DO CAPİTAL INFLOWS PROVİDE ECONOMİC GROWTH: A CASE OF TURKEY BETWEEN 1984-2007

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Abstract:

One result of the revolution on "Information Communication Technologies" (ICT) is globalization and mobility of capital, which includes both advantages and disadvantages. Since 1980's we have been witnessing capital inflows and outflows effecting global economies and emerging markets very deeply. Capital inflows help economies cover saving gaps and provide economic growth, but on the other hand sudden outflows may cause financial crisis with devaluation, high rates of inflation and recession, especially under the fixed exchange rate of currency. Capital flows have played an important role in the currency crisis in emerging countries and regions, such as Mexico, Argentina, Turkey and East Asia. For that reason, some economists consider capital outflows dangerous, besides taking into account that capital inflows would be useful for emerging countries. Many countries set rules to restrict capital outflows, whereas encouraging capital inflows to get enough foreign capital to achieve economic growth and other economic aims. However, the restrictions on capital outflows are not so effective and they also prevent potential capital inflows that may happen after the crisis. When we study economic history of Turkey, we can see many financial crises caused by sudden capital outflows. Such memories can make some economists or policy makers take a position against capital inflows. People who think controls are necessary, believe in doing so they can prevent financial crisis. But this approach ignore the advantages of capital inflows

Our study analyzes if capital inflows were used for productive investments and supported economic growth in Turkey as a capital importing country since 1980s. At first, we studied theoric substructure about the relationship between capital inflows and economic growth performances. The second part of our study is about Turkish economic performance, examining the figures from TUİK statistics. These statistics about Turkish economic variables between 1984 and 2007 are analyzed by using SPSS 15.00 statistical package programme. Analyzing the relation between economic growth and capital flows, we did not forget that capital flows are not the only factor that effects economic growth. According to "Endogeneous Growth Theory", factors such as knowledge, education, human capital and technology may also be effective for sustainable economic growth. Considering positive correlation as a consequence of foreign capital invested in productive areas, we tried to reveal if Turkey achieved this goal.

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Introduction

Economic globalization can take forms such as free international trade or movement of capital beyond borders. In literature we call movement of capital and financial firms across borders as financial globalization. According to standart economic models, financial globalization should create opportunities for less developed countries. These opportunities are financing investment needs of less developed countries. Capital flows that are coming from developed countries can finance investments in less developed or developing countries. But some of the empirical studies have found little growth effects of financial liberalization (Rodrik, 1998; Edwards, 2001). Also Rodrik (1998) has shown that there is no correlation between capital account openness and economic growth. Meanwhile according to Mishkin (2006:5) adaptation to globalization is important for economic performances of countries. Globalizer countries such as South Korea took advantages of globalization and won while non-globalizer countries such as Somalia lost.

The aim of our study is to analyze economic growth performance of Turkey and reveal the contribution of capital inflows to this performance. At first we mentioned previous theoric studies about the relationship between economic growth and capital inflows. Then statistics of Turkish Economy between 1984 and 2007 are analyzed.

1. Capital Flows

Mobility of capital is the result of ICT (Information Community Technologies) Revolution and globalization. Economists and policy makers are discussing reap tangible benefits from financial globalization for less developed or developing markets. Although most scholars agree that economic benefits of globalization can be substantial, there are some different opinions, too (Rodrik, 1998; Edwards, 2001).

First of all, Foreign Direct Investments (FDI) and short term capital flows are different from each other. FDI measures foreign ownership of productive assets such as lands, factories, mines etc. Empirical studies show that Foreign Direct Investments (FDI) are encouraging economic growth (Alagoz and others, 2008; Borensztein and others, 1998; Gruben ve Mclead, 1998; Zhang, 2001). But countries should have advanced financial markets to get benefits of FDIs (Durham, 2004). Short term capital flows are liquid funds that can easily move towards countries because of the differences between interest rates. Generally it is thought that short term capital flows are less affective than FDI.

We can mention about two different scenes. At the first scene liberalizing capital account would permit financial resources to flow from developed countries, where expected returns are low, to less developed countries where expected returns are high (Henry,2003:91). Generally rapid growth and stable economy increase the likelihood of loan repayment and expectations that portfolio assets yield high rate of return for given risk levels. So rapid growth and positive expectations about the economy attract capital flows (Oliva and Batiz, 2002:260). Political institutions and democracy variable, that encourage capital flows, generally have positive but not significant effects in growth (Tavares and Wacziarg, 2001).

The second scene is pessimistic. If capital comes inside suddenly then it can go out suddenly, too. Sudden capital outflows can be major actors in financial crisis. Current Account Deficits (CAD) can convince investors that devaluation can be occured. So investors, who make their decisions by looking risks and expected revenues, can stop lending and pull their capital out of the country. The reasons of the crises that began with 1990s Mexico and continued in 1997s East Asia are large and growing current account deficit caused by a fixed exchange rate (Feldstein, 2002; Glassman, 2001; Doraisami, 2007). Some specialists, who examine financial crises occured between 1990-2000, think that financial liberalization played an active role in diffussion of financial crises (Özkan, 2007;2005). Stiglitz (2000:1075) mentioned that countries, which have strong controls on capital flows, can continue growing despite of a difficult global economic environment. Governments were forced to reduce the spending that had been financed by foreign credits and to deflate their economy in order to increase net exports. Despite constitutional reforms and preventions incomes in some of the crisis, countries remained below their pre-crisis levels for some time (Feldstein, 2002:3).

The mechanism of capital flows keeps on working because there are two kinds of countries, one of them is capital abundant and other is capital scarce country. Economic theory says that the price of abundant asset is low while the price of scarce asset is high. Therefore liberalization of the capital account would permit capital to flow from capital abundant countries to capital scarce countries. After these flows, capital prices increases in old capital scarce countries while capital prices decreases in old capital abundant countries. As a result, prices will be equal in all countries when we exclude other factors such as risks, democracy, political institutions that effect capital flows (Henry, 2003).

Because of these two scenes, economists have opposite viewpoints to interventions in capital flows. According to Stiglitz (2000:1075) controls on capital flows strengthened economy against financial crisis. Mishkin (2007:547) disagree with Stiglitz because of four reasons. First, private sector can easily find ways of moving funds out of a country. Second, capital

inflows will be stopped after controls are put into place, because of the weak confidence to government. Third, controls generally lead to corruption while domestic residents are trying to move funds outside. Fourth, because of the controls, governments do not think that they have to reform their financial system.

2. Search

2.1 Aim of The Study

The aim of this study is to search if FDIs and portfolio investments provide economic growth in Turkey. Economic growth can be obtained if FDIs and portfolio investments are channelized to real sector or used in fixed capital investments succesfully. Addition to this, it can be seen that FDIs and portfolio investments decreases while economy is shrinking. Because investors know that they can lose money when they invest on a country that is shrinking. To realize this aim we used data from TUİK that are belonging to years between 1984 and 2007.

2.2 Method

We tried to construct a regression model by using TUIK statistics that are given in Table 1. In direct regression models we need dependent and independent variables. Our independent variables are portfolio investments and FDI's, while dependent variable is GDP per capita. FDI's result in foreign management or ownership.

Portfolio investments are the purchase of stocks, bonds, Money market instruments to get financial return. But these purchases do not result in foreign management or ownership and do not provide legal control by foreigners. There is no barrier that prevents movement of them. They can easily come in and outside of the country.

$$Y= a + b.X_1 + c.X_2 + \varepsilon$$

X_1, X_2: independent variables

Y: dependent variable.

We chose GDP per capita at current producer's prices because we want to eliminate population factor. As you can see, portfolio investments before 1986 are just zero. Because of the stable inflation in USA, we use GDP in terms of US Dollar. The starting point of our analysis is 1984 because capital liberalization was started after "24 January decisions" and the effects on capital flows felt after 1984. Exchange trading is liberalized and controls on

Exchange currency market are removed by 24 January decisions (Karluk, 2007:419; Şahin, 2007;195).

Table 1. Turkish Economy Statistics

Year	Portfolio Investments (Million Dollar)	Direct Investments (Million Dollar)	GDP per capita at current producers' prices ($)
1984	0	113	1204
1985	0	99	1330
1986	146	125	1462
1987	282	106	1636
1988	1178	354	1684
1989	1386	663	1959
1990	547	700	2682
1991	623	783	2621
1992	2411	779	2708
1993	3917	622	3004
1994	1158	559	2184
1995	237	772	2759
1996	570	612	2928
1997	1634	554	3079
1998	-6711	573	3255
1999	3429	138	2879
2000	1022	112	2965
2001	-4515	2855	2123
2002	-593	958	2598
2003	2465	1252	3383
2004	8023	2005	4172
2005	13437	8967	5008
2006	7373	19065	5477
2007	717	20089	6511

Source: TUİK (2008:492-493,683)

By using SPSS 15.00 statistical package programme we construct a linear regression model. We found adjusted R square as 0,72. Therefore, the changes in portfolio investments and direct investments define 72 % of the changes in GDPs per capita. In addition, since adjusted R square is more than 70 %, we can say the model is statistically meaningful (Nakip,2006, 146). In our model, the constant is 2316,70; the coefficient for portfolio investments is 0,216 and the coefficient for direct investments is 0,759. In other words, a $ 1 increase in portfolio investments causes an increase of $ 0,216 in GDP per capita, whereas such an increase in direct investments would end with an increase of $ 0,759. Our model can be shown with this statement:

$$Y= 2316,70 + 0,216.PI + 0759.FDI$$

As a result, portfolio investments do not have much effect on economic growth. Financial markets perform the essential economic function of channeling funds from actors who have saved surplus by spending less than their income to those who need funds to spend them. If the funds could be transferred to actors who need them for business and production then we can say that succesful financial markets support economic growth. Weak relationship between portfolio investments and economic growth shows that very little of portfolio investments are transferred into business and financial markets.

Conclusion

Neoclassical theory accepts, when domestic saving are not adequate, foreign savings can be important funds for investments and growth (Yentürk 2003: 131). As a result of financial globaliztion, the aim was to achieve the capital flow to developing countries and to reach the similar levels of yields as the ones of developed countires. But the wish to have short term incomes caused a negative atmosphere for the real investment opportunities. This was also true of Turkey. In the whole world, the financial capital movements started in 1990s, have shown a development somehow far from the real trade. Namely, short term capital movements and so called "hot money" played a big role in Turkish recent economic history.

Capital flows can provide stable economic growth if a country has successful financial markets, democratic and political institutions, suitable investment conditions. Otherwise sudden capital outflows can be a major factor of financial crisis and economic contraction. We searched the effects of capital flows on economic growth of Turkish economy between 1984-2007. 1984 is a milestone in Turkish economy. Because after 24 January Decisions, the capital markets were liberalized to provide long term resources to get economic growth. One could realize the results of this policy after 1984.

We found weak but positive relationship between capital flows and economic growth. As a result, Turkish financial system achieved to channelize these funds to real sector weakly. Also we found that the relationship between FDI and economic growth is stronger than the relationship between portfolio investment and economic growth. Because FDI effects economy directly, but portfolio investments need financial system to effect economy. In other words portfolio investments works indirectly.

Especially considering the financial crises, the shrinking economy, capital loss of firms and government liabilities in Turkey, it is very clear FDI is one of the most important factors for

economic growth. Therefore, to attract more such investments in the future, suitable policies are needed. The structure of Turkish economy should be designed again and the modernization and liberalisation of financial markets would be more profitable for everyone (Alp 2002: 260).

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