

العنوان:	Foreign Direct Investment and Economic Growth in Kuwait
المصدر:	المجلة العراقية للعلوم الاقتصادية
الناشر:	الجامعة المستنصرية - كلية الإدارة والاقتصاد
المؤلف الرئيسي:	Al-Mihyawi, Sabah Noori
المجلد/العدد:	مج 17, ع 60
محكمة:	نعم
التاريخ الميلادي:	2019
الصفحات:	91 - 103
رقم MD:	995467
نوع المحتوى:	بحوث ومقالات
اللغة:	English
قواعد المعلومات:	EcoLink
مواضيع:	الاستثمار الأجنبي، التكنولوجيا الحديثة ، التطورات المالية
رابط:	http://search.mandumah.com/Record/995467

Foreign Direct Investment and Economic Growth in Kuwait

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Abstract

There is a strong belief that foreign direct investment has positive effects on host countries by providing jobs, training, technology transfer, licensing agreements, creating links between foreign and domestic companies, as well as direct capital financing, thereby boosting the economic growth of any country. Moreover, other factors push developing countries to try to attract foreign direct investment. This result is not absolute because some studies indicate that the ability of a country to benefit from the process of attracting foreign direct investment may be affected by many internal factors, including the level of education and the availability of skilled labour, the development of financial markets. Some studies also indicate a negative impact of foreign investment flows at the level of the local economy. This paper attempts to clarify the relationship and explore the direction of interaction between FDI and economic growth in Kuwait for the period 2000-2016 and to determine whether the impact of investment flows negatively or positively on economic growth using a range of economic variables and using the program EViews to perform calculations by regression analyses. The study showed that there is no relationship between foreign direct investment and economic growth in both directions and there is a positive relation between GDP and some other variable and with non-relation with inflation.

Keywords: FDI, GDP, Kuwait
JEL Classification: F21

1. Introduction

FDI inflows in the 1990s were concentrated on developing countries. Unlike other capital flows, foreign direct investment is less volatile and does not exhibit pro-cyclical behaviour. Thus becoming the "preferred capital flows" of developing countries.

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Although foreign direct investment is important, its impact on economic growth on the host country varies from country to country. Thus, the problem of the study is trying to identify the impact relationship between foreign direct investment and economic growth in both directions and the effect of foreign investment on GDP as an indicator of growth in Kuwait and this is the study problem of this study.

The hypothesis of this paper there is a relationship between foreign direct investment and economic growth in both directions and there is a positive relation between GDP and some other variable on the period 2000-2016.

The paper aims to identifying the trends of both GDP and foreign direct investment flows of the State of Kuwait for the period 2000-2016. In addition to test the causal relationship between foreign direct investments flows to Kuwait and gross domestic product during the study period. This study also tests the relationship between a various variables and gross domestic product in Kuwait during the period 2000-2016.

This paper contains the introduction, and the second section deals with the social and economic effects of foreign direct investment, the third section deals with foreign direct investment in Kuwait, fourth section reviews the literature on the study, and the fifth section deals with the quantitative application aspect.

2. The economic and social effects of foreign direct investment

Foreign direct investment (FDI) as defined by the IMF and ECO is the objective of obtaining permanent interests by an investor in a country in an investment institution in another country (UNCTAD, 2015). The Foreign direct investment also defined as the ownership of foreign assets and this property may be wholly or partially of a company in a foreign country called the host country (Juma, 2015). FDI is also defined as a company investing in projects outside the country's borders. FDI can take many forms, such as establishing a whole new project, buying existing projects, or through mergers and acquisitions (Al Mihyawi, 2016).

Attention to the increasing role of FDI in developing economies and the growing expectations of its contribution to higher economic growth rates, job creation in the host country and the contribution of investing companies to improved production practices, the transfer of new technology and other expected benefits. But these activities do not prevent the existence of many of the negative economic and social effects and other positive that may accompany the transfer of capital to the host country.

There is no doubt that the positive economic and social effects of foreign investment, of which we have already referred to some of them, are well known and aimed at raising the level of economic development in the host country.

While the negative effects Some economists accuse investment companies of unfair competition by taking advantage of low wages, and the violation of human rights and labor rights in host countries by not respecting the rules of international labor (OECD, The Social Impact of Foreign Direct Investment, 2008).

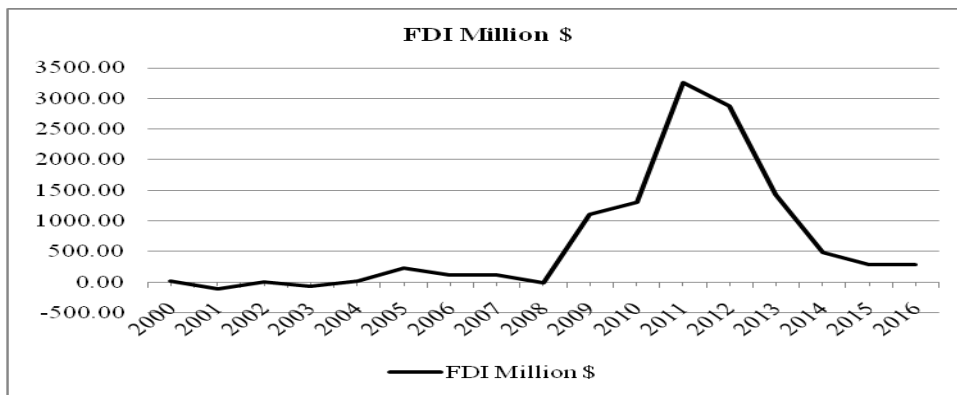
3. Foreign direct investment in Kuwait

FDI inflows around the world rose from about \$ 55 billion in 1985 to \$ 1.511 billion in 2000 before falling to \$ 573 billion in 2003. As a share of GDP, this share increased from about 0.5 to 1.0 per cent In the 1980s to more than 5 per cent in 2000. Then fell to 1.4 per cent in 2003 (Bank, The World Development Report, 2005). Foreign investment flows around the world rose to \$ 967 billion in 2005 and continued to rise to \$ 1244 billion US dollar in 2010 (Al Mihiyawi, 2016). In 2016, foreign investments flowing around the world reached \$ 1746 billion, down 1.6 percent from 2015. Although these flows declined around the world in 2016, they rose to Arab countries by 25 percent from \$ 24.6 billion in 2005 to \$ 30.8 billion in 2016 (Guarantee, 2017).

The flow of foreign direct investment (FDI) in the Gulf Cooperation Council (GCC) countries has witnessed a positive development from 2000 to 2008. A larger share of FDI has often attracted three major economies in the GCC countries - Saudi Arabia, the United Arab Emirates, and Kuwait.

Kuwait's investment flows in the coming years declined to \$ 2.873 billion in 2012 and to \$ 1.434 billion in 2013, equivalent to 29 and 14 percent of total investment flows during the period 2010-2016. In 2015, direct foreign direct investment flows to the State of Kuwait amounted to about \$ 285 million, rising in 2016 to about \$ 292 million, representing about 3 percent of the total investments flowing during the research period figure (1).

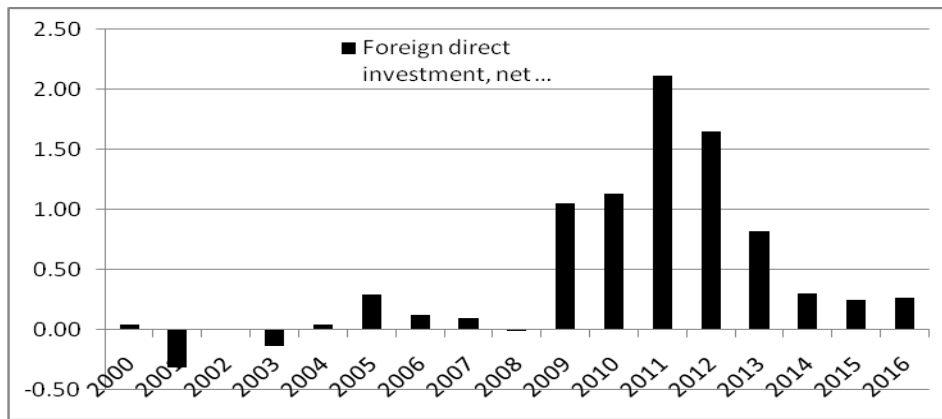
Figure (1): Foreign direct investment flows in Kuwait for the period 2000-2016



Source: Author's elaboration based on data (Bank, World Bank Open Data, 2018)

Figure (2) shows the decline in the volume of direct investment flows as a share of GDP. The figure shows that the highest percentage achieved in 2011 is equivalent to 2.11 percent of GDP. The ratio fell to 0.26 percent in 2016.

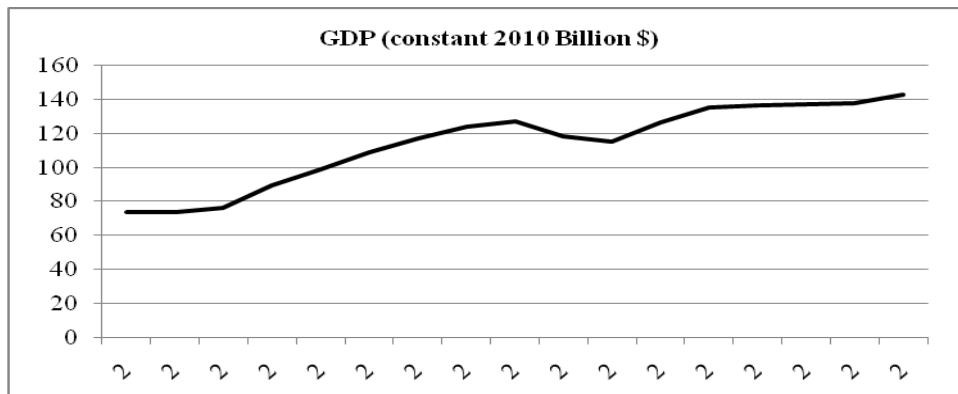
Figure 2: Foreign direct investment inflows as a percentage of GDP in Kuwait for the period 2010-2016



Source: Author's elaboration based on data (Bank, World Bank Open Data, 2018)

Regarding to the GDP in Kuwait for the period 2000-2016, Figure 3 shows that the trend of the value of GDP at constant prices for 2010 is an upward trend in general, where GDP rose from 115.4 billion dollars in 2010 to 142.8 billion dollars in 2016 at constant prices for 2010.

Figure 3: Gross Domestic Production in Kuwait for the period 2010-2016 (Constant 2010)



Source: Author's elaboration based on data (Bank, World Bank Open Data, 2018)

However, this increase in the value of GDP at constant prices did not reflect the per capita GDP at the same prices as the per capita share declined From 38.5 thousand dollars in 2010 to 35.2 thousand dollars in 2016 at constant prices for 2010. This is because the increase in the population was not accompanied by a similar increase in the growth rate of GDP at constant prices for 2010.

4. Literature review:

FDI is an important source of funds for local investment and encourages capital formation in the host country. At present, there is more attention to FDI issues at the national and international levels (Al Mihiyawi, 2016). FDI is an influential factor in economic growth according to some views (Barro & Xavier, 1995). The FDI has contributed to increasing the level of education and technological progress as well as the development of infrastructure in some countries that host investment (Busse & Groizard, 2006). Three main views describe the relationship between FDI and economic growth according to economic literature; positive, negative and conflict impact.

Study of (Saltz, 1992) on the impact of foreign direct investment on the economic growth of developing countries, the results of their empirical tests revealed a negative correlation between the level of foreign direct investment and growth during 1970-1980. A study by Pardeep Agrawal in 2000 about economic growth of FDI in south Asia found a negative and positive impact in different period of the study (Louzi & Abadi, 2011). A survey by (OECD, 2002) showed that out of 14 studies on the relationship between foreign investment and economic growth, 11 showed a strong positive relationship between them (Alfaro, L; Chanda, A; Kalemlı-Ozcan, S; Sayek, S, 2004).

A study of Chowdhury (Chowdhury & Mavrotas, 2005) Shows that foreign investment is an important source of capital and promotes economic growth in host countries. A study of Alfaro proved that countries with better financial systems and financial market systems could use FDI more efficiently and achieve higher growth rates. A 2005 study by Kang, Y & Du, J for a sample of 20 OECD countries showed that there is no link between foreign investment and economic growth (Massoud, 2008). Study of Basu and Guariglia found that there was no correlation between economic growth and foreign investment and that the results of the study were mixed (Basu & Guariglia, 2005).

The study of Mottaleb (2007) found that foreign direct investment effected in economic growth in developing countries (Louzi & Abadi, 2011). Studies of

Greenaway and Kneller (2007) and Alguacil (2011) show an ambiguous role for FDI in economic growth (Trojette, 2016).

Bruno and Campos in their study re-examining the conditional effect of foreign direct investment found a significantly positive effect of FDI on economic growth (Randolph & Nauro , 2013). Najabat Ali1 and Hamid Hussain in their study Impact of Foreign Direct Investment on the Economic Growth of Pakistan, found a positive impact of FDI on economic growth (Najabat & Hamid , 2017). Study of Levine and Carkovic show that a weak impact from FDI on economic growth (Levine & Carkovic, 2002).

A study of Malik and Imran (2015) about the impact of FDI and trade openness on economic growth in Pakistan for the period 2008-2013, found a positive effect of FDI on economic growth (Gul & Naseem, 2015). Study of Shiva S. Makki and Agapi Somwaru (2004) that covering 66 developing countries found a positive impact to FDI on economic growth (Makki & Somwaru, 2004). A study of Bengoa and Sanchez-Robles (2003) for Latin America using a panel data conclude that FDI has a significant positive effect on economic growth for host country (Bengoa & Sanchez-Robles, 2003). An Empirical Study on Malaysia to Har Wai Mun and others (2008) using OLS model found a positive impact to FDI on economic growth (Mun , Lin, & Man, 2008).

The negative view is shown in the study of Volker Bornschier (1980) on the impact of multinational corporations on economic growth which, explain the long- term negative effect for these companies in developing countries (Bornschier, 1980). A study of Patrick D. Nolan (1983) concluded that dependency has a negative impact on economic growth per capita (Nolan, 1983). Ana Balcao Reis on his study about the impact of FDI on policy implication for developing countries shows that foreign investments decrease the national welfare and there is a negative impact to foreign investment on developing countries (Reis, 2001).

The conflict view between positive and negative impact is shown in the empirical research such as ((Dunn, 1975); (Hermes & Lensink , 2003); (Amitava , 1997); (Haddad & Harrison, 1993); (Kose, Eswar, Rogoff, & Shang, 2009)), while some empirical studies such as ((Caves, 1996); (De Mello L. J., 1999); (Hsiao & Shen, 2003); (Sylwester, 2005)) conclude that they are a positive impact between FDI and economic growth.

5. Data and Methodology:

Our data in this paper are collected from different sources such as World Bank data, Central Statistical Bureau in Kuwait, and Arab Organization for Investment Guarantee and Export Credit. The scope of our paper included the

period 2000-2016. We choose the variables as below which are available in the sources and we thought they can be a relationship between them and GDP:

(GDP) - Gross domestic product per capita (GDP per capita) as dependent variable

- | | | |
|-----------|--|-------------|
| variables | (FDI) - Foreign direct investment inflow | Independent |
| | (GC) - Gross capital formation (% of GDP) | |
| | (I) - Inflation, GDP deflator (annual %) | |
| | (O) - Openness trade ((Import + Export) divided by GDP) | |
| | (D) - Domestic credit to private sector by banks (%of GDP) | |

Several studies have examined the relationship between FDI and GDP growth from the applied side, during which different mathematical models were used to explain the relationship between the two variables. In this paper we will test the causal relationship between the GDP and FDI flow to Kuwait by using Granger-Causality test in EViews program in first step.

Granger-Causality test used to illustrate the direction of causality between two variables and whether two or more variables are in certain relationship (Abadir & Taylor, 1999). In other meaning if two or more variables in long term move closely together that is means the difference between them is constant. Otherwise, if these variables are not in common integration that's mean they are far away from each other (Dickey, Jansen, & Thornton, 1991). In our paper these variables are GDP per capita and FDI flow. This test is showing that if a series X is better predicted by the complete universe of past information than Y. then Y Granger-causes X.

In order to start our test it is important to make a test for the stationary (order of integration) or determine the stability and instability of the time series. In our paper we choose the Augmented Dickey-Fuller (ADF) to test statistic by using a Unit Root test. We made the test to all the variables that we used to estimation of regression equation. The results of the test in the table (1) show that all the variables are non-stationary except inflation, for that we made the first deference to all others variables in order to get the stationary.

Table 1: Augmented Dickey-Fuller Test Statistic

Variable	Level		Variable	First deference	
	ADF statistics	Result		ADF statistics	Result
Y GDP	-0.181522	Non- Stationary	DGDP	-1.897080	Stationary
X1 FDI	-1.165066	Non- Stationary	DFDI	-3.557087	Stationary

X2 Domestic	1.182610	Non- Stationary	DD	-3.208538	Stationary
X3 Inflation	-3.261551	Stationary	I	-	Stationary
X4 Openness	-0.972766	Non- Stationary	DO	-5.574067	Stationary
X5 Gross	1.048472	Non- Stationary	DG	-4.326877	Stationary

Source: author's elaboration according to EViews program

The test of Granger Causality between GDP and FDI in table (2) shows that there is no relationship between the two variables. It is meaning that GDP does not granger cause FDI because the Prob is 0.4004 and it is more than 0.05. This rejects the null hypothesis of no causality at the 5% significance. At the same time FDI does not granger cause GDP at the same significance because Prob is 0.2137 and it is more than 0.05.

Table 2: Granger Causality Tests

Pairwise Granger Causality Tests

Sample: 2000 2016

Lags: 2

Null Hypothesis:		Obs	F-Statistic	Prob.
DGDP does not Granger Cause DFDI	No causality	14	1.01488	0.4004
DFDI does not Granger Cause DGDP	No causality		1.84053	0.2137

Source: author's elaboration according to EViews program

In second step we will test the relationship between the GDP and all the variables which are selected in our paper. The regression specification is considered as following:

$$Y = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \beta X_4 + \beta X_5 + \mu \dots\dots\dots(1)$$

Where:

Y: Gross domestic product per capita (GDP per capita)

X₁: Domestic credit to private sector by banks (%of GDP)

X₂: Foreign direct investment inflow

X₃: Gross capital formation (% of GDP)

X₄: Openness trade ((Import + Export) divided by GDP)

X₅: Inflation, GDP deflator (annual %)

The regression specification equation can be re- written as flows:

$$GDP = \alpha + \beta D + \beta FDI + \beta GC + \beta O + \beta I + \mu \dots\dots\dots(2)$$

According to table (1) once-lagged level were taken to the variables GDP, D, FDI, GC, and O, in order to get the stationary. The regression specification equation can be re- written as a flowing below after taking in mind the first deference:

$$DGDP = \alpha + \beta DD + \beta DFDI + \beta DGC + \beta DO + \beta I + \mu \dots\dots\dots(3)$$

By using the EViews program version 10 we tried to test in different of ways. In this paper we test the equation by using logarithm, twice-lagged level, and by using once-lagged level. The best results we get it were in once-lagged level which is presented in table (3).

From the table above we can estimate the model as below:

$$GDP = 22451.64 - 459.4542 DD + 83.147 DFDI + 2225.708DGC + 264.9837 DO + 158.1527 I + \mu \dots\dots\dots(4)$$

Table 3: Model summary

Dependent Variable: DGDP
 Method: Least Squares
 Sample (adjusted): 2001 2016
 Included observations: 16 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	22451.64	5369.090	4.181647	0.0019
DD	-459.4542	115.3792	-3.982125	0.0026
DFDI	83.14790	1299.980	0.063961	0.9503
DGC	2225.708	302.9055	7.347864	0.0000
DO	264.9837	52.88260	5.010793	0.0005
I	158.1527	73.45080	2.153178	0.0568
R-squared	0.914491	Mean dependent var	41006.51	

Adjusted R-squared	0.871736	S.D. dependent var	5307.318
S.E. of regression	1900.760	Akaike info criterion	18.21789
Sum squared resid	36128875	Schwarz criterion	18.50761
Log likelihood	-139.7431	Hannan-Quinn criter.	18.23273
F-statistic	21.38929	Durbin-Watson stat	3.121400
Prob(F-statistic)	0.000048		

Source: author's elaboration according to EViews program

The function coefficient shows that the constant value is 22451.64 with Prob value 0.0019 which is less than 0.05 gives significance effect. The function shows there is a significance negative relation between GDP and domestic credit to private sector by banks (%of GDP) because the Prob value is 0.0026 and it is less than 0.05. The Foreign direct investment value is + 83.147 with Prob value 0.9503 which is < 0.05 give insignificance effect and we can reject the null hypothesis of no relationship between FDI and GDP. This result is proving to the result test of Granger Causality between GDP and FDI. The gross capital formation has a positive value with 2225.708 and it is significance relation with GDP because the Prob value is 0.0000 and it is less than 0.05. The relationship between GDP and openness trade is a positive because the coefficient is 264.9837 that is means the increased one GDP leads to increased 264.9837 in openness trade. The Prob value is 0.0005 and it is less than 0.05 it is mean it is significance. The last variable is inflation and from the coefficient which is a positive 158.1527 and Prob value 0.0568 which is a little more than 0.10 it is a clear there is no significance between GDP and inflation.

The Adjusted R-Squared value is 0.87 that mean the independent variables which are using in OLS model are explain about 87 % of the variation in the dependent variable. The F ratio statics test is $21.38929 < \alpha$ 0.05, hence the results are significant. Durbin-watson stat is $3.121400 > 2$, and this value is accepted.

6. Conclusion:

The paper has examined if there is a relationship between GDP and FDI in Kuwait using time series data. The results of this paper show that there is no serious relationship between the GDP and FDI, and GDP does not granger cause FDI, as well FDI does not granger cause GDP.

There is a positive relationship between GDP and some variables (Domestic credit to private sector by banks (%of GDP), Gross capital formation (% of GDP), and Openness trade ((Import + Export) divided by GDP) which we used in our paper. The inflation, GDP deflator (annual %) is without any relation with GDP according to our results.

Moreover, in the years 2001, 2003, and 2008 the FDI inflows to Kuwait were negative due to more funds investment in other countries. A new law of investment and

many benefits to the investors started in 2003 in Kuwait. Therefore, the results of these benefits start shown after 2 years when the inflows of FDI started to be positive and increased generally year by year, although it has declined in some years. The government of Kuwait made another changes in the law of investment in 2013 in order to increase the FDI inflows and from the data, we cannot say that these changes gives a results.

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