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FOREIGN DIRECT INVESTMENT IN AFGHANISTAN AND THE FACTORS WHICH AFFECT IT

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ABSTRACT

This research focus the factors affecting (FDI) or foreign direct investment in Afghanistan. In general, this study has focused on the factors affecting direct investments towards developing and underdeveloped countries. The primary goal of this research is to focus and find the factors affecting foreign direct investment inflow to Afghanistan. In this research we focus to the effects of the following factors; indices, gross domestic product, globalization export volume, import volume, and exchange rate of dollar to Afghani. The mentioned factors were determined according to a review of the literature. About the interaction across variables, 3 different regression models were analyzed to examine the effects of those factors on foreign direct investment inflows to Afghanistan. Ordinary Least Squares estimation was employed. According to the report or the analyzed of the integrated model globalization has a statistically key positive effect on foreign direct investment, whereas the GDP has a statistically significant negative effect on foreign direct investment. When we test the effect of gross domestic products and exchange rate (EXC) jointly on foreign direct investment, we find the statistically positive effect of mentioned variables on foreign direct investment. The final results of this research recommend the economy politicians in Afghanistan implement exchange rate policies that promote the foreign direct investment in order to increase the inflow of foreign direct investment to the country.

Keywords: Afghanistan, Globalization Indices, Foreign Direct Investments (Fdi), Investment, Exchange Rate.

INTRODUCTION

Before we start it is essential to define the FDI or Foreign Direct Investment. The word “foreign” in the concept of “Foreign Direct Investment- is used on being from abroad or outside the borders of a country (Ouaret, 2011). The term “foreign capital” refers to a specific and particular amount of capital in a territory or a country held by a citizens of other country. The word “direct” defines foreign investments from portfolio investments. FDI or Foreign direct investment is expressed as a kind of investment to reflect a very the long-term interest of an organization or enterprise

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within an economy in other enterprise within another economy and the long-term control of such enterprise(s) by this enterprise (Türkcan, 2008). Those enterprises making foreign direct investment should not have to be multinational enterprises.

Afghanistan is in to top list of "*Least Developed Countries*" according to the classification of countries by the UN. Hence, it is vital to demonstrate the point and factors affecting FDI or foreign direct investments in the country. Economic policy of Afghanistan is composed of overseas investments and foreign direct investments. The development and growth level of the private sectors of Afghanistan is directly depend on the FDI or foreign direct investments and external financial aid and the effective use of such kind of supports and investments. As far as the government of Afghanistan does not have any adequate funding for reconstruction of this country under existing conditions, the constructing of the country in the medium term largely depends on the foreign countries support and aids.

LITERATURE REVIEW

Zeren and Ergun (2010) explored the factors determining foreign direct investment inflow into European Union countries. They used the dynamic panel data model for the period between 1995 and 2007. They concluded that the rate of increase in gross domestic product, increased openness ratio, and the rising development level enhances foreign direct investment inflow. They also determined that the current account balance and gross capital formation are in an inverse relationship with foreign direct investment. A similar study was carried out in Turkey by Kar and Tatlısöz (2008). The factors determining foreign direct investment movements between 1980 and 2003 were explored under the titles of investment-inviting factors and investment-uninviting factors. In the empirical analyses made within this framework, the following nine economic variables were used to explain the factors determining foreign direct investment: net international reserves, real exchange rate, and gross domestic product, the quantity of labor lost through strikes, openness ratio, electric power, production index, labor costs, and investment incentives. While a positive relationship was found between foreign direct investment and net international reserves, gross domestic product, openness ratio, electric energy, production index, and investment incentives, a negative relationship was found between foreign direct investment and real foreign exchange and labor costs. Comprehensive research carried out by Meşiri and Kiyhanpor (2012) explored the factors affecting foreign direct investments in 209 countries between 1980 and 2007.

Gross Domestic Product (GDP): gross domestic products and foreign direct

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investment have been used and focused most often in FDI research, both as an independent and a dependent variable (Paul & Feliciano-Cestero, 2020). One of the important and key effects of FDI is its impact on the economic growth of the host country. This effect is much more important for developed and least developed countries. Cause; FDI have an enhancing effect on economic development. Beside that an increase takes place in the equity of the host country as a result of the investment or acquisition, and the existing resources may be used more efficiently (Moosa, 2002).

Foreign trade: the effect of foreign trade volume of FDI depends on the type and nature of investment. In order to have a desire to have a positive effect on foreign direct investment, the intention to trade in the market of host country must be encouraged. As a result of that, the import effect of firms will be eliminated, and foreign firms will start to consider investing in the domestic market.

Exchange rate: Based on studies limited foreign investment has been made for relation between FDI and exchange rate volatility. Exchange rate is one of the main and very primary determinants toward foreign trade and foreign investments. The exchange rate can affect both FDI and trade, Mobility in the exchange rate allows comparing export earnings with other countries.

Globalization Index: New issues in the areas of FDI are an essential globalization. FDI has been one of the main features of globalization and the global economy over the past 2 decades (Cho, 2003). The global economy has been going toward the globalization process, especially in the last quarter of the century. in globalization the opportunities have expanded for cooperation between developing, developed, and underdeveloped countries. Barriers to trade in between the countries have started to decrease and disappear; the volume of international trade has expanded; the new and modern technologies transferred from developed to developing countries; the global financial markets have developed.

REGRESSION MODELS AND ANALYSIS RESULTS

In the published research of 5 past decade, Paul and Feliciano-Cestero (2020) analyzed 500 studies. Their summary of the methodologies of mentioned researches indicated which 127 studies used OLS regression, 41 studies use the Granger causality test, 28 studies employed co integration analysis, and 24 studies used the VAR method. Based on that, OLS was the most widely effective and used method to estimate the equations, including foreign direct investment as an independent or dependent variable.

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Factors affecting FDI flowing in Afghanistan will be tested by framework of 3 regression models. If non-stationary time series are employed, spurious regression may occur, which may lead to misleading regression analysis summary.

The regression models are:

Model Number one (Integrated Model): It includes all independent variables determined based on the literature review. The model aims to identify the effects of those variables on FDI inflow. Since the model includes all exploratory variables, the model is referred to as integrated model.

$$LnFDI_t = \varphi_0 + \varphi_1 LnIMP_t + \varphi_2 LnEXP_t + \varphi_3 LnOGlob_t + \varphi_4 LnGDP_t + \varphi_5 LnEXC_t + \varepsilon_{1t}$$

The variables in the integrated model (Model 1) were grouped into two categories, and two separate regression models covering each group were generated.

Model Number two (Model globalization): the globalization model containg the following independent variables; export, globalization index and imports. Mentioned variables are regarded as representing the level of integration of the country. The model is formulated as follows;

$$LnFDI_t = \beta_0 + \beta_1 LnIMP_t + \beta_2 LnEXP_t + \beta_3 LnOGlob_t + \varepsilon_{2t}$$

Model Number 3: (Model Local): This type model contain GDP and exchange rate. The main aim of this model is to identify the effect of the variables which are regarded as local indicators. The model is formulated as follows;

$$LnFDI_t = \gamma_0 + \gamma_1 LnGDP_t + \gamma_2 LnEXC_t + \varepsilon_{3t}$$

The analyses were conducted for the three models.

When I wants to work on regression method, homoscedasticity should be checked. With two simple methods we can determine whether the residuals of the regression analysis have homoscedasticity or heteroscedasticity. Here are formal analysis with statistical analysis. The Breusch-Pagan / Cook-Weisberg analyze can be used for statistical analysis. The alternative hypothesis (H1: Heteroscedasticity) is tested against the null hypothesis of the residual values (H0: Homoscedasticity). Table two presents the results of the heteroscedasticity test carried out for the residual values of each model.

According to the Breusch-Pagan / Cook-Weisberg test results, the hypothesis of homoscedasticity is refused and rejected for the model 1 (X^2 = 20.99; p = .000) and the model 3 (X^2 = 6.57; p = .0103). or in short residuals had heteroscedasticity, and distribution of residuals was not homogenous for model 1 and model 3. to summarize the magnitude of heteroscedasticity, we decide whether it is need for a correction of heteroscedasticity, our decision must be made by combining these test summaries and

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graphical results. The test summary and the graphical results indicated heteroscedasticity in Model 1 and Model 3. In order to correct the heteroscedasticity problem would be much meaningful to repeat the regression analysis as ***robust*** regression analysis.

If there is linear relationships between independent variables, the estimation summaries cannot be uniquely calculated for the regression model. In the term collinearity refers to an almost perfect linear association between 2 variables. Multi collinearity happens when over that 2 variables have such a relationship. When the level and degree of multi collinearity increases, the estimated coefficients of regression moves and become unstable. In that reason, the standard errors of coefficients may be too inflated. High VIF values indicate that these variables are possibly unnecessary. According to the result of the analysis, there was no multi collinearity in the models.

CONCLUSION

In this research we explored those main factors which are affecting FDI "between" 1991 to 2017 in Afghanistan. Remarkable increase took place in FDI or foreign direct investment in Afghanistan, especially in the year 2002. The year 2005 was the year in which the very high level of FDI or foreign direct investment flowed into Afghanistan (FDI amounting to 271 million USD) within the 27 years under examination. Because of the global financial crisis of 2008, FDI or foreign direct investments made in Afghanistan fell from approximately 188 million USD to 40 million $. One of the main reasons for such fluctuation in the foreign direct investment flow into Afghanistan is the state of war Afghanistan which has going through. There are also several other factors which have it's effects in this situation, such as inadequate infrastructure of the country, lack of labor especially qualified labors, and insecurity situation felt by investors.

Studies on the literature report several positive and negative factors affecting FDI or foreign direct investments. However, sound data lack for concerning many of these factors. Hence, the factors affecting foreign direct investment or FDI in Afghanistan cases were limited to the variables about who the literature contains correct data. In this sense, GDP or gross domestic product, the total level of globalization index, export volume, import volume and exchange rates are taken as independent variables while FDI were taken as a dependent variable. The correlation analysis indicated a very high relationship between foreign direct investment and total globalization; a high significant relationship between foreign direct investment and import volume; a moderate positive relationship between foreign direct

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investment and export volume, the positive relationship between foreign direct investment and gross domestic product; and negative relationship between foreign direct investment and exchange rate. Based on the results of the integrated model, globalization have the statistically positive effect on foreign direct investment. However, GDP has a statistically negative effect on foreign direct investment. Whenever we wanted to test the effects of gross domestic product and exchange rate (EXC) jointly on foreign direct investment, hence we find a positive effect of those variables on foreign direct investment. The summary of this research recommend the economy Politicians in Afghanistan implement exchange rate policies that promote the FDI and to increase the inflowing of FDI into the country.

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