



THE IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH: EVIDENCE FROM IRAQ

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Abstract

The paper shows the impact of foreign direct investment to economic growth in Iraq. It was discovered that the impact of FDI to growth is determined to be positive. In this research we are trying to find out that by which the level of FDI is stimulating economic growth in Iraq and if there is a connection between increasing of FDI and GDP levels, also to study Iraq's GDP is effected positively by increased levels of FDI. The aim of this study is to clarify impact of FDI on Iraq's economic growth when more FDI is needed, and what are the factors of FDI impacting on the economic. In the analyzing process by using regression analysis we found out what we seek to discover, data that used are from specific time from 2004-2013, the methodology analysis is quantitative. The results of this paper shows that Iraq should pay more attention to annual economic growth and try to bring more foreign direct investments to start businesses and develop economics of Iraq, the investment law should be updated and revised because in the past it was not effective and supportive to motivate foreign direct investors to invest in Iraq, a stable political policy must be implemented to secure the future and rights of foreign director investors will not be seizure in the long-period investment process, with a good environment for foreign individuals and employees.

Keywords: Foreign Direct Investment, Economic Growth, Correlation

Introduction and Background

In developing countries Foreign Direct Investment (FDI) is a possible instrument for economic growth. One of the main sources of external funding for under developed countries is FDI. Furthermore, generally FDI has a positive collision on the national economy of the host country such as job creation, skill development, technology transfer and growth of local markets. Therefore, most of the developing countries are trying to create a friendly relationship with developed countries to attract investors. Obviously, foreign investors are pursued to invest in areas that are more productive than other areas. Nowadays, a major concern for policy makers and researchers is compassionating the patterns and the arrangements of Foreign Direct Investment. Historically, after the end of the Second World War, the world was looking for a new way to rebuild itself. The most important subject for all countries,

especially European countries was finding solutions for economic instability and crises. As a result, several treaties and agreements signed between states to cooperate economically, politically and socially. More importantly, most of the Western countries and developed countries decided to invest between themselves. However, the situation for most of the under developed and colonized countries was different. Most of the African and Middle Eastern countries were seeking self-determination in terms of politics and economics. Remarkably, Iraq as most of other Middle Eastern countries emerged as a new destination for foreign investors after the collapse of the Saddam's regime. It has made a crucial advance since the announcement Investment Law 13 in 2006. After 2003, Iraq has been successful in increasing the level of foreign and national investment compared to other parts of Middle East. However, many of the

foreign investors has not invested in Iraq because of the some security issues which could create issues for foreign and national investors. After enacting the Investment law, Iraq established a responsibility for all investment projects in all sectors.

This research studies the impacts of Foreign Direct Investment in economic growth of Iraq by using panel data analysis. Single variable regression model was developed to assess the effect of FDI on economic growth in Iraq. The study also underlies the roles of sectors and governorates that have played in motivating FDI capital inflows.

This paper consists of five sections. The first section gives a brief summary of the main points that have been considered. The second section contains the thesis through the finding results that have been achieved. The third section offers some recommendations based on the

Investigations. Section four affords some details concerning some of the restraints of the study. Finally, the last section suggests future studies associated to the theme of this research.

In this research paper, the impacts of FDI on economic growth of Iraq have been examined by using a time series data analysis approach. To the best of my knowledge, this study is one of the academic work examining determinates of FDI in Iraq especially at the governmental level using econometric methodology. Appropriately, to aim the objective, this study seeks to answer how the FDI has impacted the growth of GDP in Iraq. In addition to the introduction chapter, the thesis contains 6 chapters. Chapter 1 discusses the theoretical background to understand the objectivity of the thesis. Chapter 2 shows the dataset that is used in this study. Chapter 3 describes the

methodology used to analyze the data. Chapter 4 explains the data analysis and the resulted outcomes. Chapter 5 is dedicated

for the conclusion, and Chapter 6 recommends some suggestions for further studies.

Problem Statement

This paper attempts to answer the following research questions:

- 1/ How does foreign direct investment promote economic growth in Iraq?
- 2/ What are the FDI impacts on economic growth of Iraq?
- 3/ Is there any positive or negative relation between FDI and economic growth..?

The paper also attempts to achieve the following research objectives:

- 1/ To determine the extent by which the level of FDI is stimulating economic growth in Iraq
- 2/ To examine whether there is a relationship between increased levels of FDI and increasing GDP

- 3/ To examine whether the increased levels of FDI positively affects Iraq's GDP

Aims of the Study:

The reason of this thesis is to clarify the impact of FDI to economic growth of Iraq country so to be sure about whether ask for more FDI is good job. The connection between FDI and economic growth is argued.

What happened or what has been the impact of FDI on economic growth of Iraq..? does the impact positive or negative? And the argue answered more questions

For data analysis, data are used according to Iraq GDP how it changed from period time and FDI. So the positive or negative change that happened at Iraq GDP, it shows that foreign direct investment has effect on economic growth of Iraq.

Review of previous studies

For the last two decades the role of foreign direct investment (FDI) has been very important to countries around the world in term of their economic growth. Particularly in developing nations, clearly the relation between FDI and it depend on number of factors from host country that influence foreign firms to invest, such as open trade, developed financial market and level of resources and human capital (Almfraji and Almsafir, 2014). According to World bank 2013, 80% of world trade is associated by FDI. During the economic crises such as US in 1980s, FDI has become a source to rebuild the economic system of a state and most of the African countries have also reestablished their economy by allowing foreign countries to invest in their nations (Ramachandran and Shah 2005). In other words, FDI could be seen as a tool for solving the economic issues that a state may face. Moreover,

The FDI has known as one the most important sources of the money flow for the developing countries. More importantly, the positive effects of the FDI on the growth of economy depend on the type of sectors. For instance, as Alfaro (2003) claims that the importance of the FDI depends on the sectorial organization of an economy such as manufacturing sector which could bring the positive influences on the state's development. Another important aspect of the FDI is the absence of the colonization process. After the end of the Second World War, most of the colonized countries achieved their independence, and they started to not let other countries to interfere their country. However, at the begging of the 21st century most of the countries, specifically African countries has accepted foreign countries to join their economic growth. As Adewumi (2006) argues that "Now, almost every country wants FDI to

Supplement local investments and this has increased the activities of Multinational Enterprises in developing countries tremendously” (Adewumi, 2006) Clearly, FDI has become a tool for improving the country’s economy. As Koffi Annan the previous general secretary of the United Nations stresses the importance of the FDI by asserting that “With the enormous potential to create jobs, raise productivity, enhance exports and transfer technology, foreign direct investment is vital factor in the long-term economic development Of the developing countries” (United Nations, 2003. P. iii) FDI is viewed as a set of capital, entrepreneurship, technology and management that allows company to move abroad and provide product or services in a foreign market. According to Griffin and Pustay (2007), FDI regarded as “the ownership or control of 10 % or more of an

Enterprise’s voting securities or the equivalent interest in an unincorporated business”. FDI can be categorized into two different types: Horizontal and Vertical. Horizontal is where a firm operates in the same industry and produces or offers same products and services to the host country as they offer at home (Griffin and Pustay, 2007). Economic growth, which is also known as economic efficiency per capita, is mostly driven by enhancement in productivity. Boosted productivity mean more products and services are produced with the same amount of input such as resources, energy, and labour. Hypothetically, FDI is known as an important strategy that have a direct impact on economy growth through capital accumulation, and the combination of new inputs and foreign technologies in the production function of the host country (Almfraji and Almsafir, 2014) FDI will

create benefits for both host and investing economies. The advantages that may accrue to the host country include employment opportunities, resource transfer, improved productivity and competition, and balance of payment effects. FDI will also benefit home country through the inflows of foreign earnings to the host countries (Keillor, 2013). There is an indication that apart from the economic growth, FDI has other positive effects to the domestic economy, which includes technology transfers, higher productivity and management skills into the host country. However, in some cases FDI can also be negative and harms domestic economies. For instance, some investors tend to reduce opportunities for local businesses. There is also concern that some foreign investors might protect their firm specific knowledge spillovers to the host or away country. These have created ambiguities among literature, while some author believes that FDI has a positive

impact on economic growth, but also few believes there is no major relation between FDI and growth (Noormamode, 2008). FDI has played an active role in term of globalization, which means nations are more interconnected to each other by increasing trade and culture exchange and also rise in the production of goods and services. This is what national firms are changed to multinational corporations with subsidiaries in other countries. The primary mechanism of interconnecting within global economy has shifted from trade to FDI. For instance, global FDI stocks in 2011 were 30% of world GDP, comparing to 1990 which was 10%. According to Letto (2013) in theorizing strategic behavior theory, FDI creates more employment which means more tax revenue and less welfare payment. Also if firm produces products for abroad than it will be more export. For example Nissan and Toyota moved to UK after 1980s, since then UK's been the net export

of cars to Europe. Without of FDI will be no

advantages of export, higher GDP and economic growth.

Data:

The data in the below table (Table 1: Data on Iraq GDP at Current Prices, USD Billions, Foreign Direct Investment, Net Inflows (BoP, Current US\$), Annual Growth Rate) used in this study are time series dataset that cover the period between 2004-2013. Datasets are derived from two different sources. The dataset used to measure Iraq GDP at current prices of

billions of US\$ is derived from the International Monetary Fund (IMF) database published on Quandl origination website on 2015. The dataset used to proxy Foreign Direct Investment, measured as Net Inflows to Iraq's Balance of Payment in current US\$, is derived from the World Bank – World Development indicator database published on Quandl origination website on 2015 too.

Table 1: Data on Iraq GDP at Current Prices, USD Billions, Foreign Direct Investment, Net Inflows (BoP, Current US\$), Annual Growth Rate

Year	Iraq GDP at Current Prices, USD Billions	Ln (GDP)	Foreign Direct Investment, Net Inflows (BoP, Current US\$)	Ln (FDI)
2013	232.50	5.45	2,852,000,000	21.77
2012	218.03	5.38	3,400,000,000	21.95
2011	185.75	5.22	2,082,000,000	21.46
2010	138.52	4.93	1,396,200,000	21.06
2009	111.66	4.72	1,598,300,000	21.19
2008	131.61	4.88	1,855,700,000	21.34
2007	88.83	4.49	971,800,000	20.69
2006	65.14	4.18	383,000,000	19.76
2005	50.07	3.91	515,300,000	20.06
2004	36.64	3.60	300,000,000	19.52

Data Source:

International Monetary Fund (IMF) database published on Quandl origination website on 2015.
World Bank – World Development indicator database published on Quandl origination website on 2015

Methodology:

A quantitative approach is used in this study to analyze the effect of the growth of the share of net inflows of foreign direct investment to Iraq's balance of payment on the growth rate of Iraq's GDP measured at current prices of US\$. A single-variable, log-log, ordinary least square regression model is constructed where the dependent variable will be the natural logarithm of Iraq GDP measured at current prices billions of US\$ during the period 2004-2013 and the independent variable which is the natural logarithm of foreign direct investment, measured as net inflows to Iraq's balance of payment in current US\$ during the same period of time. Since the purpose of the study is to measure the effect of the increased inflows of FDI to Iraq BoP on Iraq's economic growth rate, the data was converted by taking the natural logarithm of

the level of both variables. The data are analyzed upon running the regression on the above mentioned datasets using the Statistical Package for the Social Science (SPSS).

Data Analysis & Results:

The regression results reported 80% R-Square value, which states that almost 80 percent of the variation in the value of the dependent variable is explained by the variation in the independent variable. The results also reported a 0.001106 p-value for the FDI coefficient, so the p-value is lower than 0.05. Thus, the null hypothesis that the coefficient equals to zero, which is the hypothesis that the change in the share of FDI in Iraq's BoP has no effect on economic growth, is rejected at a two-sided 95% significance level. Thus, the alternative

hypothesis which states that the increased share of FDI net inflows to Iraq's BoP positively affect Iraq's economic growth rate is accepted at the same significance level. The best linear unbiased estimator (BLUE) for the coefficient that measures the effect of the increased share of FDI in Iraq's BoP on Iraq's economic growth represented by growth rate of Iraq's GDP is reported as 0.057. Thus, the increase in the percentage of FDI share in Iraq's BoP will positively affect Iraq's economic growth rate as everything else held constant. So the ceteris paribus effect of 1 percent increase in FDI net inflow to Iraq's BoP will be reflected in 6 percent increase in the economic growth rate considering that the natural logarithm form of the variables used in the regression model. The SPSS regression results are shown in Appendix A. Regression Results.

Conclusion

The concept of the foreign direct investment is one crucial additive of economic growth. The FDI is not only for increasing the level of economy, but actually it also necessary for creating job opportunities, transferring technology and developing local skills. Iraq has become one of the promising areas for attracting foreign direct investors through a set of characteristics that differentiate from other parts of Middle East. Absolutely, the main reasons include; announcing a friendly Investment Law, its geographic location, and the availability of natural resources such as oil. Foreign direct investment capital flows has been tried to be distributed equally among the sectors and governorates.

Recommendations

In order to make the process of foreign direct investment more successful, this paper suggest steps to curtail barriers. Iraq should open its door more and be more concerned about the annual economic growth rate. In order to attract more foreign direct investment, Iraq needs to amend policies and regulations related to trade openness. Therefore, Iraq should pay more attention to revise and update the Investment Law to draw attention more foreign direct investment as well as affording solutions to the mismanagement of investment projects in the region. More importantly, Iraq should support and provide a secure environment and maintain political stability which is one of the most important characteristics that increase the number of foreign investors. The policy makers should create effective policies to organize the policies of economy such as increasing economic growth and trade openness.

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Appendix No. 1 –Regression Results

Regression Results

SUMMARY OUTPUT

Regression Statistics

Multiple R	0.895196375
R Square	0.801376549
Adjusted R Square	0.77300177
Standard Error	0.252471495
Observations	9

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	1.80023354	1.80023354	28.2425656	0.00110599
Residual	7	0.44619299	0.06374186		
Total	8	2.24642653			

	<i>Coefficients</i>	<i>Standard</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper</i>	<i>Lower</i>
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	<i>Error</i>					95%	95.0%
						-	
Intercept	-7.06180527	2.23279289	-3.1627677	0.01586696	-12.341521	1.782089	-12.341521
						0.824461	
21.77128634	0.057058198	0.1073658	5.31437349	0.00110599	0.3167022	76	0.3167022

RESIDUAL OUTPUT

<i>Observation</i>	<i>Predicted</i>	<i>Residuals</i>
1	5.460780961	-0.0119036
2	5.180941048	0.20370079
3	4.95295092	0.27145076
4	5.030085789	-0.0990927
5	5.115285899	-0.3998274
6	4.746195109	0.13367829
7	4.214917652	0.27184055
8	4.384217465	-0.2076173
9	4.075551569	-0.1622294