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The Impact of FDI Inflows and Outflows on Economic Growth of Iraq

اثر تدفقات الاستثمار الاجنبي المباشر الداخلة والخارجة في النمو الاقتصادي للعراق

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Abstract

Foreign direct investment (FDI) is a main part of investment since the aim is to obtain lasting interest or effective control over an enterprise operating outside of the investor's economy. **Objective;** the main objective of this study is to examine the impact of FDI inflows and outflows on the economic growth of Iraq from (1980 to 2017). **Method and Sample;** to accomplish that ARDL approach was used. **Result;** the study results show FDI inflows for Iraq have a significant and positive impact on economic growth, while, FDI outflows of Iraq have a negative and statistically significant impact on economic growth. **Finding;** the study found that Gulf War has a negative and significant impact on economic growth (GDP) within the study period. **Recommendation;** this study's recommendation is to diversify the government revenue source by diversifying the foreign market sources and providing new services to attract new foreign investors.

Keywords: *Foreign direct investment (FDI), Inflows, outflows, Economic Growth, ARDL approach, Iraq.*

المستخلص

يعد الاستثمار الأجنبي المباشر (FDI) جزءً رئيساً من الاستثمار، حيث أن الهدف هو الحصول على فائدة مستدامة أو مراقبة فعالة على المؤسسة التي تعمل خارج اقتصاد المستثمر. إن الهدف الرئيس من هذه الدراسة هو دراسة تأثير تدفقات الاستثمار الأجنبي المباشر الداخلة والخارجة في النمو الاقتصادي للعراق من (1980 إلى 2017). حيث تم استخدام نهج .ARDL . أظهرت نتائج الدراسة أن تدفقات الاستثمار الأجنبي المباشر الوافدة للعراق لها تأثير كبير وإيجابي على النمو الاقتصادي، في حين أن تدفقات الاستثمار الأجنبي المباشر الخارجة للعراق لها تأثير سلبي وذات دلالة إحصائية على النمو الاقتصادي. توصلت الدراسة إلى أن حرب الخليج كان لها تأثير سلبي وحيوي في النمو الاقتصادي خلال فترة الدراسة. كما توصي هذه الدراسة بتنويع مصادر الإيرادات الحكومية من خلال تنويع مصادر السوق الخارجية وتقديم خدمات جديدة لجذب مستثمرين أجانب جدد.

الكلمات المفتاحية: *الاستثمار الأجنبي المباشر، التدفقات الداخلة، التدفقات الخارجة، النمو الاقتصادي.*

1. Introduction

Investment is an asset that an investor possesses or controls, directly or indirectly, which demonstrates a commitment of capital or other resource and an expectation of gain or profit or an assumption of risk (Malik, 2008: 6). Besides, foreign direct investment (FDI) is a main part of investment since the aim is to attain enduring interest or effective control over an enterprise operating outside the investor's economy. FDI could be designated as one of the most noticeable features of the global economy. According to some transnational corporations (TNCs), FDI is considered to be a significant catalyst for reaching economic growth (Azzutti, 2016: 2). It has been viewed as one of the fast- growing economic activities throughout the world (Oyin, 2015: 15).

The IMF (2018) also states that FDI is an investment that seeks permanent interest in enterprises operating in a different economy to the investor. Nonetheless, according to the OECD, a direct investment enterprise is an incorporated or unincorporated enterprise in which a foreign investor possesses 10% or more of the regular shares or voting control. However, in some cases, the ownership of 10% of the regular shares or voting power may not necessarily have any important impact whereas possessing less than 10% could result in a substantial amount of control over the management (Chaudhuri, 2014: 5-6).

There are two types of FDI: **inflows and outflows. FDI inflows** account for the value of inward direct investment made by non-resident investors in the reporting economy, including reinvested earnings, intra-company loans and the net repatriation of capital, and repayment of loans (Barauskaite, 2012: 17). On the other side, **FDI outflows** are the value of outward direct investment made by the residents of the reporting economy to an external economy, comprising reinvested earnings, intra-company loans and the net receipt from the repatriation of capital, and repayment of loans (Barauskaite, 2012: 17).

Most of the FDI flows originate from the OECD countries while the developed countries comprise approximately 80% of the recipients of these inflows (OECD, 2002). However, the share of FDI inflows for developing countries has been growing since 2005, though it remains unequal, with two-thirds of the total FDI inflows going from OECD members to non-OECD countries, such as Asia and Latin America. It was reported that developing countries accounted for a record 52% of the global FDI inflows, surpassing FDI inflows to developed economies for the first time in 2012 (Chaudhuri, 2014: 5). Additionally, FDI outflows from developing countries have grown faster in the last two decades than those from developed countries. According to UNCTAD (2013), the share of developing countries in the total world FDI outflows increased more than thirty-fold from 0.5% in the early 1970s to close to 16% in 2008. FDI outflows from developing countries reached approximately 300 billion US dollars (USD) in 2008, which is more than three times the value of the world's FDI outflows in 1970. Developing countries' FDI outflows have reached 426 billion USD, a record 31% of the world's total outflows (UNCTAD, 2013). Equally, the share of developing countries has been increasing since 2000 due to economic reform in developing countries (Chaudhuri, 2014: 5).

Problem Statement

Iraq could be regarded as one of the most important oil-exporting countries in the world. As such, oil is a vital source of revenue for the Iraqi economy. The overdependence of the Iraqi economy on the oil sector may harm the development of its economy. This is because the price of oil is out of the Iraqi economy's control and is subject to a high level of vulnerability owing to political instability, global economic and financial crises. Conversely, since Iraq has these vast natural resources, they present a great opportunity for FDI. However, FDI is not given significant attention, and the current level of FDI in Iraq does not reflect its resource base and the potential need.

Significance and Motivation of the Study

The aim is to understand the impact of FDI on economic growth for the following reasons:

1. FDI performs a positive and important role in economic growth in both developed and developing countries. Therefore, understanding how to increase FDI inflows and outflows, following the experience of other countries to gain desirable growth outcomes, will be crucial for the Iraqi economy.
2. Given its investment capacity, especially for marketable commodities such as oil and gas to attract FDI, Iraq can be regarded as having a great deal of potential.
3. Research on FDI inflows and outflows in Iraq shows certain strategies and solutions to overcome the obstacles such as (ongoing conflict in Iraq, war, poverty, and corruption …etc.) confronting its economic growth.
4. There are currently limited studies on Iraq to be able to investigate and measure both currents of FDI (the inflows and outflows) and their impact on economic growth.

Objectives of the Study

The main objectives of this thesis are:

1. To examine the impact of FDI inflows and outflows on the economic growth of Iraq.
2. To determine how the Iraqi economy can benefit from the experience gained in other countries in terms of their economic growth as a result of FDI.

Research Questions

To explain the role of FDI inflows and outflows and how they affect economic growth, this study has formulated the following set of questions:

1. What is the impact of FDI inflows on economic growth?
2. What is the impact of FDI outflows on economic growth?
3. How can FDI inflows and outflows impact economic growth in Iraq?

Research Hypotheses

The following hypotheses have been empirically tested to answer the research questions:

Ha_1: Inflows and outflows of FDI positively impact economic growth in Iraq.
Ha_2: Inflows and outflows of FDI have a similar impact on the economic growth in Iraq.

Methodology and Scope of the Study

This study focuses on the impact of FDI inflows and outflows on economic growth in Iraq during the period of (1980 -2017). To achieve this, ARDL approach based on secondary annual time series data was used and data were obtained from the World Development Indicator, World Bank data, and some other local sources.

Research Structure

This study is divided into five subsequent sections. **Section 1:** present introduction, Problem Statement, Significant of the study, research hypothesis, Question of the study**.** **Section 2:** discusses the Literature Review. **Section 3:** primarily describes the theoretical framework of the research, through an analysis of the neo-classical, dependency, and endogenous theories. **Section 4:** presents the results and discussion. **Section 5:** presents the FDI and Economic growth of Iraq. **Section 6:** provides a summary and conclusion.

2. Literature Review

The FDI inflows and outflows and economic growth disparity in countries around the globe have resulted in a great deal of research interest among economists. There is a large body of empirical research in the literature concerning the impact of FDI on economic growth.

(L. Barauskaite, 2012)

The objectives of this study are to determine the world FDI inflows and to analyze the relationship between FDI inflows and economic growth (GDP) in Nordic and Baltic countries. To achieve this objective, the study used Ordinary Least Square (OLS) to cover FDI effects on the world economy. The study found that the entire world's FDI inflows are considerably affected by world economic conditions. That is to say, when there is economic growth, FDI inflows also increase. Also, the highest level of FDI in the world GDP was in 2000 and 2009. The study also found that Nordic countries have attracted much more FDI per capita to their economy than Baltic countries.

(Cuneyt Kilic et al., 2014)

The main objective of this study is to examine the effect of European economic and monetary union on the inflows of FDI to the Euro Zone. The data are collected from International Monetary Fund (IMF) of (20) countries for the period of (1999-2012). Furthermore, apanel data estimation model and theoretical framework for achieving the study objective were used. The study found that the inflows of real (FDI) positively affect real GDP and GDP growth. Additionally, the study also found that inflows of real (FDI) negatively affect exchange rate volatility. In conclusion, the European Economic and Monetary Union contributes to the inflows of FDI by reducing the exchange rate volatility and supporting economic growth.

(Pandya V. & Sisombat S., 2017)

The main objective of this study to examines (FDI) inflows and its impact on economic growth in Australia. The methods used for accomplishing this objective were regression analysis between FDI and different measures of economic growth. The multiple regressions are used to derive a conclusion on the importance of FDI. The results highlight that FDI inflows contribute to the Australian economy including growth in GDP. In conclusion, the findings provide critical information to Australian policy decision-makers to make an informed decision and attractive investment sectors and policies in encouraging foreign investors to invest in the country.

(P. Asheghian, 2004)

The objective of this study is to examine the determinants of economic growth in the United States and to see if there is any time-series support for the FDI-led growth hypothesis in the United States. To achieve these objectives the study uses a model that is based on the postulates of de Mello. The model is estimated using the Beach Mackinnon technique which corrects for autocorrelation. The results of the study show that the major determinant of economic growth in the United States is FDI growth. Additionally, the study shows that there are Causal relationships between FDI growth and economic growth (Uni-directional), running from FDI to economic growth.

(Ridzuan A.R et al, 2017)

The main objective of this study is to analyze the impacts of (FDI) on three main pillars of sustainable development (SD) consists of growth, income distribution, and environmental quality, for two selected countries which are South Korea and France. To achieve this objective the study used (ARDL) estimation technique based on annual data covering the period from (1980 to 2014). The study results show that higher FDI inflows in France are found to increase economic growth as well as improving income distribution in the country. However, the relationship between FDI inflows and economic growth is found to be insignificant, just like its impact on environmental quality. The study recommendation: France should be more selective and only allow those foreign industries that use cleaner energy in their production of goods and services to operate in the country.

(Madariaga. N. & Poncet. S., 2006)

The main objective of the study is to examine the impact of FDI on economic growth in China. To achieve, this objective a data set from (1990 to 2002) for estimation (OLS) was used. Furthermore, the study found that Chinese cities take advantage not only of FDI flows received locally, but also of FDI flows received by their neighbors. In conclusion, a policy of promoting FDI can be justified since Chinese cities benefit from FDI flowing locally and globally.

(Jallab.M. S et al., **2008**)

The main objective of the study is to examine the impact of (FDI) on economic growth in the particular case of The Middle-East and North African countries (MENA). To access empirically this relation in MENA countries, a dynamic panel procedure with observations per country over the period (1970-2005) was used. Also, (standard difference) and “system” (GMM) and (2SLS) estimator were used. The study found that there is no independent impact of FDI on economic growth. The study also found that the growth-effect of FDI does not depend on trade openness and income per capita. While the positive impact of FDI on economic growth depends on macroeconomic stability.

(Tiwari & Mutase, 2011)

The main objective of this study is to examine the impact of FDI on economic growth in Asian countries. To achieve this objective, a panel framework model was used. The data collected by using a panel model from 23 developing Asian countries during (1986 to 2008). The study found that FDI enhances economic growth processes.

(Gupta.K & Grag I., 2015)

The main objective of this study is to examine the time lag required for FDI to make its utmost impact on economic growth in India. To achieve this objective data on FDI and GDP for the period (2000-2012) were analyzed by using lag regression models. The study found that FDI requires a period of three years to make its contribution to economic growth. Thus, there is a need for the regular rise in FDI to bring a continuous increase in economic growth. Furthermore, the study recommendation to attract sufficient FDI, the Government of India needs to improve the investment climate for foreign capital through the maintenance of political, as well as, economic stability along with curbing corruption.

(Al-shawaf and almsafir, 2016)

The study objectives are to look at Malaysia's FDI inflows and outflows and to determine their relationship with economic growth. To achieve this objective annual data cover the period of (1984-2013) and tests based on the autoregressive distributed lag (ARDL) model. The study found that FDI inflows is positively and significantly affect GDP in the long run, while FDI outflows have an indirect relationship with GDP in the long run. Therefore, FDI inflow benefits the Malaysian economy as a whole by boosting the GDP which in turn will lead to a further increase in FDI outflows. It was noted that based on the results, FDI inflows would cause an increase in GDP, while FDI outflows would not have a direct effect of GDP. There was unidirectional Granger causality between them as well as between inflow and outflow of FDI.

(N. Tashpinar, 2011)

The objective of this study is to investigate long-run equilibrium relationship between FDI and real income growth in Turkey. To accomplish the study objective Johansen co-integration and Granger causality tests were used. The study found that there is a long-run relationship between FDI and economic growth. Additionally, the study also shows that FDI has a direct, statistically significant, but the inelastic impact on economic growth in Turkey in the long run. Finally, Granger causality tests show that FDI inflows in Turkey are output and saving driven. When income and saving in Turkey increase, this will attract more FDI.

(Habibi F.and Karim S. M., 2017)

The main objective of this study is to investigate whether FDI affected economic growth in Iran and the Gulf Cooperation Council (GCC) countries over the period (1980-2014). To accomplish this objective (ARDL) model was used. Nonetheless, the empirical results show that FDI is one of the major drivers of economic growth in Iran and (GCC) countries. The result of the study also indicates that there is a long-run steady-state relationship between FDI and GDP in Iran and for An individual country of GCC.

(**Al-tamimi S.A., 2008)**

The main objective of this study is to determine both of the positive and negative effects of FDI on Iraqi economy. This objective is achieved by studying the reality of the Iraqi economy , and diagnosing the restrictions facing the multinational enterprises that restrict inflows of FDI to Iraq. The study found that FDI has positive effects on Iraqi economy such as (Transferring of technology, capital accumulation ,and creating job opportunities …etc.). On the other hand, the study also found that there were plenty of negative effects of FDI on the Iraqi economy for instance (crowding –out of national firms, creating uneven growth in economy sectors). In conclusion, the government of Iraq should determine the continuous assessment of its investment policies to get benefit from FDI for its economic growth and development.

(Abas S.A., 2010)

The main objective of the study is to determine the economic dimensions of FDI and its impact on the structure of the Iraqi economy. In order to achieve this objective descriptive economic analysis method (DEAM) was used. The result of the study shows that FDI contributed positively to economic growth in Iraq, and had a positive impact on the Iraqi economy if suitable investment circumstances were available.

(Ghassan F.H et.al, 2014)

The main objective of this study is to assess the determinates of FDI in Iraq's energy sector. To achieve the study objective, a qualitative methodology and an explorative case study design were used. Also, the data were collected from interviews with business and government subject matter experts, and a review of publically available documents. The study found that despite Iraqi's huge potential to attract FDI, but the political instability, security, and corruptions were factors impacting negatively on FDI inflows.

(M. N.Al zibedy, 2017)

The objective of this study is to examine the contribution of FDI in Iraqi's economic development. To achieve this objective, the study used a theoretical and analytical framework of the reality of Iraqi economy, also investment environment and their determinates, according to the data available in this field. Moreover, the study result shows a weak relationship between FDI and the process of development of the Iraqi economy, due to low FDI inflows to Iraq. The study main recommendation is that Iraq has to build functioning mechanisms to promote FDI.

(Mrzuk & Ali, 2017)

The main objective of the study is to examine the influences of FDI on Iraqi economy after 2003, to compare inflows and outflows of FDI in Iraq and to compare it with some countries such as (France, Qatar, Turkey , and Indonesia). To achieve this objective the study used the comparative investment data of inflow and outflow. The result of the study shows the inflows of FDI to Iraq is larger than the Iraq outflows of FDI.

The existing evidence is, however, mixed with some studies showing the positive impact of FDI on economic growth while others report limited or no evidence. In this section, a review of the relevant existing literature was presented to ascertain the impact of FDI on economic growth. Furthermore, most of the studies showed that there is a positive and significant impact of FDI inflows and outflows on economic growth in developed and developing countries and that the main determinant of FDI in developing countries is trade openness, financial freedom , and domestic capital stock constituting. However, in the case of Iraq despite its huge potential to attract FDI, the political instability, the security conditions, and corruption were factors that negatively impacted FDI inflows and outflows. Further, the Iraqi economy does not receive sufficient benefits from FDI to promote its economic growth. Moreover, some of the studies suggest that to allow FDI to be able to contribute positively to economic growth, Iraq should have a sufficiently developed financial system, and be able to implement an open-door policy.

3. Theoretical Framework

The main purpose of the theoretical framework adopted in this thesis is to understand the fundamental of the study.

3.1 Definition of Investment

Investment is the current commitment of money or other resources with the expectation of gaining future benefits. For instance, an individual may purchase stock shares expecting that the future proceeds from the shares will justify the time and money committed and the investment risks (Bodie et al., 2008: 1). In other words, the term 'investment' means every kind of asset invested directly or indirectly by investors of one contracting party in the territory of another contracting party (Qi, 2011: 164).

Foreign direct investment (FDI) is an investment made to acquire a permanent management interest (normally 10% of the voting stock) in a business enterprise operating in a country other than that of the investor which is defined according to their residency (World Bank, 2018).

Foreign indirect investment (FII) is also called international indirect investment. It refers to economic activities in which investors increase the value of their invested capital through the purchase of foreign stocks, other securities or the provision of loans. To be more specific, the investors do not become involved, nor do they have any say in the operations and management of the invested enterprises; they simply invest in particular stocks and securities that can provide an income (Huan, 2011: 8).

3.2 FDI Classifications

According to the IMF (2018) guidelines and the existing statistics on the FDI flows between a country and the rest of the world, they are classified into two main categories: FDI inflows (FDI inward flows) and FDI outflows (FDI outward flows).

FDI inflows are the value of inward direct investments made by non-resident investors in the reporting economy, including reinvested earnings and intra-company loans and the net repatriation of capital and repayment of loans. A country's FDI inflows at the end of a given period are the total amount of direct investments it has received from non-resident investors during this period.

FDI outflows are the value of outward direct investments made by the residents of the reporting economy to external economies, including reinvested earnings, and intra-company loans and the net receipts from the repatriation of capital and repayments. Moreover, a country's FDI outflows are the value of all GIs, joint ventures and mergers and acquisitions (M&As) made abroad by the residents during a given period.

3.3 Advantages and Disadvantages of FDI

Advantages of FDI

Furthermore, there are many benefits of FDI for most countries' economies which can be summarized as follows (Meskerem, 2014: 9; Barauskaite, 2012: 7; Wang, 2017: 4):

1. FDI enables a country to reduce the scarcity of capital and other strategic sources and increase the possibility for both companies and countries to develop various technologies with greater speed. Moreover, FDI acts as a catalyst for increasing domestic savings and investment.
2. FDI acts as a vehicle for the transfer of advanced manufacturing technologies from the developed countries (DCs) to the less developed countries (LDCs).
3. FDI increases competition in the host countries' markets.
4. FDI helps the host countries improve their foreign exchange reserves (or their balance-of-payments position) by increasing exports, finding new market niches for products, and services and reduces the burden of imports on the host countries through import replacement.
5. FDI brings the management know-how necessary to run the facilities and to take over the most recent methods of management and work organization. Furthermore, FDI enhances the training and employment opportunities for the people of the host country.

Disadvantages and limitations of FDI

Despite the advantages of FDI, there are also several disadvantages, which can be summarized as follows **(**Barkauskaite and Naraskeviciute, 2016: 62):

1. Technology and skills from foreign countries can have certain negative consequences, such as unfair competition between foreign and domestic corporations.
2. FDI harms the domestic producers, which can occur when local producers lose their position in the market because foreign investors have monopolized it. It indirectly starts to affect local manufacturers, who must try to survive in the market with foreign companies, and as such, it may displace local businesses, increase the competition between firms in a certain sector to achieve economic benefits, and move earned capital out of the country.

3. FDI can raise fears of a somewhat nationalistic nature. FDI, especially when it includes the control of major sectors of individual companies, a nation's economy, or even landmarks like buildings, can raise concerns that foreign entities may be overcoming of resources that are vital to a nation's identity or even security.
4. Another concern is that corporations in richer countries are closing their higher-cost domestic manufacturing operations and sending them overseas to developing countries where they can take advantage of lower wages and less restrictive environmental regulations. This allegedly results in a switch by corporations from domestic production toward a greater reliance on imports and causes higher domestic unemployment.
5. Increasing disparity in economic sectors is a further negative consequence. It has been shown that FDI is unevenly distributed between different sectors in a country owing to the returns of some economic sectors, such as the oil sector in Iraq.

3.4 FDI and Economic Growth Theories

This part deals with the main FDI theories that have been examined in the literature. Many economic theories evaluate the prominent role of FDI in a country from a positive and negative point of view. Economic theories such as the Neo-classical, Dependency theory, the Endogenous growth model and the Modern theory are going to be considered as the basic points of discussion, as follows:

Neoclassical theory

The Neoclassical theory of economic growth directly emerges from Harrod-Domar's model. The neoclassical point of view is based on a simple principle in Economics, which proposes that economic growth requires a capital investment in the form of a long-term commitment (Oyin, 2014: 16). Thus, this theory creates an improved link between the FDI and economic growth of most countries, particularly developing countries. In terms of the relationship between FDI and economic growth, it is Neoclassical economics considers that FDI only impacts GDP per capita (Yt/POPt) and not economic growth (Yt – Yt–1 /Y t–1). Hence, FDI is not the economic growth engine in the long term. Nonetheless, Neoclassical theory argues that FDI contributes to economic growth via capital accumulation. It further suggests that long-term economic growth depends on technology and employment tools. Constant technological development is a pre-condition for FDI to play a positive role in a country's economic growth. However, these models suggest that FDI has the same impact as a domestic investment on a country's economic growth.

The Neoclassical Theory of capital movement regarded the movement of FDI as part of the international factor movements. Based on the Hecksher-Ohlin (H-O) model, the international factor movements of production, including FDI, are determined by different proportions of the primary production inputs available in different countries. International capital movement implies a flow of investment funds from countries where capital is relatively abundant to countries where capital is relatively scarce. In other words, capital moves effectively from countries with low marginal productivity of capital to countries with high marginal productivity of capital. As such, these international investments may benefit the investing and the host countries. The host country may benefit from an increased income from FDI to the extent that the productivity of the investment exceeds that which foreign investors take out of the host country in the form of profit or interest (Ali, 2014: 75).

Dependency theory

The dependency theory is based on Marxist thought. It was developed in the late 1950s under the supervision of the Director of the United Nations Economic Commission for Latin America, Raul Prebisch. Prebisch and his colleagues were disturbed by the fact that economic growth in the advanced industrialized countries did not necessarily result in growth in the poorer countries (Ferraro, 2008: 1). They argued that developing economies face the prospect of FDI negatively impacting them owing to profit repatriation, declining reinvestment, and income disparity. Thus, FDI inflows to the "outside" divert local firms, stifle technological innovation and "crowd out" domestic firms. Despite FDI showing a positive impact on growth in the beginning, in the long run, the dependence on FDI has a negative impact on economic growth. The institutions and infrastructure support further FDI and negative spillovers, such as income disparity, unemployment and over-urbanization (Javaid, 2016: 16).

Endogenous growth theory

While neoclassical theory assumes the idea that long-term investment is a positive determinant of economic growth in a country, dependency theory explains a nation's economic growth and development in terms of certain external influences that are political, economic and cultural on national development policies (Ferraro, 1996: 2). However, endogenous growth theory reveals that physical investment is not a measure of a nation's economic growth. Instead, it is the effectiveness and efficiency in the use of these investments that is important. Economic models of endogenous growth have been applied to study the effects of FDI on economic growth through the diffusion of technology. This theory demonstrates an improved relationship between the FDI and economic growth of developing countries. According to Endogenous growth models**,** attracting FDI through a technological transfer can give rise to economic growth. FDI can cause economic growth from overflows and a technological transfer if a rising return on production is achieved (Oyin, 2014: 17). R&D models within this theory emphasize the constant rate of return on capital and R&D. Nonetheless, following these R&D models, long-term economic growth is explained by capital accumulation and R&D, respectively. Furthermore, in the overlapping generational model, the degree of technology spillover is determined by FDI inflows, and the technological gap is conditional on the country's level of infrastructure (Leitão and Rasekhi, 2013: 3).

Modern theory

This growth model is defined by the driving force of economic growth in the innovation or development of already existing products. The model focuses on increased capital as a result of innovation in that they play an essential role because they prompt the market to provoke further competition, thus enhancing economic development (Javaid, 2016: 18). Within this modern theory, FDI is believed to affect production per capita and economic growth. Although many theories show that FDI results in economic growth through certain factors, such as a transition of technology, technological spillover and an increase in productivity, there are other theories that take the opposite position. The latter theories predict that FDI could be harmful to resource allocation in the presence of preexisting trade, price and other financial disorders and that it could decrease economic growth. This is mostly observed in developing countries. Nevertheless, the main problem in such countries may be their weak economic structure; for instance, improper infrastructure, weak human capital, traditional and old technology does not make the necessary capacity available to attract the required advanced technology and knowledge (Behname, 2012: 4).

From these discussions، each of these theories holds different assumptions and depends on different variables to obtain the right conclusion and each theory applies to a different group of countries (that is developed and developing countries).

4. Case Study: Background and Motivation of FDI in Iraq:

4.1 The reality of FDI in Iraq

Iraq has the third-largest oil resource in the world in addition to an abundance of other natural resources, offering business opportunities for foreign investors. However, foreign investors have avoided the country due to its ongoing unrest. This includes two wars: the Iran-Iraq War from 1980 to 1988 and the Gulf War in 1991. It also suffered from the UN embargo for about 13 years in which there was almost no foreign investment despite attempts to attract it into the country. In 2002, Iraq issued the Arab Investment Law (62), which limited investment to Arab investors[*]. It was replaced by Law (13), (2006). The provisions of this law apply to all areas of investment, including oil and gas processing projects, but they exclude those in extraction, production and investment in banks and insurance companies, which are yet to be regulated (Hanna and Hammoud, 2014: 2-5).

- Foreign investment in Iraq is not new while some imagine that its beginnings are related to the exploration of oil in Iraq in 1927. In 1950, the dependency was on foreign companies after the Council of Reconstruction was founded for the purpose of realizing numerous projects in the fields of agriculture, irrigation, roads and bridges. From 1963 onwards, a change in economic thought inclined towards a totalitarian central system known as a socialist doctrine, and this pushed for making decisions contrary to foreign investment and later mapped the way for dominance over all the attachments of the economic state, including decisions of nationalization and exportation. The regime attempts at economic reform in the late 1980s provided some limited avenues for FDI. And during the UN embargo, the regime specifically prohibited foreign investment. Many decisions were made and laws were passed in Iraq in relation to encouraging FDI. All these laws were acting as boosters for Arab investment and Arab capital flows. Foreign investment was prevented officially according to the Law (36), (1983), and this prevention reached a level in which the foundations and capital sharing on the part of Iraqi companies with Arab companies involving foreign capital (unclear sentence- amend) (for further information see Abbas (2010: 3), Al-Aaamri (2007: 203), Al Azawiwy (2015: 13) and Sanford (2003: 20).

Prior to 2003, given the ideologies dominant at the time, Iraq had not yet possessed the experience of attracting FDI. Iraq considered a foreign investment to be detrimental to the national politics combined with the socialist thought prevalent during the previous rule. Despite the state's attempts to encourage Arab investment by extending privileges through legislation codes, Arab investment remained limited to several joint companies. The reason for this was the political circumstances surrounding the Arab political systems and the existing disagreement about the UN economic embargo on Iraq, which was reflected in the economic activity. That is why it is necessary to alleviate the situation for Iraq to be able to receive FDI and foreign companies.

After 2003 and the transformation in the market economy, the way was paved for investment capable of serving the national economy, especially FDI through the Foreign Investment Law (39), (2003). This law enabled foreign banks to open branches in Iraq. Nonetheless, all these measures were not adequate to attract the necessary FDI due to a lack of an encouraging business environment for foreign investment, the political situation and the unpredictable conditions in the country. This also reflected weakness in the Foreign Investment Law (39), (2003) as a result of the bureaucratic procedures, administrative corruption, legal and administrative intersections, which negatively affected Iraq's potential to enter into the world economy (Al Tamimi, 2008: 15; Azzuti, 2016: 16; Iraqi Parliament Research Center, 2012).

4.2 Advantages and disadvantages of FDI to the Iraqi economy

FDI has many advantages and disadvantages, which differ across countries and time, but for the Iraqi economy, they can be divided into the following:

Advantages of FDI to the Iraqi economy

FDI has constituted a source of finance in developing countries including Iraq, and it is an engine of economic development in most countries in the world. The advantages of FDI on the Iraqi economy can be explained as follows (World Bank, 2014; Al- Azawiwy, 2015: 17-20; OECD, 2016: 18):

A: Iraq suffers from financial and economic dilemmas due to several undergoing wars, economic sanctions, political corruption and internal conflicts. Moreover, Iraq cannot solely depend on oil revenues for financing its economy since this poses many risks. Hence, Iraq should provide new financial resources and foreign capital to finance plans for diversification for the reconstruction of destroyed areas owing to the war.

B: FDI can create job opportunities, develop human capital, provide access to capital and technology and enhance productivity.

C: FDI works by stimulating the competition between Iraqi companies, institutions and their foreign counterparts؛ it is represented by reducing the monopoly and stimulating companies to provide improved goods and services.

D: Another advantage is opening new markets for exportation, especially when foreign companies reach the exportation markets with their high marketing expertise. FDI can also contribute to improving the Iraqi balance of payments by increasing export opportunities.

Disadvantages of FDI to the Iraqi economy:

Although FDI can contribute to stabilization and economic growth, it also has certain disadvantages, which can impact the Iraqi economy negatively, as described in the following (Xalaf, 2010: 12-13; Essays, 2013: 6-9; OECD, 2016: 18):

A: FDI in Iraq does not always represent positive economic investments in that productivity may not increase if the investment constitutes the purchase of a state company to privatize it. This only leads to the process of transferring a company from national to foreign ownership.

B: Some of these investments do not include a new flow in the net FDI, but they can represent a re-strengthening of aspects of existing international companies in Iraq.

C: Directing certain investments toward non-friendly environmental industries, such as the oil industry, may not serve the Iraqi market and economy since it may contradict the multi-national corporation (MNC) approaches.

D: FDI can have a dual economy, with a developed sector mostly owned by foreign firms and an underdeveloped sector owned by domestic firms. Since the country's economy becomes over-dependent on the developed sector and its economic structure changes. Often, this developed sector is the capital-intensive one while the other is labor- intensive such as the crude oil sector in Iraq.

4.3 FDI and economic growth in Iraq

Nowadays, FDI is considered to be an engine of economic growth in most developed and developing countries, including Iraq, thus acquiring FDI are essential, especially for the Iraqi economy since it is a source of economic growth (Hammad, 2013: 12). Despite its importance, FDI has not had a notable impact on the Iraqi economy due to uncertainty in the region, political instability and certain economic issues (Al-Ma'amudy, 2005: 102). FDI net inflows as a percentage of its GDP in Iraq were (0.09) in 2016. Its highest value since 1970 was (2.19) in 2013 while its lowest value was (-0.33) in 1975. The FDI net outflows (as a % of GDP) in Iraq were (0.177) in 2016. Its highest value since 2005 was (0.468) in 2006, while its lowest value was (0.009) in 2007 (World Bank and IMF, 2018).

Needless to say, conflict and economic growth are two constructs that work in opposite directions as the risk of violence is accentuated by poor economic performance, which further complicates efforts to reach political reconciliation. The country's risk factors, such as political, economic and financial instability, have adverse effects on the FDI inflows. Governments interested in attracting FDI need to lower their countries' risk factors (Al-Nasrawi, 2001: 14).

Furthermore, the Kurdistan region (KRG) is a safe and sustainable part of Iraq, which has a self-contained economic system and a welcoming environment compared to the rest of the country. Its rich natural resources (including oil and gas), and competitive investment laws are expected to attract FDI into the region. The KRG issued Law (4), (2006), which took precedence in the region over the Iraq Investment Law (13), (2006) (Hanna and Hammoud, 2014: 7). Since the issuance of the Investment Law (13) for the year 2006 in the KRG, the amendments between 2009 and 2013 and the added advantages of new investors, the Investment Commission in the KRG has been granted from 2009 to 2016 1336 billion USD, distributed across various sectors. It also announced 992 FDI opportunities in 2016, distributed across the three provinces in the region and various economic sectors (Al-Mihya, 2017: 3). Additionally, the total investment in all sectors in the region for the period 2006 to 2016 equated to 47 billion USD. The proportion of foreign investment did approximately 6.1 billion USD equal 13% of the total investment in the region. Moreover, 36.8 billion USD equated to 78.4% of the total investments were domestic investments. Further, the proportion of joint investments was only 4 billion USD, which equals to 8.6% of the total investment (Investment Board - Kurdistan region, 2017).

To attract FDI and improve the living standards of its citizens, a post-conflict state, such as Iraq, should undertake the creation or rebuilding of the destroyed infrastructure. As such, it could shift from a war economy to a market one and resume relations with the international community. The capacity to transition to a rule of law represents a major challenge for FDI in Iraq. Without this stability, there is an increase in the potential investment risks owing to the absence of the required institutions and systems to guarantee a successful investment (Al-Nasrawi, 2001: 14). Likewise, Iraq necessitates a sense of openness so that FDI can cover the reconstruction of destroyed areas to be able to develop an economic model that reduces oil dependency through economic diversification and a stronger private sector. Iraq's ability to attract and mobilize investment is necessary (that is local and foreign investment), and it is necessary for reconstructing the destroyed area and economic revitalization. Investment, especially outside the hydrocarbon sector, can create jobs and new perspectives, allowing for growth and development, which will, in turn, contribute to setting conditions for stability and peace. They can also generate fiscal revenues, which, if well managed, can enhance human and physical capital and ultimately support further private investment (OECD, 2016: 5-11).

5. Results and Discussion:

This section consists of the data collection, variable descriptions and model specification, time series estimation by using (ARDL) approach with stationary and co-integration tests.

5.1 Data collection and the sources of data:

The current study used annual secondary data for the Iraq for a period (1980-2017). The data were obtained from the World Bank's World Development Indicators, United Nations Conference for Trade and Development (UNCTAD), Central bank of Iraq and the

Ministry of Planning of Iraq. The reasons for choosing these data sources are their reliability and wide use. On the other hand, the databank from World Bank offers various data arrangement tools.

5.2 Variables description:

For better understanding, the current study attempts to describe all variables used in econometrics analysis for all countries, which are as follows:

Table 1: Variable description and the sign of variables

Variables	Description	Sign according to Theory	Sign according to literature	Expected sign
GDP	GDP (current US$)			
IN	Foreign direct investment, net inflows (BoP, current US$)	(+)	(+) (-)	(+)
OUT	Foreign direct investment, net outflows (BoP, current US$).	(+)	(-)	(-)
ER	Real effective exchange rate index u(2010 = 100)	Causality	(+) (-)	(-)

Source: prepared by researcher based on:

1. سامي عبيد التميمي، 2008. الاستثمار الأجنبي المباشر في العراق: الواقع والتحديات مع نظرة خاصة لقانون الاستثمار الأجنبي لعام 2006. مجلة الغري للعلوم الاقتصادية والادارية، 2(9).
2. عاطف لافي مرزوك، 2017. الاستثمار الأجنبي المباشر وأثره على الأداء الاقتصادي في العراق-القيود والحدود. *مجلة مركز دراسات الكوفة*، *1*(44).
3. Basirat, M., Nasirpour, A. and Jorjorzadeh, A., 2014. The effect of exchange rate fluctuations on economic growth considering the level of development of financial markets in selected developing countries. *Asian Economic and Financial Review*, *4*(4).

5.3 Model specification

To model the relationship between FDI and economic growth, a functional form model containing (FDI inflow, FDI outflow, Exchange rate and GDP) can be expressed as follows:

$$GDP = f(IN, OUT, ER, D) ....1$$

The functional equation (1) can be converted to an econometric model by introducing a drift parameter, slop of each explanatory variable and the stochastic error term, as shown below:

$$LGDP_t = \beta_0 + \beta_1 LIN_t + \beta_2 LOUT_t + \beta_3 LER + D1, D2, D3, D4, D5, D6 + U_t ....2$$

Where:

LGDP = economic growth.
LIN = net FDI inflow
LOUT = net FDI outflow
LER = real effective exchange rate.
β = intercept parameter.
U = random error term that is expected to be normally distributed.
D1to D6 = dummy variable that represents the event that happened in Iraq.

The coefficients are the parameters of the econometric model, and they define the directions and strengths of the relationship between GDP and the factors used to determine in the model (called Explanatory Variables). Is the major coefficient of interest that tells the percentage response in GDP growth for a percentage change in inflow / and or outflow FDI.

5.4 Time series estimation by using (ARDL):

To examine the impact of inflows and outflows of FDI on the economic growth of Iraq, the study uses (ARDL) approaches for estimation. The estimation of the variables is tested using E-views 9 software.

5.4.1 Stationary test Unit root test (Augmented Dickey-Fuller ADF)

A stationary series is a key idea in time series. It refers to the mean of the series, which is no longer a function of time. Stationary series play a fundamental role in the study of a time series (Studenmund, 2014: 402). In the literature, there are several stationary tests, namely the Dickey–Fuller (DF), the Augmented Dickey–Fuller (ADF), the Phillips-Perron (PP) and the Kwaitowski, Phillips, Schmidt, and Shin (KPSS) tests. The most commonly used tests in the literature are the ADF and the PP. Hence, this study employs the ADF unit root test. The stationary test result is reported in the table below:

Table 2: Result of Unit root test for variables in economic growth model for Iraq

Variables	Intercept	Trend	
LGDP	0.0000*	0.0001*	**Note: (*), (**) denotes Significant at 1%, 5% respectively.**
LIN	0.0007*	0.0029*	
LOUT	0.0086*	0.0426**	
LER	0.0000*	0.0002*	

From table (2), all variables with log (GDP, FDI inflow, FDI outflow and ER) are stationary in the first difference (intercept and intercept with trend) at the 1% and 5% significance level, respectively.

5.4.2 Co-integration test

The co-integration concept relates to whether the variables are co-integrated, then spurious regressions can be avoided even though the dependent variable and at least one independent variable are non-stationary (Tashpinar, 2011: 34). A time series is believed to be integrated. Additionally, there are several methods for examining the co-integration analyses. The Johansen procedure is the most commonly used in the literature, amongst others. The Johannsen co-integration result is reported in the table below:

Table 3: Summary of the Johannsen co-integration test

Variables	Critical value 0.05	Prob.
LGDP	63.8761	0.0009**
LIN	42.1953	0.0105**
LOUT	25.8721	0.111
LER	12.5179	0.5744
(**) denotes rejection of the hypothesis at 5% (significance level).		

The above table trace tests indicate (2) co-integrating eq(s) at the 0.05 level for Iraq. Therefore, the null hypothesis of no co-integration among the variables is rejected. Additionally, the table also indicates.

5.4.3 Economic growth Model estimation for Iraq:

Estimation is the process of finding an estimate or approximation, which is a value that is usable for some purpose even if the input data may be incomplete, uncertain or unstable. There exist hundreds of methods in the literature that can be used for estimating, but, nowadays, the most common methods used are OLS, ARDL, VAR and GMM. However, the current study will use the ARDL approaches for estimation. The tables below present the result of ARDL estimation for Iraq:

Table 4: Estimation for economic growth model using ARDL approach

Regressors/ Iraq	**1980-2017**	**2005-2017**	**Dummy variables**
Constant	7.384[0.0186]	10.4699[0.3405]	Global financial crisis(D1) -0.4578[0.5223]
FDI inflows (LIN)	0.1843[0.0057]	0.5011[0.2745]	Iraq Iran war (D2) -0.4578[0.2438]
FDI outflows (LOUT)	-0.232[0.0832]	0.2632[0.0712]	Golf war (D3) -1.663[0.0001]
Real effective exchange rate (LER)	-1.8076[0.0055]	3.2996[0.0377]	Economic embargo (D4) 0.922[0.0029]
			Iraq war 2003(D5) -0.3132[0.5026]
			Financial crisis in Iraq (D6) -0.1988[0.7023]

Table (4) shows that from 1980 to 2017 the (IN) has a coefficient positively signed. It illustrates that FDI inflow has a positive and statistically significant impact on economic growth (GDP) within the study period in Iraq. Thus, a one percent increase in FDI inflows leads to (GDP to increase by 0.18%. The positive sign of FDI inflow in Iraq is due to technology transfer, spillover effects, productivity gains and the introduction of new processes and managerial skills. This result is supported by (Abas, 2010) showing that FDI contributed positively to economic growth in Iraq and might have a positive impact on the country's economy when suitable investment circumstances exist. However, the FDI outflows in Iraq have negatively signed a coefficient, illustrating FDI outflows have a negative and statistically significant impact on economic growth. This is consistent with the literature and expected sign developed by (Al-tamimi, 2008). Hence, FDI outflow may lead to (crowding –out of national firms, creating uneven growth in economy sectors). Furthermore, according to (Mrzuk & Ali, 2017) the inflows of FDI to Iraq is larger than the Iraq outflows of FDI. Additionally, the (ER) has negatively and statistically significant impact on economic growth.

The second part of the table presents dummy variables: D1 represents the global financial crisis which an impact on economic growth in Iraq was negative. While D2 represents Iraq-Iran war which the impact is also negative on economic growth. Additionally, the impact of D3 which represents The Gulf War is negative, statistically significant on economic growth and its impact is larger in comparison with other dummy variables. On the other hand, D4 represents economic embargo on economic growth which the impact is positive on and statistically significant on economic growth, but this is opposite to what is expected since the impact of economic embargo on Iraqi economy has had negative and strong. Likewise, D5 represents the Iraqi war (2003) that harmed impact on economic growth. Finally, D6 represents the financial crisis in Iraq (2008) which an impact on economic growth is negative and statistically significant.

5.4.4 Diagnostic Checking for economic growth model:

One of the most important steps in a time-series regression model is checking the model and the goodness of fit. The purpose of diagnostic checking is to check the adequacy of the applied method. In the current study, a diagnostic test has been applied to ensure the fit and accuracy of the ARDL approach. Besides, diagnostic checking includes six main tests (Autocorrelation problems, Multicollinarty problem, Heteroscedasticity problem, Model specification and model accuracy, Normality problems and Stability problems) that are performed to fit the model adequacy theoretically, statistically and economically. The diagnostic tests and statistical indicators are presented in the table below :

Table 5: Diagnostic tests and Statistical Indicators for the economic growth model

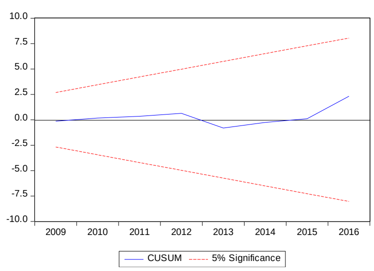
Tests	LM test	(ARCH) test	Ramsey RESET test	Jarque-Bera	VIF	CUSUM & CUSUMQ
R-Squared = 0.93	F-statistic	F-statistic	F-statistic	F-statistic	Centered VIF	-

Adjusted R^2 = 0.92	0.1426 [0.8700]	0.6988 [0.4248]	0.2179 [0.6548]	Not applicable [0.7182]	Less than 10	Stable

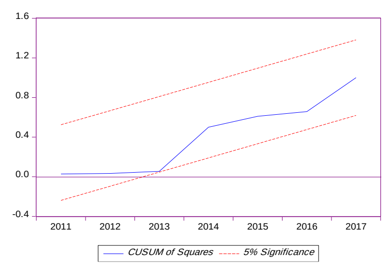
Table (5) shows that for all the tests that used (LM, ARCH, Ramsey RESET, Jarque-Bera and Variance Inflation Factor) the F-statistic is more than the critical value. The model passed these tests. The null hypothesis (H0; the econometrics model does not exist) is accepted for the economic growth model. Therefore, the ARDL models are correctly specified. Table (5) also shows that the R^2 and adjusted R^2 are too high for the economic growth model. This finding shows that the model fits the data and has the correct specification.
Additionally, the study used (CUSUM and CUSUMQ) for checking the problem of structural change which there is no evidence of this Problem and involves the existence of a stable relationship between variables. The relationship between economic growth and foreign direct investment as follows:

Fi Figure 1: Relationship between Economic Growth and FDI inflows and outflows for Iraq

Plot of Cumulative Sum of Recursive Residuals



Plot of Cumulative Sum of Squares of Recursive Residuals



6. Conclusion and Recommendation

First: Major Findings and Conclusion

The study findings and conclusions are as follows:

1. FDI inflow has a positive impact on economic growth (GDP) within the study period (1980-2017) in Iraq. However, FDI outflows in Iraq have a negative significant impact on economic growth.
2. FDI inflows and outflows beyond (2005) have positive and similar impact on economic growth. Also, the study estimates the impact of FDI inflows and outflows from (2005 to 2017) or after the government abolished all the previous decrees and issued a new law by the name of the Iraqi Investment Law (13) which had positive impacted FDI. So the relationship between FDI and economic growth in Iraq is positive.
3. The study found that (ARDL) model fits the data and has a correct specification, as a result of the (R^2 and adjusted $R^{2,}$ F-statistic and the value of S.E regression). Besides, (ARDL) estimations can be used for forecasting purpose since based on diagnostic checking, the (ARDL) model is free of econometrics problems and the structural change in the model are very small and accepted.

Second: Recommendations of the Study

Relying on the conclusions, the current study recommends the following:

1. Iraqi government should diversify its FDI inflows to cover all the sectors in the country not only the oil and gas sector. It should determine the continuous assessment of its investment policies to benefit from FDI for its economic growth and development.
2. Getting benefit from the experience gained in other countries in terms of their economic growth as a result of FDI, including developed countries such (USA, UK and France) and developing countries such (Malaysia, Turkey and Iran) which have improved economic growth due to FDI inflows and outflows.
3. Iraqi government should build functioning mechanisms to promote FDI. The policy-makers should facilitate for FDI through activating investment law, employing transparency principle, eliminating routine, confronting financial and administrative corruption, offer business opportunities for FDI inflows and outflow, provide more incentives to foreign investors to ensure the flow of more foreign investments and protect foreign investors and make friendship with domestic investors by joint investment.

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