Chapter 11
The Determinants of Foreign Direct Investment Outflows from Turkey

Raif Cergibozan
Kırklareli University, Turkey

Caner Demir
Kırklareli University, Turkey

ABSTRACT

The aim of this study is to specify the determinants of the outward Foreign Direct Investment (FDI) flows from Turkey. For this purpose, the ARDL Bounds Test is used in order to observe the possible relation between these flows and define potential factors that might have an effect on them. The evidences of the empirical analysis reveal that the destination countries' market size, the home country's development level, trade openness and wage rate are positively related to outward FDI while the home country's interest rate shows a negative relationship. Turkey's outward FDI is significantly determined by the opportunities of the foreign markets as well as the outstanding home country factors.

INTRODUCTION

Foreign direct investment (FDI) flows have made an important impact on the globalization process. Since 1980's, the volume of FDI inflows has shown a substantial increase especially in developing countries. Even though the impact of FDI inflows on developing economies is still discussed by various perspectives in the literature, main findings state that it is hard to ignore the long run benefits of these types of investments for many developing countries. Nowadays, many firms or investors from developing countries seek to invest in abroad. This type of investment, which is termed the outward foreign direct investment (OFDI), reveals that the investors from developing world intend to compete in foreign countries. However, economic development performance of countries is not the only motivation for firms and investors to make a decision on investing abroad. There might be some other factors determining the outward foreign

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direct investment flows. From this point of view, the analysis of this chapter attempts to investigate the determinants of the FDI outflows from an important emerging market and developing country; Turkey.

Since the foundation of the Republic of Turkey in 1923, Turkish Economy has passed through several policy periods. During the first decade of the republic, the government had promoted the private sector and also established some public enterprises to provide the necessary inputs for the private sector. Despite these public interventions, until the great depression the main objective of the Turkish economic policies was forming an open economy model that advanced the country to an industrialized stage. As from the 1930's, the Turkish Economy had been considerably affected by the great depression. Moreover, the incentives given in the previous decade did not serve the purpose of the open economy. In order to change the course of economic developments, the government applied state-oriented economic policies and changed its exchange rate regime to the fixed system. In 1930s, the Central Bank of the Republic of Turkey was also established. In the late 1940's and 1950's Turkey shifted to liberal economic policies. In 1947, Turkey became a member of the International Monetary Fund (IMF) and World Bank. Also some foreign economic supports, such as under the Marshall Plan, were received to help rebuild the development process. Likewise in 1950's, foreign capitals were encouraged to come to Turkey for the purpose of contributing to the development process of the country. Besides, the means of credit were expanded and credit volume was increased particularly with the infrastructural investments. However, the inflation problem that showed itself later left behind the initial benefits. As a result, the paradigm of the Turkish economic policy was again changed to the planning mentality. Between 1960 and 1980, Turkey had been aiming to limit the volume of import and raise the exports. The oil shock in the mid 1970's influenced Turkish economy in a unfavorable way and the high prices in energy damaged the industrialization process. During the 1970's the country also faced with some internal and external political issues. Even if the economic administration had tried to overcome the emergent economic issues, their efforts could not succeed. In the beginning of 1980's, the economy was upgraded to a new stage which might be called as a transition stage to a free market economy. In 1980's the main economic policies were as followings; encouraging foreign investment inflows, limiting the public interventions and ensuring the economic stability (Boratav, 2009; Eğilmez and Kumcu, 2015).

The financial liberalization process of the Turkish Economy in the late 1980's was accompanied by the commercial deregulation process; and thus the free movement of both goods and capital became possible. Since then, the great deal of foreign direct investment has been flowing into Turkey and making the economy more integrated with the world. The obvious effects of this transformation have been being observed since the early 1990's. In the same time, the outward FDI flows have shown significant increase. To be able to investigate these investment developments, econometric time series analysis methods on the outward FDI flows from the Turkish Economy are used over the period 1992-2015.

In 2015, the volume of the outward foreign direct investment flows from Turkey was worth about USD 5.3 billion. Figure 1 provides information about the destinations of these investments for the period of 2005-2015. 54% of these flows go only towards three countries; Netherlands, Azerbaijan and USA. Of the total outward FDI from Turkey, Germany, U.K., Malta, Luxemburg and Russia receive 6%, 5%, 4%, 3% and 3%, respectively. Thanks to its largely liberal economic structure and conveniences for foreign investors, Netherlands is one of the most attractive countries for the global FDI flows. Like many other investors around the world, Turkish investors also mostly invest in Netherlands. Due to the fact that both countries have a long historical and cultural relationship, Azerbaijan is the second biggest destination