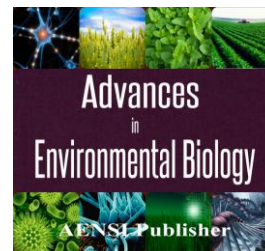




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The Impact of Foreign Direct Investment on the Economic Growth of Selected Oil-Producing and Non-Oil Countries, (Pooling Data Approach)

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ABSTRACT

Background. Economic growth and development is one of the controversial issues in the economy, the significance of which is increasingly rising. In this regard, one of the main concerns of many countries within the scope of boosting economic strength has been relevant ways towards economic growth and development. In this study, the relationship between Gross Domestic Production (GDP) and Foreign Direct Investment (FDI), the degree of economic openness, economic liberalization, government size, and domestic investment has been investigated among a number of selected oil-producing and non-oil countries from 1999 to 2011. The population of the research included four oil-producing countries, namely, Iran, Algeria, Venezuela, and Ecuador, as well as four non-oil countries, namely, Malaysia, Singapore, Thailand, and Brazil. Panel data were used to estimate the model, and the data analysis was carried out in the form of panel data in E-views software. The results of the study indicated that all variables except the 'economic liberalization' show a positive relationship to economic growth. Also, "foreign direct investment", "degree of economic openness", and "domestic investment" show a positive relationship with economic growth, while "government size" indicate a negative relationship to economic growth. Furthermore, dummy variables in the model were characterized as significant

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INTRODUCTION

Economic growth has a significant role in economic system of any country, and investigating on its determinants can involve valuable achievements. Theoretically, one of the prerequisites of economic growth is capital accumulation which can be provided by domestic sources (savings) or foreign ones [Saeedi, Miadi, 2009]. Foreign sources can be foreign portfolio investment (FPI) and foreign direct investment (FDI).

Since a country cannot solely provide necessary capital for comprehensive invest, it tries to fundraise from out of borders by different methods such as selling portfolio or direct fundraise like establishing a factory in a country. Inflow of large capitals to a country results in the economic mobility, and since capital inflow enhances the national income, production, and employment, and thus it raises the economic growth and generally the sustainable development, counties compete with each other for attracting more capital. Because of necessity of finding an answer for the question that whether foreign direct investment has positive or negative impact on the economic growth, we carried out the investigation to survey the interact rate for these two categories. This study is different in some aspects. Firstly, here we investigate this effect in some selected Oil-Producing and Non-oil countries. Secondly, panel data are used in this work which involves both temporal and cross-sectional changes. Thirdly, here the influence of the structure of countries on the FDI effectiveness is investigated. Also, some other factors like qualitative differences including economic freedom, the degree of economic openness, etc are analyzed, that composition of these indexes with FDI can change its impact on the economic growth.

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Assumptions of this investigation are:

- 1- FDI has positive impact on economic growth
- 2- The impact of FDI in non-oil countries is more than oil-producing countries.

Also, the aims of this study are:

- Investigating the impact of FDI on development of countries
- Investigating the impact of FDI on economic growth of non-oil and oil-producing countries.

The present investigation is an applied one for macro planners of a country, since by understanding the type and rate of impact of FDI on the economic growth, it can be used to improve the growth, trade balance, efficiency, employment, etc.

Necessary data can be provided through databases like central bank, the World Bank, UNCTAD, and the internet.

It should be mentioned that, to avoid multiplicity and sprawl of data sources, variables' statistics and data are gathered from identical sources, as much as possible.

Also, this investigation is driven in some selected oil-producing and non-oil countries in the period 1995-2011.

In this article, firstly the concepts of foreign investment, GDP, domestic investment, index of economic freedom, openness and government size are determined, and then the research model are estimated, afterward the data are analyzed. Finally, conclusions and recommendations are offered.

Foreign investment:

In the dictionary of international law, foreign investment is defined as the transfer of funds or materials from one country (exporter) to another (host country) to use the facilities of an enterprise in the second country, instead of participating in direct or indirect profits of that enterprise. The way of benefiting from these funds in organizing the enterprise defines the distinction between foreign investment and foreign trade (Emadzadeh et. Al).

All types of foreign investment:

- Foreign direct investment
- Foreign portfolio investment

And also

- Borrow or attraction of deposits

Foreign Direct Investment:

FDI is investment to acquire a permanent interest in an institution in a country other than the investor's country, and its result is the achievement of effective voting rights in management of that company (or organization). FDI in Iran is in general defined as the physical presence of the foreign investor, and with accepting financial responsibility and the risk of profit and loss he will probably grab the direct control and management of the production unit. Thus, the investor has an effective direct role in performing manufacturing activities. Regarding the definition of foreign direct investment, the result arises that such investments are sustainable and less volatile. In other words, at the recession in the host country, this type of investment not only does not exit from the country, but also in the case of desirable activity, will help the country to get out of the crisis and the recession. Generally, the portion of foreign investment which has played an important role in the process of economic globalization is foreign direct investment.

Foreign portfolio investment:

Generally, portfolio is the list of economic activities (such as investing in the stock market and securities of the host country) on which the investor allocates his capital to escape the risk. Unlike foreign direct investment, portfolio investment is short-term and does not involve in management activity, vote on the decisions or control of the issuer.

Borrowing or attracting deposits:

When host country's banks give a higher interest rate than the world, they attract foreign investment, and thus raise their power to foreign currency loans. In this type, private capitalists usually do not interfere, although international organizations usually attach some conditions.

2- Gross Domestic Production (GDP):

GDP is the total value of goods and services produced in a country with the market price, during a particular period (usually a year). GDP is one of the ways of measuring a country's national income and product. Another definition of GDP is the sum of values added at every stage of production of all goods and services produced in a country during a particular time, and the value is expressed by a specific money.

Way of measuring GDP is:

$$GDP = Consumption + Gross investment + Government expenditures + (exports - imports)$$

The word "gross" means the ignorance of the capital depreciation in the equation.

3- Domestic investment:

One of the major economic factors and the engine of the development is investment, because it provides the financial resources needed for production. Investment means spending money for something with the expectation of profit. More specifically, investment is the commitment of money or capital to financially purchase instruments or other assets, in order to profitable returns in forms of interest, dividend or appreciation of the value of the goods (capital gains). In macroeconomics theory, investment is the amounts of purchased per unit time of goods which are not consumed but are used in future productions, i.e., railroad or factory building. Investment in human capital includes costs of additional schools or job training. In the measurement of national income and output, gross investment is a part of GDP which is given in the formula:

$$GDP = C + I + G + NX \quad (3-1)$$

where C is consumption, G is government expenditure, and NX is the net exports. So, investment is all remaining of total expenditure after difference consumer spending, government spending, and net exports:

$$I = GDP - C - G - NX \quad (3-1)$$

Investment depends on saving and consumption. Before investment, a saving must exist. In other words, consumption has been postponed in investment with the hope to consume more in the future. Those who have volatile incomes, save to unify their consumption.

Investment is a function of interest rates and income. With higher income, people make more saving and investment. By increasing the interest, benefit of keeping the money would increase and cost of deposit investment rises too. Similarly, the economic plans which had economic justification with a lower interest rate lose their previous performance. Investors and financial managers in addition to the factors mentioned above, pay special attention to the return of investment. Because return of investment tells them how much return their capital has, and whether it covers the problems due to the investment and the risk.

Many investors due to high cost and low return on invested capital into their country seek to invest in other countries with lower costs or higher investment returns. So in a country that has the right conditions, they invest either indirect or direct investments.

4- Index of Economic Freedom:

The Index of economic freedom is an annual index and ranking created by the Heritage Foundation and the Wall Street Journal in 1995 to measure the degree of economic freedom in the world's nations. The creators of the index took an approach similar to Adam Smith's in the wealth of nations that "basic institutions that protect the liberty of individuals to pursue their own economic interests result in greater prosperity for the larger society"

Index of economic freedom is measured on a scale of 0 to 100. This number represents economic freedom, with 0 as the lowest, and 100 as the highest score. The numeric value is determined by grades in ten categories, which are averaged together for the overall score.

Economic liberalization is a part of structural adjustment policies, which involves a set of measures to reduce government intervention in financial markets, goods and services, labor and foreign sectors, and ultimately leaving it to the market mechanism. The most important of these measures are:

- Reduction in government intervention in financial markets
- Reduction of price controls, and transfer of pricing to market forces of supply and demand
- Elimination of subsidies and adjustment of subsidy price
- Tendency to floating currency system
- Liberalization of foreign trade and adjustment of all kinds of trade tariffs and economic
- Liberalization of interest rates paid on bank deposits

Overall, economic freedom is nothing but an emphasis on private ownership which specifies the range of market-based economy. People are the owner of their assets in the form of consumption, exchange or storage, and no obstacle such as the government does restrict them.

5- Economic Openness:

Economic openness is one of the main indicators of market size and indicates the amount of interaction with the world. Higher openness index means more competition between domestic and foreign firms, which

leads to increased efficiency and productivity. Economic openness can be calculated using various parameters. The simplest and most common measure of trade openness is a ratio of country's trade (exports and imports) to GDP. The main advantage of this index is the simplicity of its calculation and access to the necessary data of various countries for the calculation of inter countries studies $((X+M)/GDP)$.

6- Size of Government:

Reports about the size of government have received from Fraser Institute. Ranking of this index is between zero and ten. This index is related to the variables, namely, size of government, spending, taxes and government involvement:

- 1- Government consumption as a percentage of total and transfer payments as a percentage of GDP
- 2- Proportion of government spending in total expenditure
- 3- Rates of tax on income
- 4- Participation of government in the total production (the share of government output in total output)

The research model:

This paper examines the factors affecting economic growth in selected countries, including the impact of foreign direct investment in oil-producing and non-oil countries, and panel data techniques are used. First, a descriptive statistics of the variables are provided, then scatter diagram of variables are shown by appropriate graphs. Then stationary test of variables is performed first to estimate the model, and after that, by using the F-Limer test, necessity of using the panel and pooling data is determined. At final, the results will be analyzed, the final model will be discussed, and the hypotheses examination results will be considered. Research model is supposed as:

$$GDP = F(FDI, I, DF, IFE, SG)$$

GDP: Growth

FDI: Foreign direct investment

I: Domestic investment

DF: Degree of openness of the economy

IFE: Index of economic liberalization

SG: Size of government

where growth is considered to be a function of foreign direct investment, domestic investment, openness, liberalization of the economy, and the size of government.

Economic statistical data of studied countries during the years 1995-2011 was extracted by the world database, the World Bank website, the Fraser Institute, Heritage, and the Central Bank of Iran. To estimate the model, EvIEWS7 software is used.

Practical results:

Descriptive analysis of variables:

Descriptive statistics of variables in the model are presented in Table (1).

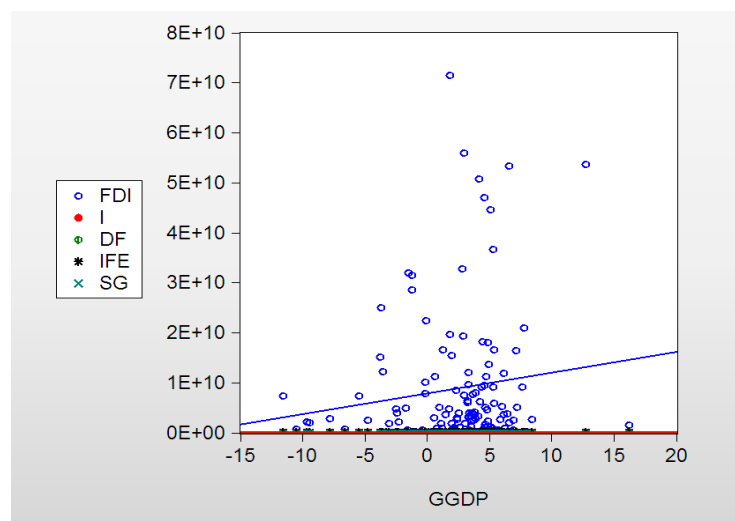
Table 1: Descriptive statistics of selected countries

	GDP growth (percent)	FDI (in dollars)	Size of government (percentage of total consumption)	Openness (between 0 to 10)	Index of economic liberalization (between 1 and 100)	Domestic investment (as a percentage of GDP)
Average	3.213554	3510000000	6.600000	0.592150	57.55000	23.22779
Standard deviation	4.123848	13400000000	1.405513	1.156347	13.52827	5.502666
Maximum	16.19617	71500000000	9.200000	4.456204	88.90000	43.11432
Minimum	-11.53281	23439368	3.500000	0.141153	34.50000	15.27776
Number of observation	127	127	127	127	127	127

Reference: research calculations

In this section, the scatter diagram of the independent variables of the model should be presented versus dependent variable.

Chart (1): Distribution of variables



Reference: research calculations

Chart (1) exhibits the distribution of economic growth, foreign direct investment, domestic investment, openness, economic freedom index, and the size of government. The most distribution is for foreign direct investment variable.

Stationary test:

Stationary test is done mainly to avoid spurious regressions. To avoid spurious regression, the variables must be stationary. Otherwise the difference of variables, which are usually durable, should be used.

Why Stationary test is necessary:

Definition of stationary data: stationary data are the ones with constant mean, constant variance, and constant covariance for any given interval. Durability or indurability of a time series can have a serious impact on its behavior and properties. For example, when a shock affects to a stationary (stationary) time series its effects on the variable are damping and gradually the effect of the shock will be destroyed. It means the impact of shock at time t is less than the time $t-1$. In contrast, in non-stationary data, the impact of shock is durable and unbounded, so that in a non-stationary series, the impacts of a shock at time t will be more than its effect in time $t-1$.

The use of non-stationary data can lead to spurious regressions. With two stationary variables which are independent random series, fitting of one on the other will have relatively low t and R^2 . This situation is obvious for independent variables, but if two variables have the time trend and have no logical connection with each other, regression of one on the other will have a high R^2 . Therefore, in such circumstances, if standard regression techniques are appropriately applied, the results will have a good regression in which all coefficients are significant and R^2 is high too. But obviously this is a spurious regression with a tidy appearance.

Stationary test of variables:

In order to avoid spurious regression of variables, one should firstly make sure about the stationary of the variables. If the variables are stationary, estimations will not have the problem of spurious regression. For this purpose, using the panel unit root test, we investigate the stationary and non-stationary of variables.

Stationary test on the level:

Table 2: stationary test on the level

Probability	Level	Variable
0.0000	-6.98796	GGDP
0.3189	-0.47090	FDI
0.2539	-0.66228	IFE
0.0146	-2.18106	DF
0.0052	-2.56364	SG
0.3193	-0.46960	I

Reference: research calculations

According to the results in Table (2) all variables except I, IFE, and FDI are stationary on the level. Therefore, for making them durable, we use first order difference. The results are given in Table (3).

LLC unit root test:

In this part, for stationary test of model variables, Levin-Lin-Chu (LLC) test is used. The results are presented in Table (3).

Table 3: LLC unit root test results for selected countries

Probability	Level	Variable
0.0000	-6.98796	GGDP
0.0000	-8.49264	DFDI1
0.0000	-7.35631	DIFE1
0.0146	-2.18106	DF
0.0052	-2.56364	SG
0.0000	-10.0464	I

Reference: research calculations

*Initial estimates of the model:***Table 4:** Initial estimates of model

Variables	Estimated coefficients	t-statistic	The probability value (Prop)
GGDP	-	-	-
C	5.283595	3.395093	0.0009
DFDI1	1.93E10	4.077059	0.0001
DF	0.751891	2.562955	0.0116
DIFE1	-0.138310	-1.053941	0.2940
SG	-0.591359	-2.443658	0.0160
DI	0.496805	4.880550	0.0000
$R^2 = 0.297$	DW=1.88	F=10.26	$R^2 = 0.268$

F-test for applying the Pooled or panel data:

Since the data structure is a combination of time series and cross section data, we use the F-Limer test for determining whether the pooling data or panel data should be used. In the F-test statistic which is carried out by the F-Limer test, the null hypothesis expresses the homogeneity of the countries, indicating use of aggregated ordinary least squares method and rejection of the null hypothesis indicates that the method is a panel for selected countries. Looking at Table (5) for F-Limer statistic (1.59964) and the probability (0.3314) shows that H_0 hypothesis cannot be rejected and our model is pooling.

Table 5: F-Limer test

Probability	Statistic value	Applied statistics
0.3314	1.159964	F-statistic
0.2720	8.738063	Chi2 square

Reference: research calculations

F-Limer test has approved the pooling model in some selected oil-producing and non-oil countries. Thus using this method, we drive the estimation in the studied countries.

*Variance anisotropy test:***Table 6:** Variance anisotropy test

Prob	Chi2
0.0544	31.06

Reference: research calculations

According to the results in Table (6) the obtained probability is 0.054 and is greater than 0.05. So, the null hypothesis based on equal variances in the level of 0.05 is verified and the model does not have variance anisotropy.

*Autocorrelation test:***Table 7:** autocorrelation test

Prob	Chi2
0.4479	0.576

Reference: research calculations

Since the obtained probability is 0.44 and is greater than 0.05, the null hypothesis which means that there is no autocorrelation in the model is verified, and therefore there is no autocorrelation in the model.

Normality test:

One of the surveyed assumptions of the regression method is normality of the distribution of estimation residual values. The test is made by Jarque–Bera statistics.

Table 8: Test of normality

Probability	Statistic value	Statistics
0.000157	17.51948	JB

Reference: research calculations

The null hypothesis of this test is the normality of perturbation terms. According to the results in Table (8), null hypothesis cannot be confirmed. Using appropriate dummy variables, perturbation terms are one of the ways to increase the normality.

Table 9: After normalization

Probability	Statistic value	Statistics
0.435953	1.660443	JB

Reference: research calculations

As it can be seen, according to the results in Table (9), the null hypothesis based on the normality of perturbation statements cannot be rejected, and at the 5% level of probability, normality of perturbation term is proved.

The impact of FDI on economic growth regardless of the other variables:

Table 10: Impact of FDI on growth

Variables	Estimated coefficients	t-statistic	Prob
GGDP			
C	2.179638	6.193603	0
DFDI	0.000000000192	674151.3	0.0004

Reference: research calculations

$$GGDP = 2.179638 + 0.192 \text{ DFDI}$$

As shown in Table (10), FDI has a significant positive impact on economic growth. So, rise of a billion dollars in the first order difference of the foreign direct investment, enhances the economic growth by 0.192 percent.

Final model, discussion, and analysis of the findings:

Table 11: Estimated model after normalizing

Variables	Estimated coefficients	t-statistic	The probability value (Prop)
GGDP	-	-	-
C	4.799577	4.638582	0.000
DFDI1	1.38 E.10	4.277597	0.000
DF	0.733015	3.731945	0.0003
DIFE1	-0.038105	-0.426918	0.6702
SG	-0.425478	-2.637868	0.0095
DI	0.193335	2.653388	0.0091
DUM1	-9.455866	-11.23817	0.0000
DUM2	8.877032	4.989489	0.0000
$R^2 = 0.69$	DW = 1.62	F = 38.82	$R^2 = 0.67$

Reference: research calculations

Since the variable DIFE1 has the probability 0.67, it does not have a significant impact and should be removed from the model. Thus, the final model is as given in Table (12).

The final estimation of model:

Table 12: The final estimation of the model

Variables	Estimated coefficients	t-statistic	Probability value (Prop)
GGDP	-	-	-
C	4.661220	4.542263	0.0000
DFDI1	1.38 E.10	4.284905	0.0000
DF	0.704136	3.616091	0.0004
SG	-0.394794	-2.480999	0.0145
DI	0.209141	2.918620	0.0042
DUM1	-9.422607	-11.22336	0.0000
DUM2	9.052877	5.220211	0.0000
$R^2 = 0.69$	DW = 1.60	F = 45.45	$R^2 = 0.67$

Reference: research calculations

In which the variables are first difference of the FDI, degrees of freedom, government size index, first order difference of domestic investment, and two dummy variables.

Discussion and Analysis of the Results:

In this section, the findings are discussed and analyzed. The results concerning the relationship economic growth and determinant variables in selected oil-producing and non-oil countries during 1995-2011 can be analyzed using panel data as follows:

The R2 statistic indicates that 0.69 of the changes in GDP rate is explained by the variables included in the model. Also, according to the value obtained for F-statistic and related probability, the model is approved.

According to the estimation of the model, it was observed that in the mentioned countries, with a billion-dollar increase in first-order difference of foreign direct investment, economic growth increases by 0.138 percent, and with a unit increase in the degree of economic freedom, economic growth increases by 0.70 percent. Government size has a negative impact on growth, so that a unit of increase in the size of government reduces the economic growth with 0.39%. Domestic investment has a direct impact on economic growth, so that rise of a unit in its first order difference, enhances economic growth by 0.20 percent. Furthermore, as can be seen, two dummy variables dum1, dum2 have significant impacts on economic growth.

Assessment of dummy variable DOIL:

To distinguish the existence of different in the influence of FDI on the growth of oil-producing and non-oil countries a dummy variable was created to be examined. According to Table (13) it is observed that the dummy variable is not significant, thus the impact of FDI on growth in oil-producing and non-oil countries is not significantly different.

Table 13: Assessment of the dummy variable DOIL

variables	Estimated coefficients	t-statistic	Probability value (Prop)
GGDP	-	-	-
C	4.661969	4.523347	0
DFDI1	0.138	4.232115	0
DF	0.704075	3.600700	0.0005
SG	-0.394800	-2.470772	0.0149
DI	0.209693	2.854493	0.0051
DUM2	9.047401	5.177078	0
DUM1	-9.423499	-11.17350	0
DOIL*DFDI1	-0.984	-0.037264	0.9703
$R^2 = 0.69$	DW=1.60	F=38.64	$0.67=R^2$

Reference: research calculations

Results of hypotheses testing:

This section presents the results of hypotheses testing. The study attempted to test the following hypotheses.

- 1- Foreign direct investment has a positive impact on economic growth.
- 2- The impact of FDI on economic growth in non-oil countries is higher than petroleum producing countries.

The hypotheses were investigated based on panel data of four oil-producing and four non-oil countries during 1995 to 2011 using panel data approach. The results indicate a positive and significant impact of FDI variable on economic growth. Also the results did not show any significant difference in the impact of FDI on growth in oil-producing and non-oil countries. Therefore, the second hypothesis is rejected.

Policy recommendations:

- 1- Laying down laws to protect foreign investors and provide safety for foreign investors
- 2- Privatization and support the activities of private corporations

- 3- Giving exclusive rights to foreign investors if required
- 4- Relative stability in the economy, and reducing risks for investors
- 5- Developing the banking system, and adjusting domestic banks with the global standards
- 6- Trade liberalization
- 7- Appropriate fiscal and monetary policies
- 8- Finding a way to deal with sanctions
- 9- Creating a perfect labor market

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