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THE RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT AND FOREIGN TRADE IN TURKEY

TÜRKİYE'DE DOĞRUDAN YABANCI YATIRIMLAR VE DIŞ TİCARET ARASINDAKİ İLİŞKİ

Erdoğan KOTİL[*]

[*] Dr. Öğr. Üyesi, Bolu Abant İzzet Baysal Üniversitesi, İktisadi ve İdari Bilimler Fakültesi, İktisat Bölümü, kotil_e@ibu.edu.tr

ABSTRACT

The relation between foreign direct investments, exports and imports have been reviewed in this article for the period 2003-2019. This is a period in Turkey during which freeness has gradually increased in foreign trade and legal arrangements have been made for FDI's. The vector autoregressive model has been estimated during the research and action reaction and variance functions obtained. The results reached have demonstrated the existence of a close relationship between exports and imports. Contrary to the anticipated, an important impact of foreign direct investment on exports and imports has not been detected. The positive impacts on each other for the shocks aimed at exports and imports have been found.

Keywords: *Foreign Direct Investment, Import, Export, VAR Model.*

Jel Codes: *F10, F19, A10.*

ÖZ

Bu makalede 2003-2019 dönemi için doğrudan yabancı yatırımlar, ihracat ve ithalat arasındaki ilişki gözden geçirilmiştir. Bu dönem Türkiye'de dış ticarette serbestliğin giderek arttığı ve doğrudan yabancı yatırımlar için yasal düzenlemelerin yapıldığı bir dönemdir. Bu çalışmada vektör otoregresif model kullanılılarak etki-tepki ve varyans fonksiyonları tahmin edilmiştir. Ulaşılan sonuçlar, ihracat ve ithalat arasında yakın bir ilişkinin varlığını göstermiştir. Doğrudan yabancı yatırımların öngörülenin aksine ihracat ve ithalat üzerinde önemli bir etkisi tespit edilmemiştir. İhracata ve ithalata yönelik şokların birbirleri üzerinde olumlu etkileri bulunmuştur.

Anahtar Kelimeler: *Doğrudan Yabancı Yatırımlar, İthalat, İhracat, VAR Modeli.*

Jel Kodları: *F10, F19, A10.*

1. INTRODUCTION

It is observed that foreign capital investments increased in the world after the Second World War. Foreign direct investments (FDI) are a special form of capital flow between countries. Foreign capital investments can be defined as the firms establishing or purchasing production facilities in countries outside the central country. This form of investment is made by multinational companies. Short-term capital inflow into the country creates various problems. Reasons such as volatility in exchange rates, risk increase in economy and political fluctuations causes short term capital to leave the country rapidly. This situation prefers foreign capital investments to short-term capital inflow especially for developing countries. In addition, the

positive effects of the parent company such as technology, management knowledge and trade title increase this preference.

Turkey has implemented economic policies of import substitution until 1980.As a result of these policies, protectionist policies were followed in foreign trade. Especially customs taxes, import quotas and prohibitions, multiple exchange rates and foreign exchange control were used intensively. Consequently Turkey has opened its domestic market to foreign expansion by quickly removing import and export barriers. In the decade before and after 1980, the foreign trade volume / gdp ratio increased from 8% to 23%, respectively.

In 2003, foreign direct investment law was enacted in Turkey. Under this law the equal treatment of foreign investors as domestic investors has been guaranteed. Also the transfer of foreign net profit, dividends, sales prices, license payments, foreign loans and interest payments abroad resulting from the activities of foreigners has been authorized.

In the period between 2003-2019 in Turkey, exports, imports and foreign investment respectively, increased by 251%, 203% and 706% over the same period GDP increased by 138%.

The purpose of this article is to determine the causality aspects of the variables of export, import and foreign capital investments, the interaction mechanism of which can be explained, and how they affect each other. The reason for the start period to be 2003 is as follows. The reasons for which the year 2003 has been taken as the starting period are the introduction of the floating exchange rate regime in Turkey, the removal of foreign investment laws and the long-term executives of economic policies being the same.

A three-variable VAR model will be used to test the interaction between variables and to find their effects.

2. THEORETICAL FRAMEWORK

The first theoretical investigation to explain the causes of foreign trade between countries can be based on A. Smith's absolute advantage theory. This model could not explain the participation of a nation to foreign trade despite its absolute advantage in all goods. This problem was overcome by Ricardo's comparative advantage model, which takes into account the cost differences for the country. What both models have in common is that they have investigated the trade of goods between countries. These theories do not investigate capital movements among countries. While the classical theory assumed that labor remained immobile (inactive) between countries, it did not provide explanations for the international movement of capital (Morgan and Katsikeas 1997). Similarly, the Hesckher-Ohlin factor equipment theory tries to explain the reasons for the composition of goods in foreign trade. The study of foreign capital investments in the theory of international economics can be based on Vernon's theory of product cycle. The product cycle theory, developed by Vernon in 1966, was used to explain the US investments in other countries after the Second World War (Vintila 2010).

According to the theory, the production cycle of a product consists of three stages. Respectively, the new product, the maturing product and the standardized product. At the end of the cycle, the product is either produced by firms in less developed countries or the innovative firm turns into a multinational firm, setting up facilities abroad for production and producing the product. Some of the US investments in Europe after the Second World War are explained by this theory.

There are many studies showing that FDIs have a positive impact on the host country's exports. The reason for these investments can be attributed to the following factors. FDIs can increase the local capital required for exports, affect exports with technology transfer, facilitate exports to new and large foreign markets, and can positively affect

exports by training for the development and management of the workforce (Zhang 2005). In addition, host countries, which have difficulties in export due to high fixed costs such as informing customers in some sectors or meeting the standards in the importing country, can overcome this with FDI (Gourdon 2010). If FDIs make use of export distribution networks and provide information to enter foreign markets, they can positively affect the export of domestic companies (Markusen and Venables 1999). FDI companies have larger capital. Since these companies have the ability to borrow from international markets, they can expand their production activities. By making use of economies of scale that will result from these, they cause an increase in the export of the host country (Mukhtarov 2019). If local firms provide input to FDI producing goods for export, both domestic added value and exports increase. If the inputs are provided through imports, there will be an increase in exports and imports (Kastrati 2013).

It is important that these investments affect imports positively or negatively in evaluating the costs and benefits of FDI. FDIs can increase imports in two different ways. First, machinery and equipment imports required during the investment phase, and secondly, intermediate goods and raw materials imports during the production phase. The volume of imports in the host country indicates the presence of a market for that property in that country. This encourages multinational companies to enter the host country (Lopez 2005). Depending on the type of product, the FDI may affect imports either positively or negatively. If the product produced by FDI is complementary to other imported products, it affects imports positively. However, FDI will affect imports negatively in imported substitution industries (Hailu 2010). If FDIs lead to domestic production of imported goods, as in the last stage of the product cycle theory, the impact of FDI on imports will be negative. If the investment purpose of FDI is due to factor productivity and wage differences between countries, FDI will cause an increase in intermediate goods and input imports (Alguacil and Orts 2003).

The increase in FDI may require more import of basic intermediate goods and capital goods for production. However, a higher increase in imported consumer goods may also have a negative impact on the import substitute industry with foreign capital, therefore FDI may decrease. So there may be causality between FDI and import (Berasaluce and Romero 2015)

The relationship between exports and imports is a bit more complicated. While export provides the necessary foreign currency for imported goods, new goods produced with the input and technologies obtained through import can be exported. In cases where exports are dependent on imports, imports will affect exports in an increasing manner. Imports of intermediate goods, capital goods and advanced technologies can increase the capacity of domestic resources and production, causing more exports (Albiman and Suleiman 2016). More exports can be made by providing high quality intermediate goods through import (Bas 2009).

3. LITERATURE REVIEW

3.1. FDI-Export Relationship

Jongwanich (2010); analyzed the determinants of exports in the economy of eight east and southeast Asia using 1993-2008 data. With Cointegration analysis, they found that FDI in these countries had a positive relationship with exports. His work covers the period of 1996-2013. In their studies using Least Square Dummy Variable regression method, they found that FDIs had positive effects on country exports. Tapsin (2016); investigated, the causal relationship between FDI, exports and economic growth using 1974-2011 data in Turkey. Using the causality test, Todo and Yamamoto found a causality relationship from FDI to export.

Perşembe (2010); has detected relationship between FDI and exports within the study he has performed by using the Turkish monthly data for the years 1998-2008 and has shown

the positive impact of the FDI increase on exports. Fernandez and Fernandez (2018); Using data from the 1970-2016 period, FDI investigated the causal relationship between exports and economic growth. As a result of the Granger causality test, a one-way causality was found form FDI to export. Klasra (2009), has found bidirectional casuality in the short term in Turkey by using the autoregressive distributed lags model conducted with the 1975-2004 Pakistan and Turkey data. Eryigit (2012); has detected a long-term relationship between FDI and export volume by cointegration test results through panel data analysis using 2000-2010 data for Turkey. Bozdağlıoğlu and Özpınar (2011); In their study performed through the Granger casuality test by using monthly data from 1992-2009, have found one-way causality from FDI to export.

3.2. FDI-Import Relationship

Altıntaş and Türker (2014); They have investigated the determinants of foreign trade during the period 1987-2011 in Turkey. As a result of cointegration analysis and Granger causality test, they have found causality for import from FDI. Pata and Terzi (2016); through usage of 1983-2014 data have detected unidirectional casuality with the import of goods in their casuality tests for Turkey to import goods and services from FDI. Karimov (2019); has examined the relationship between the FDI and foreign trade for the 1974 and 2017 period. In the study, Granger found one-way causality from export and import to FDI in causality test. Tabassum et al. (2012); They examined the effect of FDI on export performance in Pakistan. In the cointegration analysis and Granger test results they attained using the 1973-2009 data, they found a one-way relationship between FDIs and imports. They stated that FDI entries increased imports in Pakistan and that there was a positive relationship between them. Hailu (2010); He examined the FDI and foreign trade balance in African countries. He used Least Square Variable regression method in his study. In the analysis made with the data of 1980-2007, a positive relationship was found between FDI and imports. Alguacil and Orts (2003); They investigated the relationship between FDI and import in Spain. Using the 1970-1992 data, they found that FDIs increased imports as a result of the Granger causality test with the VAR model. Rahman and Shahbaz (2013); They investigated the effects of imports and FDIs on economic growth in Pakistan between 1990 and 2010. They found that there is a long-term bidirectional relationship between FDIs and imports with the Vector error correction model.

3.3. Export-Import Relationship

Yüksel and Zengin (2016); They investigated the relationship between imports, exports and growth rates in six developing countries. They have found unidirectional causality from exports to imports in Turkey by using the annual data of 1961-2014 with Todo Yamomoto casuality analysis. Gerni et al. (2008); Using 1981-2006 data for Turkey in their study performed through the Granger causality test they have detected a bidirectional casuality between exports and imports. Karabulut (2020); has used the monthly data of 1992-2019 in his studies that investigate the causal relationship between exports and imports in Turkey. He has used Dynamic Ordinary Least Squares and Fully Modified Ordinary Least Squares method. In his research, he found bidirectional causality between export and import. Fan and Nie (2013); They explored the relationship between imports, exports and economic growth in China in the 1979-2007 period. According to the VAR model and Granger causality result, the increase in imports causes change in exports. Saaed and Hussain (2015); Researched the effects of imports and exports on Tunisia's economic growth using 1977-2012 data. As a result of the Granger causality test, one-way causality was found between import and export. Chawala (2019); He analyzed the import-export and growth relationship in South Africa using 1961-2017 data. He found that there was no causality between export and import with Granger causality test.

4. DATA AND METHODOLOGY

Quarterly data of 2003.3-2019.4 period were used in the study. The tree time series are : LEX (Logarithm of merchandise export) ; LIMP (Logarithm of merchandise import) and LFDI (Logarihtm of FDI). All data are taken from the Central Bank of the Republic of Turkey Electronic Data Delivery System. The data were used in terms of moving averages. All variables were used in logarithmic form in ampirical estimates. In the empirical analysis, the following operations were carried out respectively. First of all, stationarity properties of the series were investigated. Then the VAR model was estimated by finding the appropriate delay length. In the predicted model, LM test, white test and var residual normality test were performed respectively for autocorrelation, changing variance and normality assumption. Variance decomposition and effect response functions were found for the direction of the relationship between variables.

5. EMPRICAL RESULTS DISCUSSION

Results obtained by performing Augmented Dickey-Fuller unit root test are shown in table 1.

Table 1: Augmented Dickey-Fuller Unit Root Test

Variable	t-Statistic	Results
DLEX	-3,066**	I (1)
LIMP	-2,938**	I (0)
LFDI	-5,823*	I (0)

* and ** denote %1, %5 significance respectively.

While LEX became stationary in the first difference, LIMP and LFDI were stationary. Not being stationary at the same level prevented cointegration research. In this case the vector autoregression model can be used for Turkey for testing the direction of casuality between EX and IMP. In this respect, a three-variable.

VAR (Vector Autoregressive) model is used as in equation 1. $FDI_t = \alpha_{10} + \sum_{i=1}^{p} \alpha_{11i}\, FDI_{t-i} + \sum_{i=1}^{p} \alpha_{12i}\, EX_{t-i} + \sum_{i=1}^{p} \alpha_{13i}\, IMP_{t-i} + u_{1t}$

$$EX_t = \alpha_{20} + \sum_{i=1}^{p} \alpha_{21i}\, FDI_{t-i} + \sum_{i=1}^{p} \alpha_{22i}\, EX_{t-i} + \sum_{i=1}^{p} \alpha_{23i}\, IMP_{t-i} + u_{2t}$$

$$IMP_t = \alpha_{30} + \sum_{i=1}^{p} \alpha_{31i}\, FDI_{t-i} + \sum_{i=1}^{p} \alpha_{32i}\, EX_{t-i} + \sum_{i=1}^{p} \alpha_{33i}\, IMP_{t-i} + u_{3t}$$

P denotes lag length. Model can be written as below in Matrix form.

$$\begin{bmatrix} FDI_t \\ EX_t \\ IMP_t \end{bmatrix} = \begin{bmatrix} \alpha_{10} \\ \alpha_{20} \\ \alpha_{30} \end{bmatrix} + \sum_{i=1}^{p} \begin{bmatrix} \alpha_{11i} & \alpha_{12i} & \alpha_{13i} \\ \alpha_{21i} & \alpha_{22i} & \alpha_{23i} \\ \alpha_{31i} & \alpha_{32i} & \alpha_{33i} \end{bmatrix} \begin{bmatrix} FDI_{t-1} \\ EX_{t-1} \\ IMP_{t-1} \end{bmatrix} + \begin{bmatrix} u_{1t} \\ u_{2t} \\ u_{3t} \end{bmatrix}$$

The VAR model is a multi-dimensional time series model. In the VAR model, all variables included in the model are defined by their own and other variables with lagged values. When the VAR is estimated, impact response functions and variance decomposition functions can be found. With the effect response function, the change in one variable and its effects which will be found occur during the periods over the other. With variance decomposition, how much of the change in a variable is from itself and how much of it is from other variables will be shown.

The appropriate delay length for the VAR model was found to be 2 and the model in equation 1 was estimated. Appropriate

results were obtained from the LM test, white test and var residual normality tests for estimation.

Variance decomposition results are shown in table 2. Accordingly, there is no effect of EX and IMP on the change in FDI in the short term. The effect of IMP on change in FDI is more important than EX. Similarly, the impact of FDI and IMP on exports in the short term is negligible. Imports are more important than FDI in the change of exports. When table 2 is examined, 54% of the variance in the IMP in the first period is due to EX. The effect of FDI on the change of imports is insignificant. These results suggest that there is a strong causality between exports and imports in Turkey, especially that the contribution of exports is high on the change in imports. This supports the thesis of export dependence on imports. The low correlation between the FDI's and import/export shows that the FDI's in Turkey do more production for the domestic market and also that the intermediate goods used in production are provided from the local market.

Table 2: Variance Decomposition Results

Variance Decomposition of LFDI:

Period	S.E.	LFDI	DLEX	LIMP
1	0.210646	100.0000	0.000000	0.000000
2	0.316610	99.36900	0.055238	0.575758
3	0.407413	97.31642	0.283964	2.399618
4	0.474680	94.79217	0.211798	4.996036
5	0.525376	92.07160	0.297526	7.630873
6	0.561992	89.82362	0.659263	9.517117
7	0.586413	88.57225	0.959378	10.46837
8	0.601228	88.24540	1.080401	10.67420
9	0.609703	88.41310	1.060748	10.52616
10	0.614966	88.57605	1.077168	10.34678

Variance Decomposition of DLEX:

Period	S.E.	LFDI	DLEX	LIMP
1	0.022156	0.198041	99.80196	0.000000
2	0.027461	0.866477	97.95880	1.174720
3	0.031309	1.785002	96.29514	1.919859
4	0.031846	2.753988	94.97079	2.275218
5	0.031988	3.403548	94.29242	2.304031
6	0.032843	3.481566	93.36360	3.154833
7	0.034062	3.286164	91.73894	4.974897
8	0.035094	3.096244	90.18488	6.718874
9	0.035579	3.020066	89.18223	7.797704
10	0.035701	3.014494	88.79291	8.192591

Variance Decomposition of LIMP:

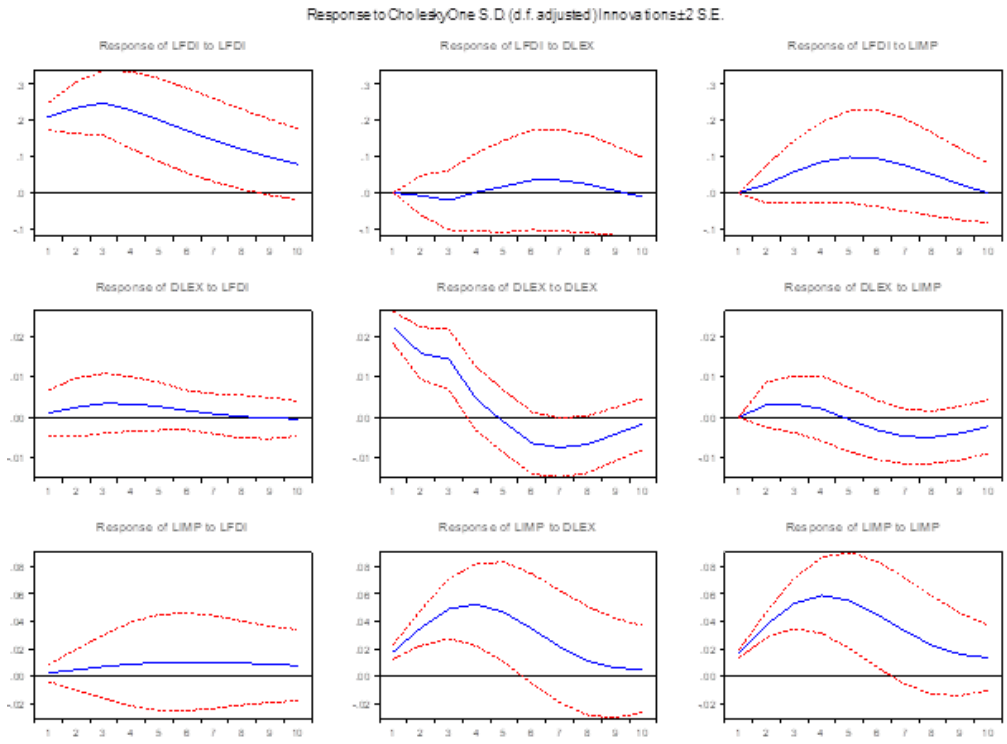
Period	S.E.	LFDI	DLEX	LIMP
1	0.024409	0.981465	54.57811	44.44042
2	0.057163	0.844018	48.36400	50.79199
3	0.092447	0.897640	46.80290	52.29946
4	0.121804	1.044581	45.38580	53.56962
5	0.141932	1.271278	44.16468	54.56404
6	0.153207	1.559988	42.98235	55.45766
7	0.158491	1.877228	42.01237	56.11040

8	0.160750	2.180282	41.33023	56.48948
9	0.161876	2.440825	40.88888	56.67029
10	0.162718	2.653333	40.57067	56.77599

Cholesky Ordering: LFDI DLEX LIMP

Impulse response functions can be used to see the duration and direction of change. The impact response functions are shown in graph 1. When the tables are analyzed, it is seen that the reaction of exports and imports to a shock in FDI is insignificant but positive, while the reaction of imports to a unit shock in exports is positive and lasting for a long time, one unit shock for imports affects FDI positively and its positive effect in exports lasts 5 periods.

Graph 1: Impulse-Response Graphs.



6. CONCLUSION

Explanation of foreign direct investment in the international economic theory is based on Vernon's theory of product periods. It is observed that foreign direct investment has increased rapidly through multinational companies after the Second World War. The impact of foreign capital direct investment on the foreign trade of countries is a subject of interest. This question needs to be answered for the case of Turkey. The direct foreign capital investment, the existence of the relation and direction between exports and imports has been researched directly in this study. The direct capital investment effects on exports had been connected to such factors as capital increase, technology transfer, information concerning the entry to foreign markets. The low but long term positive impact of the FDI's in Turkey on exports does not create a contradiction. The low impact of FDI's on exports can be explained by the sectors in which FDI's enter. Direct investments in Turkey in the last decade are more concentrated in the services sector. Investments in the service sector are approximately three times higher

than the manufacturing industry. Especially the banking and finance sector has become a center of attraction for foreign direct investments. Since these sectors do not have export links, it is understandable that there is no strong causality from FDI's to exports.

The results attained for FDI and import relations may be explained by looking for connection with multinational companies and providing raw materials through the internal market. It was found that there is a mutual interaction between export and import and the direction is positive. This situation supports the view of export dependence on imports. The results show that imports reacted positively in the short term despite a shock in exports.

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