counted along with negative effects to the competition. Efficient bureaucracy to allow the market mechanism to work with the enforcement of proper laws and regulations is a crucial aspect seen by the investors for their investment decisions and up to now sadly Turkey flunked this lesson for several times with corruption getting worse and not only staying in the public sector but also spilling through the private sector. Transposition of laws to the EU acquis chapters seemed in the recent years to be a remedy for the corruption and public governance problem since the EU legislation relies the removal of corruptive factors and the creation of an efficient and well

working public administration. However concerning Turkey has gotten backwards in the corruption index compared to the other transition countries attracting FDI, things seem to have gotten worse despite considerable efforts.[44] The main contagion points where the corruption seems to be dense are mainly public banks, municipalities, public procurement and especially the customs. The lack of properly educated civil servants in the public administration bodies creates a gap for the removal of the corruptive measures and because this lowly educated workforce is paid relatively low wages it becomes a major justification for the allocation of bribes. Better education and better payment of these government officials seems to be a remedy for the spreading of bribery among the public services. Another possible remedy as stated in the Yased report is the simplification of the red-tape process, change government organizations' approach from being service oriented to a pure control mechanism.

One last measure in the political and administrative issues concerning FDI is the legal framework of incentives. It is certain that to improve the investment environment important measures have to be taken in areas such as the protection of intellectual property rights, releasing the tax burden on foreign investment, and easing the access to financial support such as credits. From 2002 and on governmental bodies by the support of several NGOs started carrying out reform based works to restructure the legal framework on several FDI related issues such as Company establishment, employment, sector permits, investment location determination, taxes and other incentives, customs and standardization and lastly the encouraging of small and medium sized enterprises. The established committee of YOIKK woks closely with both multinational MNCs and domestic firms to rehabilitate the market and the flow of investment.

To sum up with crucial factors above linked with the political and administrative issues it is not surprising that the most weighted factor in the lot of dynamics affecting the attractiveness of Foreign Direct Investment. Turkey in order to attract better and more investment has to deal with these political and administrative issues at first hand along with the other dynamics.

[44] Turkey was ranked 54th in the corruption perception index in 2001 lagging behind Czech Republic (47th),Poland (44th), Hungary (31st)

3.1.3 Labor and Human Capital

There is a substantial literature on the effects of labor on the foreign direct investment .It is not surprising to conclude that most of the multinational investment tend to flow to the countries with lower labor costs as foreign investors favor the countries where they can get most from the human capital with paying less. Two most credible arguments on this issue are first lower labor standards lead to lower labor costs. These lower labor standards mainly include the violation of basic freedom, the lack of collective bargaining power and severe working conditions with long working hours. The second line of argument as Kucera (2002) states is that in the case of ceteris paribus foreign investors take notice of these lower labor costs and tend to invest in countries where important accounting for these differences in labor productivity exist. (Kucera pp.5, 2002)

In terms of labor supply, Turkey has an important competitiveness advantage with an population of 70 million and a labor force of 23.53[45] million when compared to the Eastern and Central European countries with labor supply of 5-6 million. The male-female distribution in the work force s 72%-28% and with the length of compulsory elementary education the women participation seemed to increase. One of the up to date problems of Turkish labor market was the volume of Turkish workforce working in the agricultural sector. In 1988 the figures were nearly half of the whole workforce whereas the numbers decreased to nearly 28 percent. From the investment perspective, still this figure is far from the average figures in the European Union and this seems to be a barrier in front of the negotiations. Decreasing the agricultural figures cause unemployment in terms of lowly educated farmers and as a result makes sustainability of a low unemployment rate harder.

Table 10: Employment Distribution among Crucial Sectors (2004-millions)

Total Employment (Age 15+)	**1980 Figures**	**2004 Figures**
Total Employment	15,7	21,7
Agriculture	8,4	7,4
Industrial	2,3	4,0
Construction	0,9	1,0
Services	4,1	9,4

Source: Türkiye İstatistik Kurumu (TUİK) - World Bank 2006-Labor Market Study

[45] CIA 2008 Turkey fact book data.

Looking at the general employment framework four main factors affecting the trend of FDI can be detected. These factors are labor costs, productivity of labor force, the degree of skilled labor force and lastly percentage distribution of the labor force among main FDI receiving sectors. Getting a proper explanation for these factors is crucial for the understanding of FDI inflows as the weighted influence of labor is as high as nearly the general macroeconomic stability.

To start our labor discussion, one of the most important elements as we considered above is the search of investors for the countries with low labor costs. Turkey in terms of wage can be counted among these low cost countries because of her lacking of several important elements of proper human capital. Collective bargaining is a great example of this lack of performance. Because Turkey has a large informal economy[46] in terms of FDI, low wages have kept labor costs competitive among the international scene among turkey's primary emerging market competitors. According to the World Bank report (2006 –Labor Market Study);

"*The ratio of minimum to average monthly wage in manufacturing increased from 33.9 percent in 1999 to 42.1 percent in 2004. A minimum wage that is high relative to the average wage can lower formal employment levels, especially for low wage workers. Minimum wage in manufacturing is currently about 43.9 percent of the average monthly gross wages. A ranking of EU candidate, accession, and member- countries for 2004 finds the minimum wage as a proportion of average wage varied between 34 and 50 percent. Poland was below 35 percent; the Czech Republic, the United Kingdom, Hungary, and Portugal were between 38 and 47 percent; and Ireland, the Netherlands, and Malta were in range of 47 to 50 percent*."

The above notation can be an explanation of why the FDI is leaking in terms of labor costs to Eastern European countries.[47] Also an important factor to pinpoint on is that because of non-wage labor costs such as payroll taxes which are well above most of the OECD countries and even the OECD average. The lack of elasticity in the taxes and other formal incentives caused the increase in the informality of labor which in turn makes it harder for the

[46] According to several key reports published on this informal economy issue and several labor reports one in three workers in especially rural and less developed areas are working informally without any social security institution registration.

[47] Still Turkey in comparison with some of the competitive emerging markets has a high per labor with 500 $ whereas China leads the pack with a highly competitive cost of 34 $ per labor.

tracking of human capital in terms of social security and other regulations. This in fact is a handicap for the attractiveness of FDI inflows.

Following the factor of low costs in labor, the second important element in the labor dynamics can be concluded as the productivity of the labor force. On the basic terms productivity growth seems to be the basis for the creation of sustainable jobs and the betterment of living conditions. Delving into the figures from the aftermath of the Second World War to recent decades, it can be concluded that Turkey has witness several changes in terms of labor productivity growth.

Table 11: GDP Growth and Labor Productivity 1960-2004 (% change in percentage)

Years	GDP Growth Per Capita	Total Factor Productivity
1960-2000	2,33	0,92
1961-1980	2,32	1,10
1981-2000	2,35	0,73
2000-2004	7,6	5,3

Source: IMF Staff Calculations (2005)

The result from the evaluation of the above table is the fast increase of Turkish growth and productivity during the last decade. This is surprising as it creates a contradiction with the trend in the middle and upper income countries. The Turkish case is through both physical capital accumulation and productivity gains seems to be in good shape and this growth and productivity increase puts Turkey in a really competitive position to receive FDI inflows. However still something to be handled carefully is the transfer and allocation of human capital resources form the low productivity sector of agriculture to the high productivity manufacturing and services sectors without creating unemployment. This is important since the unskilled labor force working in the informal agriculture sectors in the rural areas carry great danger of joining the army of the unemployed if the agricultural sectors are to be diminished. In terms of productivity increase, it is certain that this increase is due to the increase in working hours since 1995.Compared to the European countries Turkey has one of the longest working hours/day ratios and thus this surplus explains the productivity change.[48]

[48] According to the 2004 data Turkey has the longest working hours in the European Union even with the addition of new accession transition economies, with 52.1 hours per week. This figure is 38.5 in the EU-15, 40.3 in the Czech Republic, 41.8 in Poland and 40.3 in Hungary.

Human capital and the issue of skilled workforce are primary concerns in the determination of investment decisions. The educational and skill level significantly affect the volume of Foreign Direct Investments, especially in certain sectors such as the financial sector and similar other industries. In terms of human capital, Turkey has developed herself in the last decades through several reforms such as the increase of compulsory elementary education to eight consecutive years and through the opening of several private universities. Higher education has led to more skilled human resources whereas the increase in the compulsory education has led to the decrease in the percentage of illiteracy. However, compared to the EU and OECD standard still the education levels are low. The most crucial point (and also a bit sad) is that the percentage of young and unemployed people is quite high with nearly %35 university graduates are struggling to find proper jobs which means precious human capital is wasted. Integration of the skilled and educated people into the workforce is an important bottleneck in the Turkish case. As a result of this lack of integration, the control of FDI becomes harder in the hands of unqualified people.

Table 12: Unemployment Rates and Educational Attainment (%-2003)

Age	Illiterate	No Diploma	Primary	Secondary	Tertiary
15-19	18,0	27,7	13,7	29,5	0,0
20-24	17,0	37,5	16,1	23,4	38,5
25-29	16,3	14,8	12,2	12,2	14,8
30-34	13,3	16,7	10,3	7,1	5,3
35-39	11,4	16,7	8,1	5,4	4,1
40-49	7,5	9,5	7,8	4,6	2,5
50-59	5,0	4,9	5,9	5,7	2,2
60+	1,6	1,5	1,4	4,0	0,0

Source: World Bank Turkish Labor Market Study (2006)

One last dynamic that is affecting the FDI in terms of labor is the sectoral participation percentages. Turkey has witnessed a significant change on the industrial distribution of human capital with agriculture being the fist sector among the others in the mid 80s. Now services have taken the lead as the share of agriculture dramatically decreased during the last two decades. On one hand, this seems to be proper as the EU average is around %5 and Turkey still seems to deal with nearly 28%. However, an important drawback of this decrease is the huge losses of jobs in the rural areas where the level of educational attainment

is quite low. This In fact creates unemployed and unskilled human capital which is quite hard to reintegrate into the employment system.

Table 13: Distribution of Employment among Sectors (% share in total-2004)

Sector	1989 figures	2004 figures
Agriculture	47	34
Manufacturing	16	18
Services	32	43
Construction	5	5

Source: World Bank Turkish Labor Market Study (2006)

To wrap up, the considerations above have a large impact on the investment environment and the decisions regarding FDI. It is important to consider that taking several corrective actions in the labor dynamics such as a possible decrease in the legal deductions from the salaries and wages will help the change in the perspective of Turkey as a better investment location for the foreign investors. For this notion, reforms are in progress as with the establishment of a new labor law also several measures such as Permits for foreign personnel employment from Ministry of Labor and Social Security, granting of "key personnel" permits in 15 days and lastly assembling of the labor and social security system under one authority. In terms of labor there will be some improvements with the increase of FDI inflows. Privatization type FDI and the coming of MNCs to Turkey will help the enrichment of the Turkish labor market and will possibly have some labor spillovers to the domestic firms as several key measures such as management style, wage considerations and employee selection differ highly between the domestic and multinational enterprises. However still more empirical evidence has to be gathered in order to fully analyze the effects of FDI on the labor market to see whether it has positive or negative effects such as a raise in the wage inequalities or a possible transformation in the composition of labor demand in the Turkish employment structure. On the other hand one thing is sure that with the penetration of foreign capital and the technology and productivity spillovers it brings, certain changes in the labor market are inevitable. Both for attracting and maintaining of the FDI, as a conclusion, Turkey is still in infancy and more reform along with the ones in progress has to be done.

3.1.4 Taxes and Incentives

For most of the governments attracting FDI is a crucial matter in the developing of a country's welfare through the generation of new jobs, bringing of new technologies and most importantly fresh capital. The net augmentation in the domestic income is divided between the government through the taxes and the foreign companies through profits. The taxes governments receive are in different forms such as the legal deduction from the wages, Value-Added taxes, and corporate taxes and so on… In order to obtain a desirable FDI location for the multinational companies, the governments usually re-examine their tax based obligations to make sure that the FDI environment created is competitive in terms of different forms of taxes. The balance between the domestic firms and multinationals is important and certainly the appropriate share of the domestic tax should be taken form the foreign companies doing business domestically. As Jun gives evidence through an empirical research on the effects of the host country taxes, the domestic tax structure of the FDI location is an important concern for the multinational firms. Especially the main multinational consideration is the effective tax rate on the foreign income source as this directly affects the profitability of the possible capital investment. (Jun pp.1, 1994) The central debate around the tax issue is the measurement of how sensitive a country's FDI inflows to that country's tax structure. It is certain that to keep a location internationally competitive for FDI taxes should also be competitive enough for investors to choose that location as an investing option. According to the OECD reports; research conducted on the relationship between FDI inflows and the effects of taxes have given the results that one percentage point increase in the taxes causes an average 3.7 percentage in the FDI volume. This estimation varies according to different studies but one thing that is common is that the decrease usually seems to be considerable.

Another key factor in this sensitivity issue is the type of taxes that FDI is affected the most. Recent studies have shown that most of the focused taxes include Corporate Income taxes; Value added taxes and similar one. As I am going to delve into the Turkish case things seems to be a bit complex since Turkey seems to be a "tax hell" as there are lots of measures of taxes for the companies with high interest rates.

The Turkish case in terms of competitive tax systems is unfortunately a mischief. During the recent decades it is true that there has been an upward trend in the tax ratios to GDP with most of the economies due to imbalances in their public balances have pulled up the ratios received form their citizens. However, Turkey in this area have gone a bit far from severe increase as compared to the increases since 1965 in the OECD area, it has increased the ratio of taxes to national income by ten points just within the last decade meaning it has the fastest race in terms of increase percentage ending up with 33%. Recent trend among the transition economies have shown that this surge has come to a halt in most of CEECs at the end of the transition process. On the other hand, because of the unhealthy tax infrastructure in Turkey this heavy tax burden does not seem to end. Because of the fact that the tax base is too narrow and the tax in question is levied on a very scarce number of taxpayers throughout the nation, the government instead of widening the tax base tries to compensate the amount from the existing tax payers.[49] This in fact means that a certain reform is inevitable and determinants of the tax system such as efficiency, enforceability and so on should be shaped regarding the needs of both the taxpayers and the government. As a result of the malfunctioning of the Turkish tax system foreign capital has deep hesitations for the choice of Turkey as an investment location.

In most of the literature it is confirmed that high corporate taxation is a barrier in front of the development in the foreign direct investment. Nevertheless, Turkey in this area has also deficiencies as with the narrow tax base concluded above the corporate tax scheme seems to rely on bigger companies meaning that it heavily depends on the investments brought by the multinationals. As a result of this deficiency Turkey loses her competitiveness to countries like Hungary, Poland, Czech Republic along with more developed ones such as Ireland. Competitive incentives including tax exceptions combined with better tax systems create high advantages to attract the FDI to these countries. Restructuring of the tax administration and established well working tax laws can be a remedy in this case. Because of the high volatility in the government changes in Turkey however (as discussed in the political stability chapter) this seems to be a hard mission to accomplish in terms of the long red-tape processes in the legislative organs. Despite this slow progress some amendments were taken in the tax law such as the introduction of inflation accounting for the exclusion of inflationary gains from

[49] According to the statistics, among the 550.000 corporations operating in Turkey, 1500 are paying 83% of the total corporation tax amount. This figure is an indicator of how the system is unhealthy and how much effort it needs.

the tax base and to pay corporate taxes on the real profit generated, the elimination of dividend withholding taxes. Such reforms if carries out better will definitely have direct effects in terms of tax structure on the attractiveness of FDI.

Another issue carried along with the tax system is the incentives given to foreign investors for the choice of Turkey as an investment location. These incentives in different forms affect the investment decisions and change the course of investment potential positively to the host country's side. Most of the FDI literature has a strong consensus on the fact that the incentives offered by the host country governments to multinational enterprises offer strong encouragement for the investment decisions. These incentives, on the other hand do not share only one form and take various different shapes such as fiscal incentives with examples of tax reductions and exemptions, financial incentives with loans and credit based instruments or in the form of other ones such as market based incentives, monopoly rights, land and infrastructure donations so on … In terms of Turkish case in the last two decades certain changes for the structure of incentives have been performed. According to the United Nation's Survey, Turkey has established generous regional incentives, especially to create sustainable investment environment in the eastern part of Turkey. By dividing the desired investment locations into two according to their investment priorities several incentives such as; (United Nations pp.110, 2000)[50]

- "*Developments that include housing for personnel under the investment allowance Schemes are exempted from certain taxes;*
- *Public lands may, in some cases, be transferred to the investor free of charge;*
- *A cash repayment of the VAT paid is available for machines purchased or produced in Turkey and additional payments may be applied for from the Fund of Encouragement of Investments; and*
- *Industry loans are made available at preferential, low interest rates."*

As it can be tracked from the examples of incentives above Turkey has some reform based FDI attractiveness schemes. However it is quite important to think that trying to create investment incentives blindfolded is not giving the desired outcomes in all of the cases. As Blömström argues, empirical evidence have shown that incentives exclusively focusing on the

[50] For the whole Survey see "Tax Incentives and FDI: A Global survey" United Nations Report Geneva,2000

multinational companies can sometimes give negative results instead and not always a recommended strategy for the attraction of the FDI inflows. The argument here is the technology and productivity spillovers, although they are believed to be positive effects, can only be helpful if the domestic firms are able or wanting to absorb the transferred resources. The crucial point here is that this absorption process is not automatic and needs to be sustained through proper support to the domestic firms as well. It is certain that the establishment of a well incentive policy for the foreign direct investments should be a creation from the industrial schemes of the country itself and there should be integration between the local and international investors within the same package of incentives. On the other hand the Turkish case is a bit different up to now. Unfortunately, the Turkish governments (starting from the Ottoman Empire-1838) have preferred to give more incentives to the foreign capital even in the sake of spreading disastrous consequences to the domestic investors and manufacturers. Thus the end result was the extinction of most of the domestic companies or the acquisition of them by the multinationals. This to wrap up may seem to be feasible at first but in the long run is not a desired strategy as most of the sectors monopolies (especially in the natural monopolies- such as telecommunications) have been born through this strategy.

To conclude some of the recommendations in terms of incentives and tax system according to the Yased report may be as follows; (YASED, 2004)

- *"Improve the incentives provided for the foreign investment, such as providing free land, incentives*

for the created labor force, tax holiday for a certain start-up period and so on.

- *Eliminate the volatility of the tax environment and stabilize the tax system.*
- *Improve the transparency in the financial statements of the companies.*
- *Simplify and decrease the taxes on various transactions."*

3.1.5 Turkey's Deficiency: Research and Development

It is rather sad to write on a dynamic that Turkey has a weak competence. However, thinking that Research and Development activities are the crucial elements for a country to find a seat in the global competition; it is necessary for this work to focus on this dynamic and its interconnection with the Turkish case. Certain part of the FDI literature focusing on the determinants of the FDI attractiveness have emphasized the fact that in order to take a piece form the global market share of FDI, Research and Development conducted in a country in terms of innovation takes a tremendous place. Nevertheless for some of the merging markets fillip this gap is not easy whereas for some like India important steps are already taken into account.

Table 14: R&D expenditures 2000-2005 (in millions of TL)

	Current expenditure			**Capital expenditure**		
Year	**Total**	**Labor costs**	**Other**	**Total**	**Land buildings**	**Instruments equipments**
2000	596 392 270	270.684.889	325.707.381	202.045.700	77.545.558	124.500.142
2001	943 968 569	455.623.258	488.345.311	347.922.818	89.606.310	258.316.508
2002	1 418 932 258	764.327.097	654.605.161	424.355.780	81.680.661	342.675.119
2003	1 793 759 238	965.788.741	827.970.497	403.330.794	131.486.681	271.844.113
2004	2 425 533 227	1.169.149 .120	1.256.384 106	471.983.023	112.032.310	359.950.713
2005	3 217 405 419	1.747.579 .399	1.469.826 020	618.035.658	125.546.123	492.489.535

Source: TUIK data

Recent surveys have showed that similar to the case of FDI inflows, Turkey is lagging behind its competitors in the R&D spending. Current FDI spending according to Statistics Institute of Turkey (TUIK) as a percentage of the GDP was 0.76 in 2006. This figure was far below the expenditure statistics in most of the transition economies and is a valid factor for the explanation of our weakness in the competition of FDI attractiveness. Technological developments and innovation are the key aspects of attracting FDI to host countries. One thing that is for sure, is that the degree of development and market growth are being affected

by the trend in the research and development activities of the host country. Turkey in terms of R&D development have lagged behind but on the other hand have tried to reform and regulate its Research and Development schemes by giving some incentives and encouraging measures to the firms inside. These incentives include;

- *"Tax incentives in Techno parks*
- *Corporate tax postponement for R&D*
- *R&D support from Turkish Treasury up to 50% of machinery, equipment and software expenses and 100% tax allowance*
- *TTGV finance contribution up to 50% of the total R&D budget of a project. A financing advantage of 5% occurs due to postponed payback.*
- *TÜBİTAK – TIDEB contributes up to 60% of the R&D costs and the net advantage is around %30. No payback to TÜBİTAK is required."*

The interesting part of the FDI-R&D relationship is that there is also a reverse discussion. Along with the notion that dense R&D activities encourage the presence of the FDI inflows there is also the point that the FDI brought into the country has important contributions to the R&D activities inside the host country through knowledge and technology spill overs. These additions of the foreign companies with highly dense know-how help the development of the host country market conditions. The Turkish case is no different than its complementary as with the inflow of FDI into Turkey domestic Turkish firms have benefited form the technological innovation. Literature has shown four main notions of FDI and R&D relationship. The first of these notions is that, liberalization of FDI movements may cause a relocation of R&D activities, when the communication between the firms is sufficiently strong, product-market competition is sufficiently weak and external spillovers are sufficiently strong. The second notion is that large markets such as Turkey are particularly attractive as R&D hosts because the knowledge generated in the subsidiaries can then also be used to improve competitiveness in those markets. Thirdly FDI attractiveness is directly tied to the relocation possibility of the R&D activities. And lastly The R&D activities brought by the FDI inflows have a direct effect on the development of a country's welfare schemes. Turkey, in this case considering the four notions above, has to deal with this R&D issue in order to attract more direct investment.

3.1.6 Infrastructure and Real Estate

Relative research on the FDI attractiveness up to date has focused on different issues such as Research and Development, labor spillovers, technological flow and innovation and so on. Along all with this debate at hand there is also one issue that has an important weight in the decision making of FDI choices by the multinational corporations. Taking its share a substantial part of the FDI literature highlights the importance of physical infrastructure as an ingredient of both economic growth and FDI attractiveness. For the governments of both developed and developing countries, making a good quality physical infrastructure is an important concern to create and improved investment climate for FDI. This in fact helps the cost subsidizing of the total investment for foreign investors increasing the rate of return as a positive result. In general, the quality of the infrastructure of the FDI receiving host country is an important factor in the determination of a certain FDI location for the multinationals, seeking efficiency in their production and service creation. Despite the general consensus on the literature of a possible positive effect of the good physical infrastructure on the attractiveness of the FDI location, usually policy preferences of the governments tend to be overlooking this issue focusing more on the economical and political issues such as tax reductions and other incentives.

Most of the countries forget the fact that the rehabilitation of the physical infrastructure adds a marginal utility to the FDI attractiveness and the domestic welfare alike and is an important measure for the creation of a better economic growth. One drawback of this issue is, there are different dimensions of the infrastructure availability and the empirical measurement is a complex job considering the variety of aspects included. All of the physical structures such as transportation facilities, communication network, and even the number of people working in this area are different concerns when conducting a research and coming to a conclusion in this issue. Turkey as we are going to delve in this chapter, is no exception of this notion as there is an important deficiency in terms of infrastructure. The following table is a summary of the important infrastructure figures of Turkey to give us an idea of what the situation looks like and what numbers need to be developed

Table 15: Physical Infrastructure of Turkey (2006-in kilometers)

	2002	2003	2004	2005	2006
Length of pipeline					
Petroleum	3.065	3.065	3.065	3.065	3.065
Natural Gas	4.739	5.490	6.323	8 .041	8.509
Length of roads					
State road	31.319	31.358	31.446	31.371	31.335
Provincial road	30.050	30.133	30.368	30.568	30.429
Village road	364.329	365.171	285.739	285.632	...
Length of Motorways	1.851	1.882	1.892	1.775	1.987
Length of Railways	8.671	8.697	8.697	8.697	8.697

Source: TUIK data

Evaluating the table above Turkey needs to develop its physical infrastructure. According to the IMD World Competitiveness report of 2003, Turkey was at 25th rank among 30 countries which is surely not a desirable ranking. Giving out an example from the percentage of paved roads the figure is %34 to %66 which is quite a low percentage, when compared to the figures of competitors such as Ireland (%94-%6) or Poland (%68-%32) the main concern in terms of infrastructure in Turkey, because of the an unplanned structure of settlement of land and real estate the shaping of infrastructure becomes costly and thus to lower the costs there is a certain degree of decrease in the quality. This reduction in quality brings the vicious circle of renewals in small periods and in fact becomes more costly than the former process. There is also an interconnection between the corruption and political issue of municipalities as discussed in the second part of FDI dynamics of Turkey with infrastructure works being tied to local elections, bribery and benefit based transactions. The lack of proper and enough railways causes the logistics and carriage to be done mainly by roads, which creates important need of continuous costly maintenance of motorways due to high corrosion. Because the aviation sector is in a general recession due to high oil price increases the progress of building new airports and modernization of the existing ones have been suspended except the ones that are heavily used such as the Istanbul Atatürk Airport and the ones that are needed for the tourism sector such as Antalya and Dalaman airports. Legislative concerns and arrangement along with the physical contributions should also be extended to grip a firm control over these transportation issues for becoming a competitive investment location for the multinational investors.

Table 16: Transportation of freight and passenger according to transportation type (in millions)

	2001	2002	2003	2004	2005	2006
Road						
Tonne kilometer	151.421	150.912	152.163	156.853	166.831	177.399
Passenger kilometer	168.211	163.327	164.311	174.312	182.152	187.593
Maritime						
Tonne kilometer	8.100	5.738	5.400	...	...	...
Passenger kilometer	31	21	22	...	...	...
Railway						
Tonne kilometer	7.562	7.224	8.669	9.417	9.152	9.676
Passenger kilometer	5.568	5.204	5.878	5.237	5.036	5.277
Air Transport						
Tonne kilometer	285	275	276	321	392	...
Passenger kilometer	2.859	2.706	2.752	3.223	3.992	...

Source: TUIK data

Telecommunication network is an integral part of the infrastructure and may be one of the most important determinants affecting the FDI attractiveness of a country as a host. Turkey is this area is quite lucky since with the heavy investment in the 1980s to the telecommunication infrastructure, Turkey now has one of the modernized communication networks in Europe, having transmission networks in almost every corner. After the privatization of the state owned Türk Telekom, the modernization process accelerated and right now combined with the cable TV and cable network the interconnection got expanded. Also with three mobile operators there is a competitive development in the liberalization of the communications market and considerable FDI has visited this crucial sector through either acquisitions or privatizations. In the future, with total degree of liberalization, there will be a more competitive market and thus the infrastructure may see more modernization in case of technological surge.

Literature on the FDI has shown the empirical result that FDI usually flows to countries where fiscal and financial incentives tend to be in generous forms. Thus developed countries enjoy these capital investments as they have more welfare to spread out these generous fiscal incentives. On the other hand, for emerging countries development of a well working infrastructure is a chance for compensating for the lack of above incentives and

becoming a host for FDI activities. Focusing on other areas rather than trying to cope up with the competition of fiscal incentives with the developed countries, it is rather wise to focus on the infrastructure in order to mobilize the domestic and international investments. Turkey for the sake of getting rehabilitation in the infrastructure measure should take some of the below reforms;

- A better highway network interconnecting East and West more efficiently.
- Effective investments on paid motorways connecting metropolitan cities.
- Privatization of some portion of the infrastructural monopolies.
- Modernization and development of container terminals.
- Rehabilitation of ports and easing the loading and unloading red-tape for faster transportation of goods.
- Modernization of the railway system and improvement of poor rail conditions.
- Improvement of railway lines around the maritime transportation and ports.
- Increasing the degree of liberalization in the telecommunications sector.
- Directing investments to the railway, maritime and airway transportation releasing the heavy burden on the highway transportation.
- Decreasing the costs of international calls and internet access (Part of it has been achieved by the privatization of Türk Telekom and the competition received by the other operators)
- Making the regulations for both the transportation and communication infrastructure easing the investment activities rather than being preventive.
- Better coordination of legislative and regulatory organs in terms of creating a synergy to shorten the length of necessary reforms.
- A tax reform should be carried out for the communication expenses reducing the taxes on the communication costs and encouraging the usage.
- Transposition of infrastructure legislation and regulations with the European Union acquis communitaire to effectively form a competitive legal system governing the investment process in this area.

Connected to the infrastructure is the real estate and land usage as an incentive to foreign direct investment. One of the main reasons, why the infrastructure is so weak in Turkey is the improper usage of land. According to the recent studies, the interesting result is that Turkey seems to have a scarcity in plant investment lands although with 780.576 square kilometers of land with much of it suitable for tourism, agriculture and plant building it has a huge potential. There are mainly two ownership categories of real estate and land usage. The first of these categories is the privately owned lands which form %45 of the total and the second is the so called "treasury lands" which are the properties of the state. However, the unfortunate part is that usually these state-owned lands are plundered by the several people even given by the municipalities and thus this creates ineffective usage of the lands. During the 1980s, certain efforts were present for the transfer of state owned lands, especially in the Eastern part of Anatolia, to the private sector as an incentive. The motive behind these transfers was the allocation of these lands effectively for the usage in several crucial sectors such as tourism, manufacturing and several other industries. However, despite these efforts because of the lengthy procedures in the bureaucracy for the accession of the state lands, the desired outcome in the efficient usage of these lands as a carrot for the FDI couldn't be achieved. The current legislation recognizes the multinational companies doing business in Turkey as legal citizens of the country and thus these companies have no difficulties in acquiring land inside.[51]

Turkey has a long time suffering form the proper space planning issue. Because of the lack of a national strategy for space planning strategy the local governments tend to build up their own strategies in the allocation of land. Thus, it creates a non-standardization and decreases the capacity of cities for the effective usage of the given space. To wrap up both the infrastructure and land usage issue, unless some crucial precautions are taken it will be crucial to recognize that these notions will be doomed to stay as bottlenecks in front of the investors to bring more of their investments and choose Turkey as a feasible investment location. Better infrastructure, planned usage and allocation of lands will definitely harness the barriers in front of Turkish FDI case.

[51] It is questionable whether this has a positive effect or not considering that some of the accession countries such as Poland prohibited the acquiring of land for the non-citizens. More empirical evidence is needed to find a relationship between the land ownership incentive and the attractiveness of FDI.

3.1.7 Energy Considerations

With development in the industrialization, easy access to energy has become an important focus for the multination enterprises for the determination of investment locations. Especially for the manufacturing sectors, the production plants are placed near the crossroads that are near to the energy sectors to lower the transportation and storage of the necessary energy. Turkey in the last two decades has given considerable efforts and the share of private sector in the power generation has gone form 0 to %40. Continuous liberalization and privatization efforts have brought a better environment to both the energy production and consumption issues. However, still there are some deficiencies such as still high leakage and loss rates in terms of electricity, continuous change in the legal legislations in terms of privatization procedures, high energy prices set by the authorities. In last years with certain precautions taken there is a transformation phase of the energy measures in Turkey. These transformations with the actions taken below ,that are summarized in the TUSIAD report (2004), are expected to finish in 2010.

- *"The Ministry of Energy and Natural Resources will focus on development of national energy policy with the support of to-be-founded "National Energy Institute",*
- *The Ministry of Energy and Natural Resources has announced its will to decrease energy prices via taking necessary actions,*
- *EMRA will focus on market control, regulation and monitoring,*
- *Energy Corridor Project: Turkey aims to become the second largest economical energy bridge after Russia."*

Table 17: Energy Production and Consumption

Type of Energy Resource	Production	Consumption
Electricity (Including all forms in billion kwH)	154.2	129
Natural Gas (in cubic meters)	860.3	26.25
Oil (in bbl/day)	45.460	660.800

Source: CIA fact book-Turkey - https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html Link last visited on 17.07.2008.

3.2 Cases of FDI in Turkey

3.2.1 Mining

Turkey, having generous supplies in terms of certain precious natural resources[52], has an important advantage in terms of mining sector in its region. On the other hand unfortunately because of the lack of effective and efficient methodologies to engrave these natural resources, up to now most of it has been either processed by the foreign companies or sold abroad for cheap prices in raw forms. Turkey ranks 152 in the diversity of its natural ores and 52 in the global market of producers. Global understanding of mine industry is that the sector is a profitable one with high human power need, is an important igniter in the creation of marginal utility and human resource with one major drawback. The problem that these resources are non-renewable creates an absolute need for the effective usage of them and certainly Turkey has a deficiency in this notion. Combination of cumbersome state-owned searching and processing enterprises with sluggish managerial attitudes lowers the efficiency and makes it harder to harvest better results. As a result of this framework historical statistics have shown that Turkey has not recognized its full potential in mining with the above overwhelming control of public sector. The creation of such a gap caused deficiencies such as the loss of potential FDI inflows to the sector and the adverse effects on the growth of domestic mining companies. One rehabilitation measure in terms of legal considerations has showed itself with the enactment of the 1985 mining law 3213. Following the enactment a change in the atmosphere surrounding the FDI inflows have been seen and a low portion of the world famous mining companies have chose Turkey as an investment location. Some of the main natural resources that are chosen by the investors include polished stones such as granite and marble. Since 1980s the total number of companies in this sector totaled 85 and the investments amounted 275 millions which in other words counts for a tiny amount of FDI with %0.9. The interesting point in the, integration of foreign capital to mining industry is most of the multinational companies prefer to invest in certain ores rather than creating diversity. Although they have the necessary resources and technology to get the proper knowledge and R&D they instead rely on the previous research conducted by the state based MTA. This, in fact is a sign of the reluctance of these companies to invest in several areas.

[52] According to the 2008 CIA fact book Turkey has the following rich natural resource fields. coal, iron ore, copper, chromium, antimony, mercury, gold, barite, borate, celestite (strontium), emery, feldspar, limestone, magnesite, marble, perlite, pumice, pyrites (sulfur), clay, arable land, hydropower. https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html (link last visited 21.07.2008)

The main motive behind this is to harvest the precious metals and ores and leave the rest to domestic producers so that with little investment higher return can be achieved.[53]

One thing however that can surely be concluded is that most of the Turkish citizens were unaware of the fact that foreign companies were delving into these natural resources and extracting them for their own goods until the recent friction in the excavation in Bergama between the Ovacık villagers and Eurogold. Considering the FDI in mining industry issue the best example can be given as the Eurogold (now Normandy) as the Ovacık mine is operated by this company with %100 FDI capital. The riots performed by the villagers showed a dispute between the company and the natives about the environmental issues considering the fact that the company was searching and processing gold mines with the usage of cyanide. Eurogold was registered in the Turkish books in 1989 after the foundation of Gold near Ovacık, Bergama with 24 millions of Gold ore reserves. They took the right to operate the mines for 8 years and through a complex process with open and underground mines got the permit to search and filter the Gold and Silver ores. However because the cyanide is harmful to the environment as it poisons the soil, the villager started a surge for the dismantling of the company's operations even though the company had prepared an EIA report the mine and plant was shut down by a decision in the Administrative Appeal Court in 1997. Minimization of the risks included was demanded by the public authorities before the allowance of the company's continuation of activities. However, due to the slow legal progress still the case is in progress and many other FDI companies are awaiting the outcome of complex judicial and executive actions regarding this EuroGold project. This case, in fact is an important step in the attraction of FDI to the mining industry and in the case of a ruling that is against Eurogold is given certainly the companies awaiting will be directing their investment decisions to certain other locations. On the other hand , the dilemma here is whether to give up the environmental health of the country which is the primary concern in mining for the foreign capital that is breaching through with the investments in this area.

The above framework has shown us the point there should be some private initiave to disenchant the sluggish ownership on the sector, for increasing the share of FDI and creation of a favorable investment environment in this sector.

[53] Evidence shows that other than marble and precious metals such as gold. There is little interest on the other natural resources. In fact this is somehow proof to the perception of the global players seeing the emerging markets as their raw material deposits.

3.2.2 Banking

Considering the FDI inflows in Turkey in the last decade, perhaps the most attractive industry has been the financial sector. Especially the privatization of most of the private banks has been a highly debated issue considering the future of the banking sector and foreign direct investment issue. One of the highly debated issues is the questions of to what extent there should an integration of foreign capital into the Turkish Banking sector and what the maximum share of the foreign banks should there be in the whole banking industry. It seems that it is still early for coming to a conclusion as the privatization process is still in its infancy. A proper answer to these questions has to wait until proper evidence can be tracked form the financial sector performance of Turkey and the integration of these foreign players into the system.

The trend of foreign bank entry mainly started with the 2001 financial crisis and with the collapse of banking system. Nearly more than half of the private banks either went bankrupt being taken into the TMSF[54] system and because of the huge failure of the legal framework governing the establishment of the private banks, most of the people lost huge parts of their savings with these banks.[55] The end result of this huge banking crisis forced the government bodies to re-examine the banking system and bring new regulations governing the banking industry in Turkey. The new banking enactments made it harder to open new institutions and brought a better legal framework to the system about the liabilities and responsibilities of the banks. This in fact became an ignition point for the selling of most of the enterprise owned banks to the foreign capital since with the new regulations the liabilities were directly tied to the owners of these banks. (Directly to the people sitting in the board of directors)

One common point in the emerging markets is that, if looked at the privatization of the financial sectors in these countries, the entry of foreign banks to the banking system always came after financial crises. This has a two dimensional body taking both pull and push factors into account. Among the pull factors, the competition level, the low level of regulatory framework and lastly the openness and size of the host country market in terms of population

[54] Tasarruf Mevduatı Sigorta Fonu
[55] According to the current legal framework only up to 50.000 YTL is guaranteed to be under supervision of the government. As a result with the collapse of the system people with savings more than this amount lost most of their deposits.

and customer base (such a Turkey with a huge market potential) can be counted. Along with these pull factors considerations such as the decreasing ability to maneuver in the home markets, loss of profit margin and the regulatory constraints in the home country are basic notations of the foreign banks entry. Looking from the other side of the glass, there are advantages of these foreign capital entries to the host country. The technological infrastructure and risk hedging proficiencies brought by these foreign banks are integrated into the native system and thus creates a better blend. Also, financially it helps the accumulation of foreign capital in the banking system and makes it harder for this financial capital to flee quickly in case of a financial crisis. One significant importance in addition can be concluded as; the managerial excellence transfer and corporate governance issue. So far the Turkish banking sector had improvements in this area with the competition offered by the penetration of these foreign banks. Especially the excellence in their management styles has significant influence in the development of Turkish banks in renovating their organization schemes and dealing with skilled human capital.

Table 18: Foreign Banks operating in Turkey (Excluding foreign banks that only have single branches in Turkey)

BANKPOZİTİF KREDİ VE KALKINMA BANKASI A.Ş
CALYON BANK TÜRK A.Ş
MERRILL LYNCH YATIRIM BANK A.Ş
TAİB YATIRIM BANKASI A.Ş.
ARAP TÜRK BANKASI A.Ş.
MILLENNIUM BANK A.Ş
CITIBANK A.Ş.
DENİZBANK A.Ş
DEUTSCHE BANK A.Ş.
FİNANSBANK A.Ş
FORTİS BANK A.Ş
HSBC BANK A.Ş
TEKFENBANK A.Ş
TURKLAND BANK A.Ş.

Source: http://www.byegm.gov.tr/references/banking.htm. (Link last visited 21.07.2008)

There are certain reasons, why these foreign banks choose to entry into our market as FDI inflows through certain measure one of which is the acquisition of Turkish banks. One of these reasons is the liberalization and transition processes Turkey goes through with the accession talks for the full membership to the European Union. In general, literature has given evidence that countries with such liberalization schemes in their financial sectors have witnesses such penetrations in their financial sectors since the process of liberalization and the high amount of debts makes internalization inevitable. To finance these debts and to deal with the opening of industries countries such, as Turkey, find the solution to call in the foreign banks and capital which in turn would help the modernization of the financial sector and creation of diversification in terms of products and services. This is in fact true, as in the case of Turkish banking sector the weak credibility of the Turkish banks have been upgraded by the international credit rating institutions after the acquisitions, since the newly formed institutions have better product range and stronger financial presence in the Turkish market.

Table 19: Market Shares by groups in Banking Sector (As of 2007)

	Share in total assets (%)			**Share in total loans (%)**			**Share in total deposits (%)**		
Inv. and dev. banks	3.2		3.1	3.8		3.3			
Deposit banks	94		94	92		92.4	96.6		96.3
- State	30.6		28.9	20.1		21.0	37.5		35.4
- Private	58.3		53.2	65.4		56.6	55.1		51.0
- Foreign	5.1		11.9	6.5		14.8	4.0		9.9
Participation banks	2.4		2.8	4.1		4.3	3.3		3.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: http://www.byegm.gov.tr/references/banking.htm. (Link last visited 21.07.2008)

Proving the statements above, the situation in both Turkey and the Central and Eastern European countries are the same with foreign banks mainly dominating the financial arena. On Average %60 percent of the banking system is at the hands of the foreign banking groups and even in some of the CEECs and Baltic states the number climbs to %75. This therefore explains the case why as a way of Foreign Direct Investment financial sector acquisition in Turkish Banking Sector is so popular. On thing that is surely calculated by the global players is the profit possibility in the emerging markets, especially in the ones with

unsaturated markets with huge population measures like Turkey. In return, however, the governments take the advantage of easing their reform plans with the penetration of foreign banks as with the competition and technological innovation in both products and services they bring changes to both legal regulations and local companies become inevitable. Thus, structural reforms in the banking system get close ties with the flow of investments in this area.

In almost all of the FDI-banking system literature two important effects were common. One of these effects was the effect of stabilization theory, which states that foreign banks are less vulnerable to the economic crisis in the host countries than the domestic ones since they are likely to use more conservative lending procedures and have a smaller relationship with the domestic business cycles. In this case, the stabilization theory's main pillar is an assumption that because these banks operate in foreign environments and their market share therefore is less than the domestic ones, they are less likely to be affected from the domestic fluctuations. However, this theory seems not to suit the Turkish case since the Turkish banking system is mostly dominated by the foreign banks and their market share is not little but instead in large volumes. One last theory and probably the most important one is the growth effect of the foreign penetration. The theoretical background suggests the fact the presence of the foreign banks in return dismantles the excess profits of certain financial intermediaries, thus bringing equal and socially optimal results. Considering the Turkish financial system, this can be accepted as a proper assumption since the operations of the foreign banks had a significant contribution both on the general macroeconomic scene and also on the business environment. Concluding the theoretical part and before going a bit in the historical challenges of the Turkish Banking FDI case, it has to be emphasized that still all of the above statements lack strong empirical backgrounds for Turkey and still there needs to be given more empirical evidence for getting a better understanding of whether all of these effects apply to the Turkish case.

Taking the historical development of the foreign banking penetration in the Turkish Banking sector into account, it won't be wrong to start the journey from the double crisis Turkish economy witnessed in the November 2000 and February 2001 consecutively. These two doomsdays have led to a banking collapse with lots of banks going deep underwater. On the hand the best conclusion out of these crises is the restructuring of the banking system with better financial institutions operating in a more efficient way. The auditing of the banking was

given to a single entity established in 2000 under the name of Banking Regulation and Supervision Agency (BDDK)[56] This governmental body created a better system of regulation as the penalties issued for breaking the law are quite harsh and this in fact scares the banks both for financial and reputation concerns. However it has to be accepted that the main motive behind the foreign penetration of in the Turkish Banking system was the decrease in the values of the banks after the double crisis period. Certain side effects of the crisis such as the downsizing of the banks and the reduction in the number of branches have caused a significant drop in the market value of certain banks which therefore allowed the multinational banking groups to act swiftly and add these banks to their operations in Turkey. The period covering 2002-2004 showed a great leap for the system as the operations of both domestic and foreign banks went as desired under a strong recovery period. The share of multinational banking groups in the banking system along with this recovery trend have gone up and the volume of it even grew higher with the acquired domestic bank shares through Istanbul Stock Exchange. This speedy acquisition process is due to the fact that as a relatively small EU accession country the Turkish domestic banks seem to be small in size and asset volume and they are easy to be purchased or taken over.

There are some interesting examples that contradict with some of the theoretical explanations above. Although the above theories suggest that usually the penetration of the foreign banks brings positive technological spillovers to the host country and also product innovation, some Turkish cases have proved that sometimes the other way around is possible. The figures and technological infrastructure show us that some of the banks in Turkey, like Finansbank and Garanti Bankası, were stronger than their penetrating partners. Also this is valid for the diversification of the product line with some of the foreign banks as in the case of National Bank of Greece case can search for innovation on certain products and thus decided to buy a foreign bank. [57] Several underlying reasons can be tracked from the penetration of these banks to the Turkish banking system. One motive could be the increasing of the market share reaching new customers. As Turkey has a huge population, this creates a magnificent opportunity to reach beyond national borders and invest in countries such as Turkey to attract more people as loyal customers. Dexia, as reported by the BDDK reports have reached nearly 1.5 million new customers just by buying Denizbank in Turkey. One last

[56] Bankacılık Düzenleme ve Denetleme Kurulu

[57] National Bank of Greece according to certain reports decided to but Finansbank for its diverse product line in retail marketing including consumer loans, car loans and other products.

motive for the penetration of Turkish market could be such as the motive behind GE purchasing of a part of Garanti Bankası. Multinational companies operating in several countries (such as in the case of General Electric operating in more than 100 countries) use the Turkish market as a bridge creating an access point to other unsaturated markets. Also buying the banks with operations other than in the domestic market means that with one shot the purchaser gains access to other operations abroad.[58]

As a form of foreign direct investment, a positive effect conclusion can be drawn from the activities of foreign investors in the Turkish banking system. It is true that the penetration of the multinational financial groups into the Turkish banking system has paved the way to the formulation a more efficient and transparent banking system that is more resistant to the financial crisis. Positive spillovers, such as better risk management and better management of human resources have been transferred to the domestic banks, increasing the quality of the banking and financial services. In return, the FDI transferred to the sector have given this multinationals, access to certain advantages such as the abroad operations of the acquired banks and a huge population potential with active credit markets. Turkey also benefited from these FDI activities by gaining technology intensive operations ending in fewer employees doing the same job thus cutting the unnecessary operational costs. One last FDI measure is the financial support provided by these financial intermediaries to large scale projects through certain international arrangements bringing foreign capital to Turkey. To sum up the section on the other hand, it is necessary not to forget that the increase in the shares of foreigners in the banking system means less control of domestic ones in the market and eventual drop of them from the competition this in fact will bring more harm to the market making some of the players of the system monopolies than making us happy for the coming of foreign capital as a form of Foreign Direct Investment.

[58] As in the case of Garanti Bankası GE by acquiring a potion of the bank has also gained Access to the bank's operations in the Netherlands, Turkish Republics, Russia and the Middle East.

3.2.3 Manufacturing

One last part in the examples of the Turkish FDI cases should definitely be the Turkish manufacturing sector. With two cases above with one (mining) being one of the lowest and the other being the highest sector in the FDI attractiveness, it would be certainly wrong skipping the importance of FDI attractiveness of the manufacturing sectors including all of the production related companies in Turkey. According to the 2007 FDI report issued by the Undersecreteriat of Treasury-General Directorate of Foreign Investment manufacturing sectors were the second in the ranking of FDI attractiveness just behind the financial intermediation services. (Mainly banking)

Table 20: Sector Distribution of FDI inflows (2007-in million $)

Rank	Sector	Capital	% Share in Total FDI
1	Financial intermediaries	11,409	59,5
2	**Manufacturing**	**4,199**	**21,9**
3	Transport, Storage, Communication.	1,119	5,8
4	Real Estate, Renting, and Business Activities.	905	4,7
5	Electricity Production	555	2,9
6	Mining and Quarrying	341	1,8
7	Construction	260	1,4
8	Wholesale and Retailing	181	0,9
9	Health and Social Work	178	0,9
10	Hotel and Restaurants	26	0,1
	Other	17	0,1
	TOTAL	19,190	100,0

Source: Undersecreteriat of Treasury-General Directorate of Foreign Investment-2007 FDI Report

As seen from the table above manufacturing forms one of the most attractive sectors of the Turkish capital formation and certain main sub-sectors in manufacturing is quite lucky in diverting these capital movements to their sides. Especially the chemicals and chemical production industry has a high ratio in this manufacturing pie ranking first among other industries receiving FDI in 2005,2006 and 2007 consecutively.[59]

[59] Chemicals sector received 600 million $ in 2006 and nearly doubled in 2007 with 1.1 billion $

To clearly understand what kind of effects FDI has on the manufacturing sectors or the emerging markets, we have to generally delve into the motives of the multinationals figuring out why they want to invest into manufacturing sectors establishing production plants, hiring either domestic management teams or expatriates and produce what they have abroad. Recent trend have shown us that, manufacturing firms started fragmenting their business units into smaller ones and carry their operations abroad where they can either outsource the production or choose to produce themselves by building their own facilities. This in fact due to the belief that this creates an augmentation in the efficiency level, decrease costs and in general terms increases profit margins. Mostly the transfer of business is to the emerging markets with low costs, high Access to the natural resources and with potentially unsaturated markets with huge population figures ready for consumption. The flow of production from the developed country multinationals to the emerging markets usually fort he manufacturing sector chooses the intermediaries of Foreign Direct Investments including certain incentives offered by the host country governments. Usually, these incentive packages are quite attractive to the manufacturers taking the forms of tax reductions, loans, and land site and so on… Thus, along with the technological change in the global competition with a result of cheaper transport, telecommunication and computing costs, acceleration in the above mentioned fragmentation occurs. There are certain motives behind the usage of FDI especially in the manufacturing sector such as increasing the productivity through efficiency (labor costs, economies of scale, strategic alliances with the host country companies), easy access to the global customer demand through the spreading of both production and sales operations to several host countries receiving the FDI inflows), reduction of risks of losing potential markets share (shrinking market share and decreasing profits in the home country due to high competition and high regulatory affairs) and lastly minimizing the taxes (through the carriage of operations to other countries with tax incentive packages for their attractiveness of FDI)

Table 21: Breakdown of FDI in manufacturing by sub-sectors (2007)

Sector	**% Share in Total FDI**
Food and Beverages	18.5
Textiles	5
Chemicals	26
Electrical Machinery	1.1
Automotive and Side Industries.	1.6
Other manufacturing	47.8

Source: Undersecreteriat of Treasury-General Directorate of Foreign Investment

The table above is a brief summary of the current situation of FDI shares in the manufacturing sector. As we can track from the table due to certain strategic alliances and acquisitions some of the sectors above has received considerable FDI shares. The main question, however, is the linkage of the Turkish market with the key FDI decision factors above. There are certain advantages of Turkey for pushing the foreign investors to choose Turkey as an investment location. One of the key location advantages for the production based MNCs, is the size of the Turkish market. Considering the market size Turkey is one of the largest emerging markets in the global arena with a huge potential for consumption with a young population. The tremendous growth potential of Turkey, that is prospected both by certain governmental bodies and research organizations, joins it to the World most competitive ten emerging markets with forecasts of 20.000 $ for the per capita income in 2020[60]Thus it is quite attractive to slide the production to this market and ease the transactions by producing and selling in the same host market is an innovative idea.

As discussed above the low labor cost motive is also a driving factor behind the merging of FDI and manufacturing sector in Turkey. Despite the fact that Turkey has higher labor costs than most of the transition economies and almost all of the Central and Eastern European countries, it turns out to be than it has better labor productivity in terms of cost/productivity ratio. Latest research has shown that the workforce present has significantly earned the reputation of being flexible and hardworking as it turns out to be nearly %90 of men and %80 of women work more than 40 hours per week which proves Turkish people to be the second hard-working ethnic group in the world. Thus, there is an, important consideration dilemma for the multinational producers to whether trade off labor productivity or low labor costs. So far it seems they choose low labor costs as CEECs have better performances in attracting the manufacturing multinationals for building plants in their countries.[61] Concluding the labor issue one last motive could be the skilled labor availability and large supply of graduate supply for the facilities. This guarantees the efficiency of the foreign investment and by increasing the quality of production in the host country through the necessary human capital, resulting in better profit margins which are the main desire of these multinational companies.

[60] This is an optimistic forecast of the Turkish government linking the growth with the growth in the per capita income.

[61] However this may not be the only reason why Turkey has a lower performance in the attraction of manufacturing FDI. Although there is not a big difference in the labor costs and there seems to be higher productivity, the combination with the lack of proper legal framework, existence of long bureaucratic procedures and several other impediments lower the attractiveness ration.

In terms of manufacturing sector there are also other motivating factors for the multinational companies to invest in Turkey. These include the costs of resources and assets for the labor productivity, other input costs mainly in transport and intermediate products, easy access to generous and cheap supplies of raw materials. Also being a member of a regional economic integration (customs union right now) and being in the door of a large community such as the European Union affects the decisions of these MNCs. Especially, when the fact that Turkey is one of the biggest trading partners of the European Union, it wouldn't be complex to understand why some of the European manufacturers choose Turkey as a production base or at least form strategic partnerships using existing facilities of the domestic companies for production. Especially, some of the Turkish industries such as the chemicals and the automotive sector have witnessed such forming of FDI investments and up to now it seems they have performed pretty well.

One last remark for the summing up all the sector cases could be the choosing of geographic investment location inside Turkey for the foreign investors. In almost all of the sectors receiving FDI, there is a certain border division for the investment climate starting from the Western Anatolia and this in fact creates sad consequences for the Eastern part which has a less developed rural environment. This trend can be easily tracked from the following table showing the main investment location through Turkey. What remedies can be taken into account for certain rehabilitation of this, however, is such a wide discussion that it may be the topic of a few dissertations.

Table 22: Breakdown of Companies with International Capital by Sector according to the Investment Location (1954-2008/May)

Sectors	Istanbul	Antalya	Ankara	Izmır	Muğla
Agriculture, hunting, fishing and forestry				38	16
Mining and quarrying	135	15	71	40	7
Manufacturing	2.141	143	197	309	30
Electricity, gas and water supply	134	14	73	23	1
Construction	572	533	148	93	191
Wholesale and retail trade	3.913	344	373	382	84
Hotels and restaurants	459	451	69	69	254
Transport, storage and communications	1.024	240	66	72	133
Financial intermediation	232	15	6	8	6
Real estate, renting and business activities	1.549	602	200	108	432

Source: Undersecreteriat of Treasury-General Directorate of Foreign Investment.

4. Methodology and Data Analysis

4.1 Aim and framework of the Analysis.

As concluded in the literature review and in the Turkish case, one of the most difficult things in the research of the Turkish FDI case is the scarce number of studies in the field with an empirical background. Most of the research conducted on the issue covers an extensive part on the theoretical explanations, advices to develop the reputation of Turkey's FDI attractiveness and lastly some remedies in the way to the EU accession. Aside from the fact that there are limited number of empirical studies, one more drawback attaches itself to the problem which is the fact that macroeconomic studies usually cover the FDI issue in the macro level and generally find evidence in the indicators of this level such as the relationship between GDP, Public debt, inflation, interest rates and etc and Foreign Direct investment. On the other hand, conducting a micro level research in my opinion would be definitely helpful in understanding what is happening in the lower depths of the economy within the industrial and services sectors and finding evidence for their direct effect on the Turkey's attractiveness for foreign direct investment inflows. To fulfill the need, this study's main target is the micro level analysis and will be looking at the statistical data in the main sectors affecting the macroeconomic scene and mainly receiving FDI inflows. The main goal here is to reach a positive relationship between the FDI inflows and the effects of these micro level developments in the sub-sectors of main industries.

This section will have thus a sequence of first the determination of the important variables and explaining their significance for the analysis. The second part will be about both the explanation of the data collection methods and the ways of gathering the necessary data that is important for our analysis and also the deriving of the statistical analysis methods that we are going to use for our analysis. The third and the last part will be the conducting of the SPSS analysis with the data we have gathered and thus pave our way to the last part of the study where we evaluate the results and come to a conclusion.

4.2 Key indicators of the Analysis

4.2.1 The amount and percentage of GDP created.

The analysis gets its ignition indicator from the amount and percentage of GDP created by the sectors that we target to include in our regression analysis. This proxy is a crucial one since the small number of additions by sectors importantly affects the GDP figures and the macroeconomic scene which has an influence on the attractiveness of the FDI flows. The interesting point in the GDP addition discussion is the weakness of the academic literature between FDI and the GDP growth. Despite the fact that the academic research has given the outputs of a certain boost in terms of technology, investment and savings, productivity and other important measures , economists and academicians failed to find strong evidence for a positive growth effect of FDI on a country's GDP statistics. However, positive impacts have been tracked in certain countries such as China and India where intensive FDI inflows have resulted in the boom of these countries economies. Also transition countries with the EU membership process have vastly benefited from the positive effects of the investment climate within their borders. Considering the Turkish case, the creation of GDP through certain sectors receiving FDI becomes highly crucial if we think that Turkey has important struggles for attracting FDI to most of its sectors. Since this study will be a sub-sector one rather than a general macroeconomic research, the blending of this proxy into the research will give us an insight in the determination of sector by sector additions to the GDP and the effect of FDI through these percentage creations to the GDP.

4.2.2 Employment

Perhaps employment is one of the key crucial indicators of this study since it is directly affected by the FDI attractiveness. Most of the developing and developed countries see FDI as a outward-oriented strategy for their sustainable development and growth strategies and the key concept of investment is an important factor in the generation of employment and reducing the macroeconomic factor of unemployment. Thus, sector employment creation statistics is a wise way to see the direction of FDI flowing into these sectors and as a result giving an idea of what is happening in those sectors. It is certain that employment is not the only factor changing the course of the whole framework but it is inevitably important in the forming of the whole scene. Modernization of the technology by the transfer of know-how from the developed countries to the emerging ones through certain

investment flows has an important effect on the employment activities. The increase in the global competition forces the companies to shape their orientation to the abundance of low skilled labor and find new ways to increase the efficiency level that they extract from the workforce they manage. Domestic employment creation in certain sectors along with the notions becomes highly important. In this thesis, one of the key ingredients in the micro-industrial level is the link between employment figures in the chosen sectors and the amount of FDI received. Aside from the direct linkages of foreign direct investment on the employment issue there are also indirect effects such as foreign trade and investment climate changes. Perhaps the best example of this could be given on the case of whether the FDI outflows (the reverse and unwanted case) affect domestic output and employment through the changes in the foreign trade. This debate takes its roots from the general consensus that FDI outflows usually decrease domestic employment through the increase in the imports especially in the intermediary goods. Thus, combining all the information above it will be a helpful regression for us to determine whether our theory that more foreign direct investment causes more employment generation (or the other way around less FDI less employment) and help to reduce unemployment in the macro level.

4.2.3 Productivity

Another key indicator that will be used as a variable in this study is the sector and sub-sector productivity measures. Generally in theory it is believed that with the aspects of foreign direct investments such as the transferred technology implementations, know how, management and marketing techniques and product innovation formulas the MNCs bring a significant productivity spillover effect to the local production plants. Although this assumption has generalized itself in the eye of several industries, the FDI literature lacks firm evidence of these positive or negative productivity spillover effects. Thus, it will be wise to add such a crucial element to the study seeing if there is an evidence of an possible productivity increase in the selected Turkish industrial and services sectors due to the reception of foreign direct investment inflows.

4.2.4 Foreign Trade

The general assumption on the usage of FDI for the benefit of foreign trade is, FDI is majorly used as a general export promotion policy tool rather that increasing the domestic trade. This can be legitimized by the fact that the multinational companies investing in certain emerging markets tend to build up plants, factories and so on in order to come up with better cost outcomes and measures in order to increase their volume in export numbers. Boosting foreign trade (mainly export numbers) through the multinationals home country preference for the market access is also an important effect of the FDI in and outflows. Considering the rate in the tendency of World economic movements towards a full liberalization, the main actors of the FDI investments who are the world's large conglomerates with sales and profit volumes higher than GDPs of most of the developing countries form the main trading partners of the emerging market economies. Countries such as China, India and so on which are still in their infancies in terms of economic power do business mainly with the so called more developed and "modern" world through the help of these multinationals and the FDI that breaches to their land they supply. Along with the physical goods that are traded one more addition to the trade theory is about the services sectors. Since it is known that services are not as widely traded as physical goods it is important to add that with the help of these FDI movements the degree of tradability of these services in certain sectors such as banking, telecommunications and so on is getting enhanced. The spill over effects in several key measures that are brought in the services sectors by the multinationals, help the host country's domestic services to upgrade and contribute to the export competitiveness. Turkey is a good example for the trade element. Especially looking at the banking sector it has received considerable FDI and most of the Turkish banks after the 2001 banking crises have changed hands toward the foreign banking groups. Also in terms of goods there is a considerable effort in the increasing of Turkish exports. Thus it is ultimately wise to look at the trade volumes in certain sectors, both in physical goods and in services, and evaluate these numbers linking it with the FDI inflows in these selected sectors. It will then will give us an insight for the validity of the above emerging market-FDI-and foreign trade triangle.

4.2.5 Competition

Perhaps another critical element of the analysis is formed by the issue of competition. Since this is one of the areas Turkey has a great deficiency both in terms of regulations and professionalism, widely discussed is the link between competition power of companies and their effect on the attractiveness of FDI to domestic borders. Thinking that foreign entry usually comes in the form of foreign multinational companies operating in a highly diversified environment with several country based operations and a high knowledge backed by these operations, it is highly certain that these companies bring the domestic market a degree of competition. Thus it gains vitality to search for a possible relationship in terms of domestic sub sectors and foreign direct investment inflows and see whether this proxy has an effect on the foreign investments. One limitation that is discussed in the literature that is also possible for the Turkish case is the debate in the literature that mostly the FDI in the manufacturing sectors tend to be perfect while general theory of FDI postulates that multinationals are more likely to exist in imperfectly competitive markets. The analysis will focus on the issue whether an increasing trend of competitiveness affects the volume of FDI, investments in the macro level. However a consideration on the limitation above may effect the output since in the Turkish case most of the important sectors (especially in the services sectors) there tend to be a hegemony of foreign multinationals which in return decrease the competitive advantage of smaller firms.

4.2.6 Usage of capacity

Perhaps giving a concrete explanation for this crucial element is a really hard task since there is not enough empirical or even theoretical literature on the issue of capacity usage in terms of Turkish case. Dismissing a handful of numbers that is provided by certain NGOs and governmental organizations none can be found explaining the capacity usage issue in the Turkish business. It is undeniable that there is a high relationship between the increase in the capacity usage and investments schemes. The usage of capacity increases with the investments figures going upwards and more FDI directed towards the creation of goods and services means better usage of the potential. On the other hand the major drawback on the Turkish issue is the fact that, since the real interest rates are relatively quite high in Turkey the investments drop and thus limitations in front of the capacity usage occur. Increasing the

domestic demand seems to be a remedy for this but still it is not an enough solution for the whole problem. What in this context this study will look at is the latest trend in the capacity usage and link it with the volume of FDI received thus searching for a correlation between these two important notions paving the way for a possible growth strategy for the whole country.

4.2.7 Interest Rates

The interest rate issue is the key indicator in terms of several FDI related terms. The high numbers is the Turkish real interest rate figures have undeniable limitations on the FDI. High interest rates attract the investors but with a deviated condition. The investments are in the form of hot and liquid money and tend to flee in the cases of economic downturns since they are not turned into investment measures that directly effect the growth, production and so on such as the building of a production plant or buying operations of a service provider. As an example there is a general consensus that the capacity usage in the recent years has dropped because of this real interest rate problems and the domestic demand solely cannot be a remedy for the decrease in numbers. In this context it will be wise to give a look at the interest rate and FDI relationship in the micro subsector level and see if there are also microeconomic indications of this relationship.

4.2.8 Exchange Rates

Each year the volume and volatility of the FDI movements increase across the globe and there is no discussion on the issue that a high ratio of this investment, which is counted as an international flow of capital from a point to another through the multinational companies maintaining operation and sales in different locations, is received by developing countries. The exchange rates attaching themselves to the definition of domestic currency price of a foreign currency have an important effect on the place and allocation of the capital investments with both their volatility and level. An example of this impact can be given as possible currency depreciation in a country. When a country's currency depreciates meaning a decline in the value of that currency relatively to another currency certain aspects for the FDI occurs. One of these aspects is the reduction in the wage and production costs thus enhancing a possible locational advantage meaning the increase in the rate of returns for investors dealing projects abroad. Certainly there are other indications of exchange rate fluctuations on

the FDI movements however for not deviating from our main topic in this study it is not given in depth. The only thing that is considered is the fact that the exchange rate fluctuations are included in the context with Turkey having volatile past records of exchange rates it will be useful for us to look at the Turkish case and test this relationship of FDI and exchange rates.

4.2.9 Corporate Tax Rates

One last indicator that will be included in the analysis will be the corporate tax rates and their effect on the FDI levels. Taxes have always become a big burden on most of the sectors as in the Turkish case usually the preferred method for the increase in the tax collection is increasing the tax percentages rather that spreading the tax base and preventing the underground economy. As a result of this high corporate tax issue, foreign direct investments usually tend to flee if not a backdoor such as tax incentives and else could not be given to the multinational companies investing in the country. However, this in fact has a problematic effect for small and medium sized companies since with the incentives directed towards bigger companies the competitiveness of smaller ones vanish and so do themselves in the long run which is a bad side effect on the domestic production measures. According to the proper literature a percentage increase in the tax percentages causes 3.7% [62]decrease in the overall FDI volume. Considering the scarceness of the FDI volumes in Turkey this is a high percentage and thus gains high importance. Thus, as a last element in this context the addition of corporate taxes and their effects on the sub-sector FDI percentages will be tested.

[62] "There is a wide range of estimates, with most studies finding decreases in the range of 0% to 5%. This variation partly reflects differences between the industries and countries being examined, or the time periods concerned. Some recent studies find, for example, that FDI is becoming increasingly sensitive to taxation, reflecting the increasing mobility of capital as non-tax barriers to FDI are removed. Such estimates may be used to estimate the long-run impact on FDI of corporate tax reform." (OECD Policy Brief February 2008 pp.2)

4.3 Data Collection and Analysis

Because of the fact that, this thesis has a more microeconomic orientation than a macroeconomic one, there emerged a need for a sector level data set in order to look in depth whether there is a positive correlation between FDI and certain FDI receiving sectors thus creating growth. For this reason, the annual data for the selected variables are collected from TUIK (Turkish Statistical Organization) databases, Istanbul Chamber of Commerce and Industry Libraries. However, there is a certain limitation of the data collected as most of the data is not up to date or in Panel data from which required coming up with an econometric model that is quite hard for me to establish since I have a deficiency in this area. I used mainly two index type data. Most of the indexes took the index measure based on the 2003 data which I started my analysis and some of the indexes took their base year as 1997. (which I was not happy since between the years 1997-2003 there were economic crises that affected the inflow and outflows of FDI)

The first regression tests with the available data have showed results of autocorrelation[63]. This was a sign of a need for a mathematical formulation to separate the variables and in order to properly have a statistical analysis for the given variables more accurate data was needed. Also as I tried to cover around 11 variables the data set was relatively small for the correction of this auto correlation problem. I have consulted several books and also some of my lecturers for a possible remedy for this issue and given the response that I had to expand the data set with both several more sectors and several years of data, I had the only choice to separate the sectors and conduct the regression sector by sector and look which of the sector level variables had a significant effect on the FDI volume increase. Although the analysis is not an in depth analysis it gives us a pinch of an idea of whether in some sectors these variables have an impact on the FDI and economic growth relationship. In the next part I will be giving out the result of the regressions analysis sector by sector and try to explain the outcomes from the SPSS analysis. After the data analysis

[63] "*Autocorrelation is a mathematical tool for finding repeating patterns, such as the presence of a periodic signal which has been buried under noise, or identifying the missing fundamental frequency in a signal implied by its harmonic frequencies. It is used frequently in signal processing for analyzing functions or series of values, such as time domain signals. Informally, it is the similarity between observations as a function of the time separation between them. More precisely, it is the cross-correlation of a signal with itself*". Source: Wikipedia internet http://en.wikipedia.org/wiki/Autocorrelation (Link valid 18.11.2008)

chapter, I will try conclude and blend the theoretical part with my analysis of regression with the sector level data. The last part in this data analysis part after the evaluating the SPSS output will be some recommendations and remedies for the Turkish FDI Case.

The first of the sectors that I tried to analyze in the regression was the most FDI receiving sector of Food and Beverages sector according to the report of the Treasury 2008 FDI bulletin. Taking FDI as the dependent variable here in order to see which of the variables in this sector had a significant effect on the FDI levels in this sector. The analysis was as follows;

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	184495,826	1	184495,826	57,882	,017[a]
	Residual	6374,924	2	3187,462		
	Total	190870,750	3			

a. Predictors: (Constant), X2

b. Sector = 1

c. Dependent Variable: FDI

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5078,390	701,033		-7,244	,019
	X2	38,701	5,087	,983	7,608	,017

a. Sector = 1

b. Dependent Variable: FDI

The analysis in the SPSS removed most of the variables and only the X2 factor which was the productivity per hour worked index had a significant role in the fluctuation of FDI in the food and beverages sector. This factor showed a significance level of 0.017 which showed that the result was significant and the adjusted R square proved that the significance level is quite high as 1 means that the relationship is perfectly significant. In the coefficients part, we can see that the coefficient is positive which means that the productivity worked per hour

variable is positively correlated with the FDI fluctuations. Some of the variables like corporate tax rates and exchange rates seemed to have high either positive or negative correlations but because the significance levels couldn't pass the validity tests it is hard to say that these partial correlations measure were significant in the food and beverages sector.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,983[a]	,967	,950	56,45761

a. Predictors: (Constant), X2

b. Sector = 1

The second sector and probably over the years one of the sectors that carried out the most hope for the economic growth of the Turkish economy, as we were quite competitive was the textiles sector. Conducting a regression with the proxies on the dependent variable of FDI, has shown us the link that only in this sector the X6 which was the annual level of GDP creation (Annual Production) was included in the analysis and the SPSS output has excluded the other variables.

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20763,988	1	20763,988	1,677E3	,001[a]
	Residual	24,762	2	12,381		
	Total	20788,750	3			

a. Predictors: (Constant), X6

b. Sector = 2

c. Dependent Variable: FDI

However surprisingly this significant relationship proved to be a negative one with a significance level 0.001 it turned out to be that there is a negative relationship between the annual production in the textiles sector and the volume of FDI received throughout the years when looked at the correlation coefficient of -0.999. The test has given the X6 variable an R square of 0.959 which explains the validity of the regression.

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	181,796	3,545		51,279	,000
	X6	-1,689	,041	-,999	-40,952	,001

a. Sector = 2

b. Dependent Variable: FDI

To me, it proved to be rather interesting to see that there is a negative correlation between the volume of production in the textiles sectors and the received FDI. Because of the fact that more tests such as a time series analysis throughout a wider time span. (At least 10-15 years I suppose but still there are some deficiencies such as the existence of wild up and downswings in the economy)

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,999[a]	,999	,998	3,51869

a. Predictors: (Constant), X6

b. Sector = 2

Looking above and to the literature, however, seems to also be in accordance with the real life problems of this sector. Textile sector during the recent years has seen a recession due to heavy competition from countries with cheap labor and material handling costs and thus, although production seemed to increase FDI levels with an exception of one year in 2007 have been significantly in low levels. This has multiple reasons such as the ignorance of the government, the increase in competition of other countries such as China, India and so on.

The tertiary regression analysis in order is the chemicals and chemical products sector. The analysis in this sector has given an output suggesting that the X2 variable (the annual productivity) is correlated with the FDI volume as it was in the food and beverages data. The output of the regression was as follows,

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	208593,170	1	208593,170	26,936	,035[a]
	Residual	15487,830	2	7743,915		
	Total	224081,000	3			

a. Predictors: (Constant), X2

b. Sector = 3

c. Dependent Variable: FDI

As we can track from the output table above, the model has a significance level of 0.035 which seems to be in the confidence levels. The correlation coefficient (the following table) shows that there is a positive correlation between the two variables giving a similar explanation with the first sector that there is a positive relationship between the productivity figures and the FDI volume. The correlation seems high as the number is close to positive 1 with a number of 0.965. The model has an R square of 0.896 which shows that, it is significant

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2812,638	583,188		-4,823	,040
	X2	19,551	3,767	,965	5,190	,035

a. Sector = 3

b. Dependent Variable: FDI

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,965[a]	,931	,896	87,99952

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,965[a]	,931	,896	87,99952

a. Predictors: (Constant), X2

b. Sector = 3

For the fourth and fifth sectors which are the Electrical Machinery and Equipment and Manufacturing of motor vehicles, trailers and semi-trailers the regression results failed to give significant variable relationship between FDI and these sectors. The lack of efficient or neatly updated data for these sectors may be the result of this lack of output.

Warnings

There are no valid cases in split file Sector=4 for models with dependent variable FDI. Statistics cannot be computed.
No valid cases found in split file Sector=4. Equation-building skipped.
There are no valid cases in split file Sector=5. for models with dependent variable FDI. Statistics cannot be computed.
No valid cases found in split file Sector=5.. Equation-building skipped.

Looking above analysis in the SPSS has helped us to track an interesting correlation measure. The literature review part has given us the notion that FDI has a productivity spill over effect in some sectors. In our analysis in two of the sectors which are the food and beverages and the chemicals sectors we have come up with this positive correlation as I have evaluated above. This in terms of our analysis is an important aspect since with this small amount of data it is rather hard to trace such an important relationship. Finishing our evaluation of data analysis and collection part, in the next chapter I am going to conclude the study and give a brief outline of what wee have done and also what is the general framework in the Turkish FDI case. Also I will try to come up with some policy implications and remedies for a betterment of FDI activities in Turkey.

5. Conclusion

This study was essentially a basic study of the case of FDI in Turkey. In this thesis I tried to outline main elements covering the issue of Foreign Direct Investment and main feats starting with a brief summary of what FDI is, what are the types of FDI and so on. Afterward my progress was delving into the literature of finding the right theoretical evidence on the growth, FDI and country relationship and Turkey's performance on the issue. It is rather hard to cover all of the FDI case in Turkey since it has multiple dimensions which can as parts be issues of several extensive dissertations. My motive on the issue was however to give a small pinch of every corner of the Turkish case and form the first ignition in mind of the whole picture. While designing the study the first ambition was to follow up this course with a macroeconomic regression analysis to come up with the variables affecting the FDI activities in Turkey. However, after reading some of the materials I have collected, we have come with the idea that it will only be a small part in the essence of the issue since the analysis would only cover a general framework. Thus we turned out to have a microeconomic one covering different sectors and directing our analysis to the relationship of FDI with some of the selected sectors receiving the most FDI amount. However, due to limitations of deficiencies in the econometric background and also the lack of efficient and enough secondary data on the subsector databases the performed analysis could only be a limited one. I tried to summarize my limitations in the next chapter so I have to pass here with what I got as a conclusion from this study. In this concluding chapter I will try first to evaluate on the outcome of my analysis and its implications and secondly I will briefly try to come up with some policy implications for the Turkish case to increase its FDI activities especially when considering the certain probability of an EU accession as we are on the eve of negotiations and as I have concluded in the theoretical part this negotiation process has given boost to most of the accession countries (More to the transition countries in the Central and Eastern Europe)

The main conclusion I could extract from the regression analysis is that during the last five years Turkey has not progressed rapidly in receiving FDI in several sectors. Although I have to admit that a five year span is not an enough time period for conducting a time series analysis still the regression can give hints to us that the sector performance still cannot compete with the amounts received in that of other accession countries. It is rather sad that

with a very competitive position as an investment location for a possible flow of inward FDI the accession somehow seems to provide Turkey with a disadvantage as several key issues such as human rights, the conflicting problem in the eastern part and economical inequalities because of regional industrial differences emerged with the negotiation process of closing the acquis communitaire chapters. While it is certainly vital for Turkey to grab a membership from the European Union to access a better market, stability and economic growth, it is also important to harmonize its inward political environment with the necessary remedies to create a better investment climate thus attracting more FDI and directing the FDI channels from the transition countries to it. Another key factor here is that Turkey both in sector level and in macro level have to come up with successful investment promotion strategies. Good examples of this strategy can be followed from the competitor transition countries. In one of these competitors namely Czech Republic the agency for investments has created a clear strategy for the innovation of a good investment climate and thus, the success of this strategy can easily be traced from the augmentation of the figures of inward FDI received by the country. As a rational link to this success organization and promotion of a strategy for investment is an important policy implication and remedy for the sector level FDI reception for Turkey.

The separation of possible implication for the Turkish case can be in the form of short- medium and long term oriented. What I could extract from both the literature and also from the secondary sources I have traced is that in the short term Turkey has several remedies. In economic terms combating with the inflation and a possible reduction to the single digits, a better information technology base, and most importantly increasing the per population contribution to Research and Development (especially in certain sectors that receive FDI the most) can be the remedies that can be viable in the upcoming one year short term focus. In terms of political and institutional factors completion of the reforms for the EU criteria and dealing with the political obstacles of the red-tape may be the major short term implications. In the medium and long term the most important remedy may be the upgrading of the short term implications and transition to a better knowledge based economy increasing the education levels and supporting the innovation level created by the short term contributions to the R&D activities. The short term remedies in the Political and Institutional implications will also lead to the promotion of Turkey as a regional economic and political centre in the whole region in the long term. (In 5-10 years time which also will be hopefully including the full membership to the European Union)

Looking at both the literature and the secondary sources a brief conclusion that FDI has an effect on the host countries. Several important notions such as technology and productivity spill over occur and have important relationship also in sector level with the FDI measures. However still for the economic growth issue still more evidence is needed.

To conclude the study we have conducted a sector level analysis which unfortunately has not given significant evidence to us that there is a full-fledged relationship between these sectors and FDI. However we were able to track some key variables in some of the sectors that have significant relationship. The study on the other hand can be upgraded to a better one with the help of a more developed econometric model and the collection of a broader and expanded data including more that 15 sectors for a wider time span and analyzing this panel data with both inside an econometric data a time series analysis. One thing that can surely be concluded is that Turkish government has taken significant steps for the creation of a more stable economy with implications such as changes in the law and regulations and innovation of incentives. But still there is more to be done as we are still in our infancy in attracting FDI when compared with the other transition countries. I believe, if Turkey can overcome weaknesses and threats such as lack of strategy, existence of high bureaucracy, macro economic and political instability, competition from other CEECs and regional instability, it can reach several opportunities such as EU accession, economic growth and being a power center in the Balkans, Black Sea and Middle East region. Hope it can be in the medium term (Short term would be too unrealistic)

5.1 Limitations of the Study

As a concluding remark to this empirical study on the Turkish FDI case, it can surely be concluded that there had been some serious limitations. Perhaps one of the most important limitations was in the stage of data collection since there weren't enough sector level data in each of the sub sectors and in terms of the variables that were tracked. Some of the data were not in good shape, some were outdated and some was just a summary of the accumulated years. This in fact paved a negative way for a more in depth numerical analysis of the FDI issue. During the statistical secondary data collection I have found out that most of the Turkish statistical data lack the efficiency and even the data mining in the TUIK (Turkish Statistical Institute) have major deficiencies and major gaps especially in being up to date.

Another key limitation occurred during the literature review, especially in the Turkish growth and FDI history case because of the lack of analytical and in depth analysis in the Turkish resources. As a result of this gap, I had to look through the foreign articles and books and mainly tried to breach this limitation by searching through foreign journals and extracting enough literature on the Turkish investment climate. The treasury reports and some reports on the issue by non-governmental organizations such as TUSIAD helped a bit for the forming of the theoretical background but still it was not enough for a full consideration of such an important topic on the economics of Turkey.

One last limitation, I have extracted from the study is my lack of highly qualified econometrics knowledge. So the analysis includes simple relationship analysis rather than formulation of an econometric hypotheses and testing the econometric model with in depth mathematical formulas. However, the thesis can be a starting proposition to an upgraded thesis with the knowledge that I will be obtaining from my PhD studies in where I could turn this thesis in to a PhD dissertation and thus using this thesis as an ignition point can conduct a more qualified research.

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7.APPENDIX

THE DATA COVERED

Year	Industrial Sector	FDI	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10	X11
2003													
	Manufacturing of Food and Beverages	249	71,85	135,9	74,4	100	100	112,6					
	Textiles	8	79,75	125,6	82,9	100	100	104,4					
	Chemicals and Chemical Products	9	79,1	140,4	90,8	100	100	120,5					
	Electrical Machinery and Equipment	17	N/A	111,6	74,5	100	100	N/A					
	Manufacturing of motor vehicles,trailers and semi-trailers	145	63,78	91,4	101,4	100	100	N/A	1,485	30	32	100	5,8
2004													
	Manufacturing of Food and Beverages	78	71,35	134	73,4	104,5	104,5	112,1					
	Textiles	9	81,33	132,2	78,2	106,3	111	102,9					
	Chemicals and Chemical Products	38	80,69	150,1	90,6	117	119,8	139,9					
	Electrical Machinery and Equipment	6	N/A	101,1	77,5	111,3	150,7	82,6					
	Manufacturing of motor vehicles,trailers and semi-trailers	27	78,96	124,7	119,2	146,5	170,3	182,6	1,422	30	21	108,6	9
2005													
	Manufacturing of Food and Beverages	68	70,95	133,7	76,3	121,3	123,5	42,5					
	Textiles	180	80,81	129,1	73,8	110,6	113,4	1,4					
	Chemicals and Chemical Products	174	75,09	154,4	90,3	122,4	131,9	78,3					
	Electrical Machinery and Equipment	13	N/A	125,7	79,7	124	216	67,8					
	Manufacturing of motor vehicles,trailers and semi-trailers	106	83,57	127,6	143	166,3	180,8	0	1,341	30	14,9	117,48	7,4
2006													
	Manufacturing of Food and Beverages	608	71,17	147,2	75	126,8	141,1	126,1					
	Textiles	26	80,45	123,9	68,4	116,3	117,5	89,8					
	Chemicals and Chemical Products	601	76,86	172,6	90,7	144,8	144,8	168					
	Electrical Machinery and Equipment	54	N/A	116,7	80	147,7	268	116,6					
	Manufacturing of motor vehicles,trailers and semi-trailers	63	85,35	132,9	151	196,5	183	219,5	1,4294	20	15,5	128,76	6,1
2007													
	Manufacturing of Food and Beverages	760	72,77	N/A	80,7	139,6	132,3	129,09					
	Textiles	233	81,475	N/A	69,1	123,1	142,9	91,81					
	Chemicals and Chemical Products	1101	77,12	N/A	86,7	154,8	162,3	173,2					
	Electrical Machinery and Equipment	47	82,87	N/A	90	188,9	319,3	144,65					
	Manufacturing of motor vehicles,trailers and semi-trailers	65	88,041	N/A	159,5	205,17	193,5	242	1,3018	20	16,5	140,03	4,5
2008													
	Manufacturing of Food and Beverages	N/A	71,68	N/A	81,9	118,3	148,98	127,97					
	Textiles	N/A	76,34	N/A	65,9	119,08	135,11	78,27					
	Chemicals and Chemical Products	N/A	77	N/A	87,1	169,72	169,96	174,52					
	Electrical Machinery and Equipment	N/A	82,93	N/A	105,1	234,4	363,63	160,32					
	Manufacturing of motor vehicles,trailers and semi-trailers	N/A	82,6	N/A	180,8	287,87	201,55	299,3	1,257	20	16	152,73	6,6***

FDI FDI volume in millions of $
X1 Usage of Capacity index (1997=100)
X2 Productivity per hour worked index (1997=100)
X3 Employment in the specified sector index (1997=100)
X4 Volume of the exports in the specified sector index(2003=100)
X5 Volume of the imports in the specified sector index(2003=100)
X6 Annual Production Index (2003=100)
X7 Exchange rates (montly average-USD)
X8 Corporate taxes (%)
X9 Interest Rates (% yearly average)
X10 Consumer Price Index (2003=100)
X11 GDP Growth Rates (% based on 1987 prices)

THE SPSS OUTPUT

```
REGRESSION
  /MISSING LISTWISE
  /STATISTICS COEFF OUTS R ANOVA
  /CRITERIA=PIN(.05) POUT(.10)
  /NOORIGIN
  /DEPENDENT FDI
  /METHOD=STEPWISE X1 X2 X3 X4 X5 X6 X7 X8 X9 X10 X11.
```

Regression

Notes

Output Created		17-Kas-2008 17:28:00
Comments		
Input	Data	C:\Users \Desktop\Saygın.sav
	Active Dataset	DataSet0
	Filter	<none>
	Weight	<none>
	Split File	Sector
	N of Rows in Working Data File	30
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax		REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT FDI /METHOD=STEPWISE X1 X2 X3 X4 X5 X6 X7 X8 X9 X10 X11.
Resources	Processor Time	00:00:00,031
	Elapsed Time	00:00:00,032
	Memory Required	6268 bytes
	Additional Memory Required for Residual Plots	0 bytes

[DataSet0] C:\Users\Beril\Desktop\Saygın.sav

Warnings

The file is not sorted in a consistent manner on the split file variables. It is likely that any procedure output will be incorrect.
There are no valid cases in split file Sector=4 for models with dependent variable FDI. Statistics cannot be computed.
No valid cases found in split file Sector=4. Equation-building skipped.
There are no valid cases in split file Sector=5. for models with dependent variable FDI. Statistics cannot be computed.
No valid cases found in split file Sector=5.. Equation-building skipped.

Sector = 1

Variables Entered/Removed[a,b]

Model	Variables Entered	Variables Removed	Method
1	X2	.	Stepwise (Criteria: Probability-of-F-to-enter <= ,050, Probability-of-F-to-remove >= ,100).

a. Sector = 1

b. Dependent Variable: FDI

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate

1	,983[a]	,967	,950	56,45761

a. Predictors: (Constant), X2

b. Sector = 1

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	184495,826	1	184495,826	57,882	,017[a]
	Residual	6374,924	2	3187,462		
	Total	190870,750	3			

a. Predictors: (Constant), X2

b. Sector = 1

c. Dependent Variable: FDI

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5078,390	701,033		-7,244	,019
	X2	38,701	5,087	,983	7,608	,017

a. Sector = 1

b. Dependent Variable: FDI

Excluded Variables[b,c]

Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
						Tolerance
1	X1	,165[a]	2,009	,294	,895	,981
	X3	-,033[a]	-,181	,886	-,178	,994
	X4	-,166[a]	-1,023	,493	-,715	,622
	X5	-,211[a]	-1,079	,476	-,733	,405
	X6	,094[a]	,470	,720	,425	,680

	X7	,157[a]	1,540	,367	,839	,953
	X8	1,191[a]	7,154	,088	,990	,023
	X9	,180[a]	2,671	,228	,937	,902
	X10	-,235[a]	-1,930	,304	-,888	,475
	X11	-,185[a]	-1,575	,360	-,844	,699

a. Predictors in the Model: (Constant), X2

b. Sector = 1

c. Dependent Variable: FDI

Sector = 2

Variables Entered/Removed[a,b]

Model	Variables Entered	Variables Removed	Method
1	X6	.	Stepwise (Criteria: Probability-of-F-to-enter <= ,050, Probability-of-F-to-remove >= ,100).

a. Sector = 2

b. Dependent Variable: FDI

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,999[a]	,999	,998	3,51869

a. Predictors: (Constant), X6

b. Sector = 2

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20763,988	1	20763,988	1,677E3	,001[a]
	Residual	24,762	2	12,381		
	Total	20788,750	3			

a. Predictors: (Constant), X6

b. Sector = 2

c. Dependent Variable: FDI

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	181,796	3,545		51,279	,000
	X6	-1,689	,041	-,999	-40,952	,001

a. Sector = 2

b. Dependent Variable: FDI

Excluded Variables[b,c]

Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
						Tolerance
1	X1	-,004[a]	-,124	,921	-,123	,948
	X2	,017[a]	,575	,668	,498	,970
	X3	,037[a]	8,906	,071	,994	,883
	X4	-,036[a]	-5,353	,118	-,983	,881
	X5	-,033[a]	-1,944	,302	-,889	,866
	X7	,031[a]	,468	,721	,424	,223
	X8	,034[a]	4,534	,138	,977	,958
	X9	,037[a]	1,647	,347	,855	,652
	X10	-,036[a]	-12,074	,053	-,997	,891
	X11	,008[a]	,238	,851	,232	,989

a. Predictors in the Model: (Constant), X6

b. Sector = 2

c. Dependent Variable: FDI

Sector = 3

Variables Entered/Removed[a,b]

Model	Variables Entered	Variables Removed	Method
1	X2	.	Stepwise (Criteria: Probability-of-F-to-enter <= ,050, Probability-of-F-to-remove >= ,100).

a. Sector = 3

b. Dependent Variable: FDI

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,965[a]	,931	,896	87,99952

a. Predictors: (Constant), X2

b. Sector = 3

ANOVA[b,c]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	208593,170	1	208593,170	26,936	,035[a]
	Residual	15487,830	2	7743,915		
	Total	224081,000	3			

a. Predictors: (Constant), X2

b. Sector = 3

c. Dependent Variable: FDI

Coefficients[a,b]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2812,638	583,188		-4,823	,040
	X2	19,551	3,767	,965	5,190	,035

a. Sector = 3

b. Dependent Variable: FDI

Excluded Variables[b,c]

Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
						Tolerance
1	X1	-,060[a]	-,204	,872	-,199	,771
	X3	,165[a]	,798	,571	,624	,987
	X4	-2,599[a]	-4,996	,126	-,981	,010
	X5	-,615[a]	-1,056	,483	-,726	,097
	X6	,052[a]	,182	,885	,179	,812
	X7	,186[a]	,891	,537	,665	,879
	X8	-,507[a]	-1,533	,368	-,838	,188
	X9	,341[a]	1,291	,419	,791	,372
	X10	-,370[a]	-,298	,816	-,286	,041
	X11	-,262[a]	-6,587	,096	-,989	,981

a. Predictors in the Model: (Constant), X2

b. Sector = 3

c. Dependent Variable: FDI