Chapter 20
Causal Relationship between Foreign Direct Investment and Economic Growth: Evidence from Turkey

Hasan Bakır
Uludağ University, Turkey
Filiz Eryılmaz
Uludağ University, Turkey

ABSTRACT
In this chapter, the authors investigate the causality relationship between the inflows of foreign direct investment (FDI) and economic growth as measured by Real Gross Domestic Product (GDP) per capita in Turkey during the period 1974-2012 by using the Granger causality tests. The causality test indicates that economic growth Granger-causes FDI. This means that there is bidirectional causality from Real GDP to FDI in Turkey. So the author results support “the growth – driven FDI hypothesis”. This demonstrates that in the related time in Turkey, more direct foreign investment entered the economy together with an increase in economic growth.

INTRODUCTION
Most economists, politicians and international financial institutions assert that foreign direct investment (FDI) is a keystone in solving economic problems of emerging market economies (Mencinger, 2003: 491). Foreign direct investment can be thought as a factor which can be improve countries’ economies and which it can find a solution to economic problems in developing countries. Economic growth is accreted by capital formation and technological development in domestic countries. In this way, governments of domestic countries use their public funds to attract FDI (Moura & Forte, 2009: 2; Agrawal & Khan, 2011: 71). After 1980s, most developing economies reduced restriction on crucial areas such as trade and finance. By doing that, foreign direct
investment easily comes into domestic economy, which can be defined as an inflow. Money inflows to developing economies increased in 1990s and FDI becomes 60 percent of private capital flows in 2000s (Carkovic & Levine 2002: 1).

Although the effect of FDI on economic growth is studied, it has not been created a consensus yet. Some theorists predict that FDI may boost economic growth via technological transfer and business know-how to poorer countries and this process ensure spillover effects for the economy. On the other hand, some theorists do not agree with this view (Aitken & Harrison (1999), Hadad & Aitken (1993), and Mencinger (2003)) and some theorists think that FDI flow affects growth under certain policy conditions (Borensztein et al., (1998), Blomstrom et al., (1994), Alfaro et al., (2004), Moura and Forte (2009)) (Cakovic & Levinie, 2002:1-2; Antwi et al., 2013). For instance, countries with better developed financial markets will attract for FDI (Soumare & Tchana, 2011: 6). Therefore, the theory related to economic development and FDI is ambiguous.

The positive effect of FDI on economic growth is expected through accumulation of capital and knowledge in domestic country and these factors increase total factor productivity. Transfer of new technologies and know-how, qualified human resources, integration in global markets are required for economic growth in domestic country (Moura & Forte, 2009: 3-4). In literature this views seen as a “FDI led growth hypothesis”. According to this view FDI may enhance the factors such as human capital, technology and investments which are playing an important role in promoting economic development.

As endogenous model suggest that FDI enhance economic growth by diffusing technology from developed countries to developing countries, on the other hand FDI is an important source for domestic investments by providing capital. Therefore, it can be said that FDI fill in the gap of technology and capital stock (Ilgun et al., 2010). FDI helps developing countries to import the necessary technology from abroad. The transfer of technology to firm, including transfer of general knowledge, specific technologies in production and work experience for the labor force, would be difficult, risky and expensive without it. Many externalities coming from FDI make a great contribution to domestic country’s economy and affect its competitiveness by raising productivity (Antwi et al., 2013: 18-19).

Domestic firms may benefit from this information and transfers and they can change their production method. Besides, this situation cause labor turnover as employees moving from foreign firms to domestic firms with their human capital so FDI helps countries modernize the national economy and promote economic growth. However, foreign firms may reduce productivity of domestic firms by drawing demand from local firms through their lower cost in the sort run. This negative effect causes domestic firms cut production (Alfaro et al. 2004: 90; Aitken et al. 1999: 605-607). In addition to this, FDI affect labor force negatively as advanced technology provided by multinational companies leads to decrease employment level in the local area and unemployment problem is revealed (Moura & Forte, 2010:6). Most developing countries do not have enough capital. Generally, they have to face the problem such as investment and saving gap. This is the reason why developing countries want to attract FDI. By attracting FDI, these gaps might decrease or eliminate (Younus et al., 2014: 2). Most empirical studies on the role of FDI in host countries reveal that FDI provide capital complement to domestic investment create new job opportunities and increase technology transfer. On the other hand firm-level studies do not support this idea (Chowdhury & Mavrotas, 2006: 9). FDI provides capital to developing countries. Therefore, most developing countries enhance their productivity and development level by easing restrictions on foreign direct investment for domestic countries. Foreign direct investment has increased after financial and policy transforma-