

## **Causes and Effects of Foreign Investment Boom in Construction Sector in Turkey**

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### **Abstract**

This paper reviews the causes and effects of direct foreign investment in construction sector in Turkey. Foreign investment has recently played a very significant role in promoting the development of the construction industry in Turkey. It has also contributed to the capital savings and production capacity of Turkey, not leaving out the technology and management skills. Turkey has already accomplished to realize thousands of stunning construction projects all over the country over the past 15 years, which also improves its economic and political stability. Turkey has been able to attain the target of becoming among one of the most prominent countries which can attract a considerable amount of foreign capital in various business sectors as well as construction industry. As known very well, capital, raw materials and well trained workforce are the essential assets for a country to pave the way to reach to the level of developed countries. Acceleration of globalization, new trends aiming at facilities of transportation and effective communication devices, encouragement of foreign investments, simplification and reduction of red-tape, the strategic location of Turkey, cheap labor force and many other favorable factors have all played significant roles to attract so many foreign investors to invest their funds in Turkey. Therefore, the main purpose of this paper is to examine the causes and effects of drawing such a lot of Foreign Direct investment (FDI) into Turkish construction sector. This paper will also glimpse at the foreign investments in various sectors in Turkey. Thus, it will go further to analyze the statistical figures of foreign investment in the Turkish construction sector.

**Keywords:** Direct Foreign Investment, Construction Sector.

## **Türkiye’de İnşaat Sektöründe Yabancı Yatırım Büyümesinin Nedenleri ve Etkileri**

### **Özet**

Bu yazı, Türkiye’deki inşaat sektöründeki doğrudan yabancı yatırımların nedenlerini ve etkilerini incelemektedir. Dış yatırım son zamanlarda Türkiye’de inşaat endüstrisinin gelişiminin desteklenmesinde çok önemli bir rol oynamıştır. Ayrıca, teknoloji ve yönetim becerilerini yanı sıra, Türkiye’nin sermaye tasarrufuna ve üretim kapasitesine de katkıda bulunmuştur. Türkiye hâlihazırda son 15 yılda dünya çapında birçok etkileyici inşaat projesini başarıyla tamamlamıştır ki bu ekonomik ve siyasi istikrarı da olumlu yönde etkilemiştir. Türkiye, inşaat sektörünün yanı sıra çeşitli iş sektörlerinde de önemli miktarda yabancı sermaye çekebilecek en önde gelen ülkelerden biri olma hedefine ulaşmıştır. Çok iyi bilindiği gibi, sermaye, hammaddeler ve iyi eğitilmiş işgücü, bir ülkenin gelişmiş ülke düzeyine ulaşma yolunu açması için temel varlıklardır. Küreselleşmenin hızlanması, ulaşım olanaklarına ve etkili iletişim araçlarına yönelik yeni eğilimler, yabancı yatırımların teşvik edilmesi, bürokrasinin sadeleştirilmesi ve azaltılması, Türkiye’nin stratejik konumu, ucuz işgücü ve bunlar gibi diğer olumlu faktörler birçok yabancı yatırımcının Türkiye’ye yatırım yapmasında önemli rol oynadı. Bu nedenle, bu makalenin asıl amacı, bu tür Doğrudan Yabancı Yatırımların (DYY) Türk inşaat sektörüne çekilmesinin sebeplerini ve etkilerini incelemektir. Bu makalede aynı zamanda Türkiye’de çeşitli sektörlerdeki yabancı yatırımlara da odaklanılacak ve böylelikle Türk inşaat sektöründeki yabancı yatırımların istatistiki rakamları da analiz edilecektir.

**Anahtar Kelimeler:** Yabancı Doğrudan Yatırım, İnşaat Sektörü.

## **1. Introduction**

Construction industry is subject to government intervention for the arrangement, regulation, encouragement or restriction of construction business deal because accommodation has always been among one of most essential needs and assets of human beings. Therefore, governments often dictate hundreds of strict rules in order to set contemporary standards for their citizens' comfort and welfare depending on their prospective needs and demands in terms of accommodation. Demand for accommodation may somehow fluctuate for various reasons. Generally, sudden increase in citizens' income and welfare highly influence public demand for housing. Rate of profits, investors' expectations and political atmosphere may also affect the demand for buildings and infrastructural construction. This is because the government is the main purchaser of social accommodation projects. Additionally, there has always been fluctuations on the demand for construction overseas due to high competition conditions of the construction industry and also to the economic conditions of the countries. Foreign investments influence economic and political structures in most countries. Capital plays a central role in every country's foreign investment programs. The most important expectations of foreign investors are higher rate of turnover, assurance of free trade and investment laws and regulations, as well as transparency and justice in all sorts of capital transfer transactions and fair conduct (Demirtaş, 2005).

Globalization trends began to boost in almost all over the world in 1980s, especially after the collapse of USSR together with their constraints and restrictions on free trade and business services. Therefore, foreign direct investment opportunities attracted the attention of the authorities who rule both public and private sectors in developed or developing countries. As a result of the integration in the financial markets, the phenomenon of globalization has

gained new momentum to flourish international business deals and investments. The volume and pace of capital transfer transactions have increased considerably worldwide along with globalization and integration of major economies in the world since 1980s. Thus, capital is directed to regions where the capital is relatively scarce and turnover rates are much higher than the regions where investors' prospective profit rates are lower. In such cases, companies cannot handle severe competition conditions by utilizing only their own equity structures as a result of which some ruthless loan sharks emerge (Adams, 2009: 939-949).

Furthermore, with globalization, foreign investments have gained importance in the economy of most countries to create employment opportunities which cause companies to search for new company mergers, business associations and direct purchases. Many international firms find it easier to reach their target markets by getting involved in new business deals and investments with their competitive power.

Foreign direct investment (FDI) has a positive effect on development, too. Turkey is an example of one of those countries that allow foreign investments to boost in different sectors.

Turkey decided to embark on various joint venture business deals, mainly in construction and manufacturing sectors. Balance of payments and budget deficit of Turkey mainly focus on sustaining the economic development of the country in line with constant requirements of internal and external loans obtained from loan sharks by undergoing high costs or interest rates. It is necessary for policy makers to prefer FDI methods rather than borrowing money from loan sharks by promising to pay back very high interest rates. Foreign Direct Investment may be an alternative outsourcing possibility (Coerdacier, 2011: 289).

## **2. Foreign Investments in Turkey**

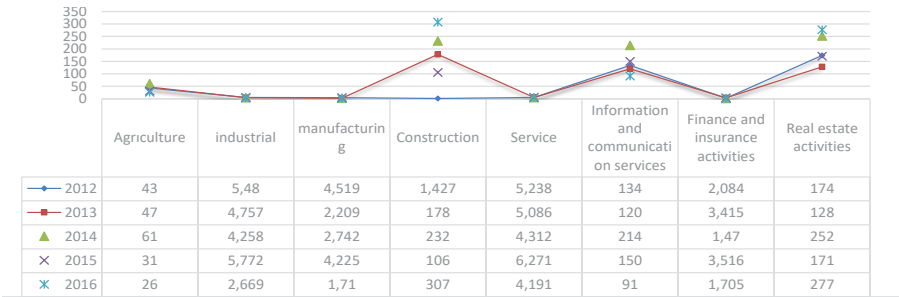
In the 16th century, during the Ottoman Empire, Turkey had some contradictions with FDI, and to foreign governments that their citizens violated cross-border jurisdiction. This policy was later ended up with certain privileges and immunity to FDI companies. Foreign investors and businessmen were exempted from direct taxation and they were given the right to resolve all their disputes or conflicts in their private courts established by their consular representatives. Capitulations became among one of the major reasons which caused the Ottoman Empire to collapse and fall into pieces completely. The Ottoman Empire and its local residents lost their economic independence. In fact, Suleyman the Magnificent provided those merchants with so many rights, distinctions and privileges bearing in his mind that those privileges were a kind of donation for the merchants to prove his power in the world. The capitulations were deemed to be a sort of contempt for those small foreign merchant groups who came to the country to pursue their business deals. Afterwards, they obtained unlimited distinctions and privileges which later turned into cross-border concessions and immunities. The capitulations, which were regarded as a network of quality and symbol of submission, were abolished in 1923 by the Lausanne Peace Treaty (Lewis, 1965:449). After the capitulations were abolished, the Treaty of Lausanne brought some restrictions and constraints to the Turkish economy until 1929. Thus, capitulations were abolished after the establishment of the Republic of Turkey in 1923.

**Table 1.** Foreign Direct Investments in Turkey (Billion US dollars)

Years	Construction	Change %	Service Industry	Change %	Total	Change %
2000	22		7035		18812	
2001	338	1436,36	7201	2,36	18686	-0,67
2002	389	15,09	55540	671,28	16270	-12,93
2003	442	13,62	10915	-80,35	30595	88,05
2004	57	-87,10	16400	50,25	37175	21,51
2005	397	596,49	43031	162,38	69907	88,05
2006	290	-26,95	34396	-20,07	93448	33,67
2007	804	177,24	104359	203,40	151929	62,58
2008	435	-45,90	56567	-45,80	75407	-50,37
2009	927	113,10	90170	59,40	138010	83,02
2010	868	-6,36	1145355	1170,22	181171	31,27
2011	949	9,33	75121	-93,44	130912	-27,74
2012	1429	50,58	102008	35,79	183767	40,37
2013	875	-38,77	79614	-21,95	143475	-21,93
2014	981	12,11	96153	20,77	174802	21,83
2015	734	-25,18	80383	-16,40	147587	-15,57
2016	575	-21,66	77727	-3,30	132856	-9,98
2017	683	18,78	985058	1167,33	174783	31,56

**Source:** TUIK

Following 1980 liberalization policies, some specific encouragement efforts were made to attract more foreign direct capital investment which yielded some efficient results and the amount foreign capital flows into Turkey increased considerably. Table 1 reveals the statistics of foreign direct investments, especially the foreign direct investments that were provided for construction industry and services industries.



**Figure 1.** FDI Input by Sectors in Turkey

Source: <http://www.invest.gov.tr/01.05.2017>

The manufacturing and service industries are the sectors in which the foreign capital is needed the most. Especially in the manufacturing industry, more foreign capital investment has been allocated to the food industry, ready-to-wear industry, chemical industry, iron-steel industry, cement industry, electronics and vehicle industry. The most important reason for this is the profitability ratios of these sectors are rather high. As of 2002, the total number of firms which are engaged in doing businesses in manufacturing industry is 1550. The total capital of those 1550 companies accounts for 2,480,442,682,000 TL. The total number of companies operating in the services sector as of 2002 is 4475. The total capital of these companies amounts to 468,224,090,000 TL (Moosa, 2002:19 -21).

As of 2002, the sector with the highest share of foreign capital in terms of total capital is the agricultural sector with its 91.58% capital share. The number of firms in the agricultural sector is 141. The distribution for other sectors are as follows; the energy sector accounts for 93.73%, the mining sector 79.49%, the services sector 61.60% and the manufacturing industry sector 58.90%.

In 2017, the total FDI inflows (\$ 10.8 billion) were net foreign capital inflows of \$ 5.6 billion, other capital inflows account for \$ 619 million

and real estate purchases of residents, foreign residents of \$ 4.6 billion. Capital inflows from real estate purchases account for 43% of total gross capital inflows. This \$ 4.6 billion entry represents a 19% increase compared to 2016.

**Table 2.** Breakdown of FDI Inflows to Turkey by Years

Years	Capital (Net)	Input	Out	Other Capital (Net)	Real estate (Net)	Years
2002	617	622	-5	520	-	617
2003	556	564	-8	16	998	556
2004	888	986	-98	554	1,343	888
2005	8,053	8,454	-401	137	1,841	8,053
2006	16,876	17,553	-657	387	2,922	16,876
2007	18,394	19,137	-743	727	2,926	18,394
2008	14,712	14,747	-35	1,855	2,937	14,712
2009	6,170	6,252	-82	459	1,782	6,170
2010	6,203	6,238	-35	341	2,494	6,203
2011	13,868	15,859	-1991	-5	2,013	13,868
2012	-	-	-	-	-	-
2013	9.936	10.523	587	578	3.049	9.936
2014	8.371	8.632	261	427	4.321	8.371
2015	11.713	12.077	364	2.133	4.156	11.713
2016	6.913	7.534	621	-	-	6.913
2017	5.568	7.437	1.869	619	4.643	5.568

Source: TCMB



**Table 3.** Sectorial Distribution of International Direct Investment Inflows

Sectors (million \$)	2013	2014	2015	2016	2017
Introduction to Capital	10.523	8.632	12.077	7.534	7.437
1. Agriculture	47	61	31	38	31
2. Industry	5.390	4.258	5.774	3.067	2.653
Production	2.843	2.742	4.227	2.241	1.261
Electricity, Gas, Steam	1.794	1.131	1.338	676	943
Mining, Quarrying	717	382	207	148	448
Water Supply, Waste Management	36	3	2	2	1
3. Services	5.086	4.313	6.272	4.429	4.753
Finance and Insurance.	3.415	1.470	3.516	1.766	1.452
Transportation and Storage	364	594	1.524	635	1.350
Build	178	232	106	291	627
Information and Communication	120	214	150	91	557
Wholesale and Retail Tic.	379	1.137	599	688	501
Human Health and Social Comfort.	106	204	58	274	62
Capital Exit	587	261	364	621	1.869
Other Capital (Net)	578	427	2.133	2.540	619
Real estate (Net)	3.049	4.321	4.156	3.890	4.643
Total	13.563	13.119	18.002	13.343	10.830

**Source:** TCMB (Including purchases of real estate by foreigners).

FDI inflows in the Services sector increased by 7% to \$ 4.753 million compared to 2016. Looking at the sub-items; Finance and Insurance Activities decreased by 18% compared to 2016, but with 30.5% share and \$ 1.452 million entry, it was the sub-sector that received the most FDI. The Transportation and Storage sub-sector, on the other hand, accounted for 28.4% of the total, with \$ 1.350 million being the second largest sub-sector with a significant increase of more than

100% compared to the previous year. These three sub-sectors in the field of services were; 13.2% for Construction, 12% for Information and Communication and 10.5% for Wholesale and Retail businesses.

The capital inflow in the FDI inflow item reached 7.4 billion dollars. In 2017, \$ 1.4 billion of the \$ 7.4 billion of FDI inflows came from the activities of financial intermediaries and \$ 1.35 billion from the transportation, communications and storage services sectors. In the period in question, 65 % of the capital inflows came from EU countries. There are 5 thousand 930 companies with international capital established since 2017, 3 thousand 671 of near and Middle Eastern countries, 897 of EU countries and 424 of other Asian countries. Turkey's foreign assets witness 2.4% change by the end of 2017, thus giving an increase of 233.6 billion US dollars. Liabilities also rose by 2.9%, amounting to about 702.2 billion US so Turkey's net is defined considering the difference between assets and foreign liabilities abroad.

The construction sector in Turkey which includes about 250 sub-sectors performed well in 2017 and it grew by 10.2 percent in the first nine months. The sector expected to protect its vitality and continued its growth momentum in 2018 with public investments and urban transformation.

It is expected that the Turkish cement sector will continue to grow in parallel with growth and export capacity in the construction sector. It is planned to reconstruct approximately 7 million dwellings within the scope of urban transformation in the last period, until 2023. In addition to housing demand and urban transformation, the investment of major projects such as the Third Airport, Eurasia Tunnel and Izmit Gulf Transit Highway also make a significant contribution to the demand for cement. Therefore, it is believed that the cement industry will maintain its vitality in the coming period both in domestic and

international markets, despite the excessive fall in export prices. In addition to receiving domestic demand, the sector is also in the first place in the world market for exports. Construction investments in Georgia, exports to Israel and also the volume of prospective potential increase in products sold to the US and Africa are likely to enlarge the potential for the sector considerably.

### **3. Contribution of Foreign Investments in Construction Sector in Turkey**

The construction of infrastructure projects which require new technologies, the means of transportation, the construction of communication networks and facility buildings are always on the focus of the construction industry. As a world in which the difference of time and space disappears, it is desired that the activities in the construction sector should be organized in global dimensions.

During the 1980s, the world economy represented an important policy for many years to transform the Turkish economy. The Neo-liberal policies that Williamson referred to as the Washington Consensus are members of the Commonwealth of Independent States, which was imposed by the international organizations of capitalism, the IMF and the World Bank, and the breakdown of China, India and the Soviet Socialist Republics of Asia, Latin America (Rodrik, 1996: 9). Developed countries wanted to take advantage of the possibilities offered by the new technology and push the key computer projects to have enough capital to travel safely around the world without any hindrance. The international finance organizations implemented a policy whereby they enter into countries where capital is scarce, so they can get much higher turnover in order to contribute to the financing of investments in those countries they enter by claiming to increase world welfare. The real estate and housing markets are among the areas which attracted most attention of financial

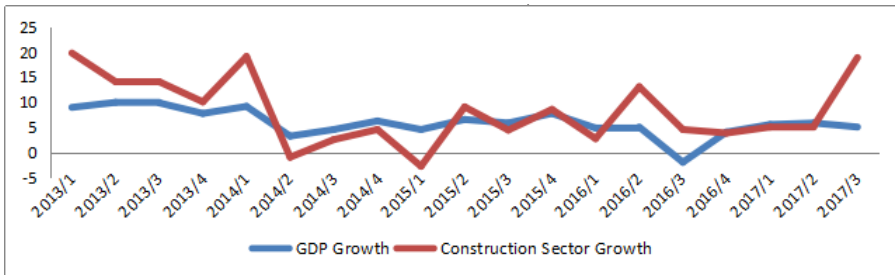
institutions. In addition to the aforementioned issues, it is important to know that the construction sector realized 15% share in 2017 in the global economy and the rate was at the level of 9% in Turkey. The construction sector has a vibrant effect in emerging economies due to its contribution to the growth of the country's economy in line with the impact of government policies and investment potentials. By 2025, the total share of the construction sector in the economy is estimated to reach 10 % in developed countries and 17% in developing countries (KMPG, 2018).

Construction sector often has a leverage role for the economies of countries together with its added value as well as employment opportunities. Nowadays, construction is evaluated not only for the construction of the environment but also for the whole activities which contribute to maintenance, repair, restoration, renewal and operation. Construction cannot be perceived only as the production of buildings. It is also engaged in various environmentally friendly projects by undertaking social responsibility events to enrich social life,

The Turkish Construction Sector has a locomotive function for more than 200 sub-sectors by utilizing nearly 680 different construction materials. In addition, it affects employment and production processes considerably because it involves hundreds of professions. Today, it is seen that the share of the Turkish construction sector in the GNP is about 30% because construction sector undertakes more complex and large-scale projects both in Turkey and abroad.

Despite the positive picture in 2016 and 2017, those who are engaged in doing businesses in the construction sector in Turkey expect to see more cautious figures in 2018. The sector increased the number of accommodation production and sales especially during the last two years. In particular, slowing down the rate of stock meltdown

in projects which were intended to sell to those people in the upper income level shows that the sector is approaching to its saturation point in this segment. If the demand imbalance continues in 2018, the sector will lose its growth momentum realized in 2016 and 2017.



**Figure 2.** GDP growth and construction sector growth, 2013 – 2017  
(Source: TÜİK, Periodic Gross Domestic Product)

Source: TÜİK

It is also seen that the construction industry has quickly recovered from the effects of the Global Economic Crisis, especially after the third quarter of 2009. The construction sector which shrank by approximately 21% in the second quarter of 2009 recovered rapidly from the negative effects of the Global Economic Crisis by reaching a growth of approximately 22% in the second quarter of 2010. Mortgage interest rates decreased from 15,75% to the level of 6.25% as a result of the intervention of the Central Bank by pulling the benchmark interest rates down in parallel with the expectation of low rate of inflation. Thus, construction sector recovered after the recession as soon as the crisis was over. As seen in Table 3 above, the monthly minimum mortgage interest rates decreased from 1.30% in the first quarter of 2008 and it went down to the rate of 0.59% in the last quarter of 2010. As also seen in Table 2 above, the construction sector reached a growth rate of approximately 22% in the second quarter of 2010 as a result of low interest rates on housing loans and

the increase in total loan amount accounted for from TL 30 billion to TL 50 billion (ITES, 2011).

Another important point that attracts attention in the construction sector is sector loans. Even in the last quarter of 2008 when the impact of the Global Economic Crisis on the economy of the country and sector increased, there was an important increase in foreign loans used by the construction sector. The positive development here was to reduce the amount of foreign credits used by the construction industry to the pre-crisis level in the first quarter of 2007 by decreasing even more after the second quarter of 2009 continuously. Therefore, the foreign loans used by the construction sector decreased by 8% from the level of 8,230 million dollars in the second quarter of 2009 to 8,640 million TL in the second quarter of 2010. In the second quarter of 2009, commercial loans used by the sector increased by 13% from TL 28,243 million to TL 31,919 million in the second quarter of 2010. Consequently, one can categorically say that the construction sector substituted foreign loans used for the growth with domestic commercial loans.

Moreover, the maturity distribution of the foreign borrowing of the construction sector as of November 2009 consisted of the debts with a short period of one year. It was a significant portion of the foreign debts of USD 8.180 million, i.e. USD 2.887 million.

Construction and real estate sectors were among the most important sectors that have kept the Turkish economy alive from 2002 to 2018. Real estate deals and the construction sector in Turkey exhibited an incredible performance for a long time due to the increasing population and urban renewal projects across the country. For this reason, it can be said that the construction and real estate sectors will be attractive options for investors for a long time in Turkey. Foreign investors purchased 6% of the accommodation projects as of September 2017. This figure is expected to increase gradually. In addition, there is

currently no requirement for a residence permit for foreign investors in order to purchase real estate in Turkey. Those investors who buy real estates by paying for at least \$ 1 million are also entitled to the right of Turkish citizenship.

The construction sector is highly sensitive to economic fluctuations. Production in the sector is generally in line with economic activity. However, in the course of recent activities in the sector, the internal dynamics of the market play an important role in various walks of life.

Real growth in the construction sector was above the GDP growth in 2016, which was 5.2% year-on-year at 3.2%. Annual growth in the sector exceeded the GDP growth of 10.2% to 7.4% in the first nine months of 2017. In this period, construction investments registered a rapid increase by 16% compared to the same period of previous year. In the third quarter of 2017, the construction sector showed a strong performance compared to the first half of the year, with a rapid increase of 11.1% in economic activity and 18.7% in real terms. The supportive measures of the public and the low base effect played an important role in this progress (Sezgin, 2017:11).

According to the IMSAD Sector Report; “Turkey in December 2017” the construction sector completed the year 2017 with a growth rate of 8.0%. With this rapid growth, it was emphasized that the renewal and transformation of old and risky buildings in cities provided the sector with a major contribution thanks to the important supports given on the housing side. It is stated that the growth in the construction sector is expected to continue with its own dynamics in 2018.

The Association of Building Materials Producers of Turkey (Turkey IMSAD) prepared the Sector Report of December 2017 to provide information and support for the construction sector by stating that

financing opportunities for consumers and producers expanded in 2017. Despite the weakening of the overseas construction deals and contracts, the export of construction materials increased again in 2017 after two years of shrinking and it was remarked that the average growth rate of the construction materials for the domestic market was 8%.

#### **4. Conclusion**

Turkish construction industry with its 6% share at GDP has a substantial economic pull regarding its major direct and indirect resource utilizing sector of the economy. The economy of Turkey has witnessed a transformation of its construction sector in line with the direct economic growth whereby there is a tremendous increase and progress in net FDI inflows to Turkey. Turkey's Balance of Payments statement, net direct foreign investment (FDI) in the domestic market amounted to USD 8.1 billion as of 2017, of which USD 4.6 billion was due to net investments for real estate purchases. In this period, the share of the real estate purchases in total FDI was 56.6%.

The effects of the construction sector on GNP directly or indirectly affected the economy of the country by 20%. In other words, the slowdown in the construction sector is an important indicator of the economic slowdown. FDI growth in Turkey stimulated economic expansion. As a mark of progresses in the country along with economic developments, the development of both foreign direct investment and foreign trade will continue. The country will also develop in terms of human resources as well.

Considering the contributions of the foreign direct investment to the general economic growth of the country, Turkey is in a better position to benefit much more from foreign direct investments. It is obvious that economic growth and employment contribution will be much



higher if new investments create more employment and transfer of more technological development in order to attract more foreign direct investment. Economic and political stability, favorable conditions and continuation of long-term growth of Turkey will certainly generate some dynamic effects on the power of becoming an attraction center to draw more of foreign direct investment. Foreign investment policies have been designated by Turkish Government. In this paper, the effect of FDI has been assessed. Specifically, the effect of foreign direct investment on growth of the construction industry and on Turkish construction sector has been focused on. By analyzing the relationship between GDP growth and foreign direct investment in construction industry, it is recognized that foreign direct investment in construction industry contributed to the growth of Turkish economy dramatically between 2002 and 2017.

## **5. Suggestions**

1. Loan contracts should not include any terms and conditions which may lead to threats for the sovereignty as well as political and economic independence of the country.
2. Recycled materials and environmentally friendly and natural substances should be preferred for construction projects. Timber, stones and bricks are the three major natural construction materials. Plastic materials cannot replace these natural structural elements in construction sector.
3. Solar energy panels should be installed on roofs and walls of all buildings urgently.
4. Renewable energy projects should be encouraged all around the country by all means.
5. All rooms of accommodations must have air shafts or ventilation stacks because 99% of human body is composed of six elements

from the periodical table of elements. There are 96 natural elements in the table of elements. The human body contains 65% oxygen, 18% carbon, 10% hydrogen, 3% nitrogen, 1.4% calcium, 1.1% phosphorus. Thus, 65% of oxygen in human body makes it necessary to install / build functional effective ventilation systems in all rooms of accommodations.

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