# THE APPROPRIATENESS OF THE SITUATION AND ENVIRONMENT IN DEVELOPING COUNTRIES FOR ATTRACTING FOREIGN DIRECT INVESTMENT

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**Abstract:** In recent years, developing countries, including Arab countries, have sought to attract foreign direct investment (FDI) to their countries and have worked to prepare their local environment for attracting such investment. Foreign investments are an important source of external financing in these countries and an engine of economic growth through which to raise the productive capacities of the local economy. This new trend of Arab countries, including Iraq, The importance of the study lies in the fact that foreign direct investment is an economic phenomenon that represents the process of encouraging and protecting it as a manifestation of economic openness. The study has reached several conclusions, the most important of which is that FDI has an important role to play in supporting the economic growth of the host countries because of the administrative and regulatory expertise it provides, the transfer of modern technology and the stimulation of local competition.

**JEL classification: P45, O4, O10**

**Key words: investment, growth, attract, integration, development**

## 1. INTRODUCTION

After the emergence of the problems of poverty and underdevelopment in many economically weak countries that suffer from lack of resources, which contributed to the reduction of the achievement of their development goals, they had to seek financial resources from external sources through external loans and foreign direct investment, with high cost of borrowing after the change. The opinion that foreign investment poses a real threat to the sovereignty of those countries. Most developing countries have in recent years raced to attract foreign direct investment by providing the appropriate environment to attract foreign direct investment because of its advantages in no economic development in those countries.

## 2. METHODOLOGY OF THE STUDY

### *2.1. The Study Problem*

The problem of the study is the lack of awareness and knowledge in the role of foreign direct investment in financing economic development in developing countries.

### *2.2. Study Hypothesis*

Foreign direct investment has a role to play in increasing economic development in developing countries at the level of domestic economy and foreign trade.

### 2.3. Purpose of the Study

The study aims to explain the theoretical aspects of foreign direct investment and economic development and to identify the trends of foreign direct investment in developing countries.

### 2.4. Previous Studies

Numerous previous research have covered the subject and objectives of the study. The subject of the study is regarded from other angles and visions than previous works in the field of studying the reality of direct foreign investment in a sample of countries in general. It analyzes the context based on prevailing events in the period of research and modern economic concepts, such as globalization and competitive advantage. The current study attempts an in-depth analysis of foreign direct investment in developing countries and their relationship to import and export activities in said countries.

## 3. THEORETICAL APPROACH - FDI AND THE CHARACTERISTICS OF DEVELOPING COUNTRIES

### 3.1. The Concept and Development of Foreign Direct Investment

There is no agreed definition of foreign direct investment (FDI) between countries or international economic organizations and among economists. The IMF has defined FDI as a set of different operations aimed at influencing the market and the management of a developed enterprise in countries contrary to its parent state (Nogouhoua, 2008). The Organization for Economic Co-operation and Development (OCDE) considers that foreign direct investment (FDI) is an activity that translates the goal of a resident entity in an economy to obtain sustainable benefit in a resident entity from another economy, while imposing the concept of sustainable FDI and FFI. On the other hand, it exerts effective influence in the management of institutions (Nabil, 2003). Samir Mohammed Abdel-Aziz argues that FDI is a joint venture between a country and foreign control entities for joint projects (Mohamed, 1998).

### 3.2. Foreign Direct and Indirect Investment

The difference between FDI and FII is clearly covered by the definitions of both concepts. FDI is considered to be direct in the case of a foreign entity having full or partial ownership of assets in a host country and this gives it the right to consider the management of the investment starting from a minimum of 10%.

Indirect foreign investment can be defined as those investments that flow into the country in the form of loans provided by private or foreign public entities, or in the form of underwriting in the instrument issued by that State, whether subscribed through fixed-interest bonds or through shares, provided that foreigners do not have the right to acquire a percentage of shares entitling them to manage the institution (Sadaka, 2008).

### 3.3 Types of Foreign Direct Investment

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FDI classifications based on motivations and incentives. The types of foreign direct investment according to its objectives can be classified as follows (Arab Investment Guarantee Corporation, 2002):

- Investment in search of natural resources: many multinational companies are moving towards taking advantage of the natural resources enjoyed by many developing countries in the fields of oil and gas and other extractive industries.

- Investment in the market: this type of investment predominates in the manufacturing sector in developing countries. This type of investment will contribute to the high economic growth rates in the host countries by increasing the capital stock and has expansionary effects on trade in the areas of production and consumption by increasing exports of the host countries and increasing imports of inputs of production and goods from the exporting countries of investment.

- Performance investment: this type of investment is made when multinational companies concentrate part of their activities in host countries in order to increase profitability. Higher wage levels in industrialized countries have led some companies to invest in many developing countries.

- Investment in search of strategic assets: This type of investment takes place in the later stages of MNC activity, when the company invests in R&D in developing or developed countries driven by its desire to maximize profitability.

Classifications of Foreign Direct Investment according to the point of view of exporting countries:

- Horizontal investment: The branches of companies in this type of investment are independent of the parent company and the relationship is limited only to the ownership element of the means of production, technological transfer and financing. This type aims to expand investment in the recipient countries for the purpose of producing the same or similar goods as the goods produced in the mother country. This type of investment occurs between countries with a similar level of growth.

- Vertical investment: By adopting this type of investment, companies aim to exploit raw materials in the host countries (back vertical investment) or to get closer to consumers through distribution outlets (front vertical investment). According to this type of investment, each branch specializes in foreign companies in part of the production processes, such as assembly or component manufacturing as a final product or in marketing operations.

Classifications of FDI according to the polarized countries' viewpoint:

- Investment aimed at import substitution: The goal of developing countries that are polarized for this type of investment is to achieve balance and economic growth, which qualifies them to pursue the path of sustainable development and compensate their needs of goods and services imported from abroad with domestic goods. In order to achieve this, the country depends on attracting foreign investments and companies, especially in the case of adequate domestic funding sources to achieve such projects.

- Investment aimed at promoting exports: The objective of host countries to attract this type of investments is to enhance their export capabilities and thus increase their competitiveness in international markets, which will reflect positively on the situation of the local economy and contribute to the provision of foreign exchange necessary to finance sustainable development projects in all economic aspects, social, environmental, political and technological.

Foreign Direct Investments by government initiative. These investments usually take the form of charitable projects, such as grants and reconstruction initiatives in the event of disasters.

### *3.4. Determinants of Foreign Direct Investment*

Foreign direct investment is directed to one country, either as a result of the host country's attraction factors or as a return to the home country as a result of the company's investment strategy. Repelling factors:

Attractions Related to the Host Country. These factors are represented by the following elements (Salam, 2007):

- Economic factors: the most important of these factors are the gross national product, growth rates, the level of inflation, interest rates, structure of the banking system, and restrictions of international trade. These factors play great importance in the investment decisions of multinational companies and the greater economic strength of a country by investors.

- Providing resources: these resources are natural (oil, gas, water, climate), human (represented by the cost, quality and efficiency of the work element), technological (research and development centers) or financing (access to loans).

- Tax legislation: Some studies have confirmed that tax exemptions have a positive effect on attracting investment, while other studies have shown that tax exemptions are positive if other factors are available (long-term financial benefits on high and uncertain tax breaks (Feverman, 1992)).

- Infrastructure: such as communications, transportation and infrastructure, where the weak infrastructure reduces the chances of the state to attract investment as the companies need to charge more, which does not fit the strategy of the company.

- The size of the market and demand for the commodity in the host countries: the increase in the volume of demand and the size of the host market makes it a more attractive for investment, especially for investment, which aims to serve the local market.

- The state of the regional economic unions: studies on the OPEC and the European Union showed the strong impact of these unions on the flow of foreign direct investment.

- The status of the internal opinion on foreign direct investment: in case the internal public opinion is opposed to foreign direct investment or to a particular country, companies become reluctance in their decision to invest.

- The trading system of the host country: in case the state imposes restrictions and barriers to trade, companies will hesitate to make their investment decision.

- Exchange rates: the share of the state of foreign direct investment increases when the currency of the state is relatively weak compared to the currency of the country to which the company belongs, as the devaluation of the currency reduces the costs of production and investment when compared to the costs in the mother country, making investment more profitable for the investor.

- Political and social factors: studies have pointed out the importance of political and social factors in the investment decision, as the investors will not risk transferring their capital to a state unless they are certain of the stability of the political situation; foreign capital is looking for security and stability and investment avoids the atmosphere of prevailing in crises.

- Social factors reflect a preference among the consumer population in one country for the national product over the other (Al-Samarrai, 2006).

- Legislative and regulatory framework for investment: In order for the legislative framework to be attractive to investment, there must be a unified investment law that is clear, coordinated and transparent and compatible with international regulations. (Sadaka, 2010).

- Non-tax incentives: the provision of facilities and reduced bureaucracy positively affects the investment climate.

- Transfer of profits and remittances: multinational companies are attracted to invest in countries that allow the transfer of profits, capital, wages and salaries to the home countries with the imposition of lower taxes as possible and that governments are ready to convert the currency at prevailing prices.

- Geographic, cultural and historical convergence: many countries tend to invest in geographically and culturally close countries due to ease of communication and low transportation costs, as in Japan's investments in Southeast Asian countries.

Factors Related to the Country and the Investor's Strategy. These factors are related to international companies (Al-Samarrai, 2006):

- The nature of economic and commercial activity. Some types of perishable activities require the search for appropriate markets.
- Seeking to increase the families of the project: Diversified commercial companies invest in other countries in order to achieve the desired profits and objectives through production at lower costs based on lower production costs in other countries.
- The desire for growth and expansion: The inability of the national market to achieve the objectives of the investment business in growth and expansion necessarily lead to the trend towards foreign investment and the search for outlets across national borders.
- Mitigating the risks of reliance on a single economic market.
- Economic policy of the developed countries: The economically developed countries are interested in encouraging their companies to invest abroad, considering that this investment has many benefits for its national economy, in addition to opening new markets for them, increasing the volume of international trade and securing their access to raw materials at favorable prices, all of which will improve their economic status.

## 4. CHARACTERISTICS OF DEVELOPING COUNTRIES

The characteristics that can control the process of attracting companies to invest in developing countries will be discussed: economic characteristics, social and demographic characteristics, political and cultural characteristics, environmental characteristics.

### *4.1 Economic Characteristics*

There are several economic indicators through which to analyze the economic characteristics of developing countries:

Per capita income: GDP per capita is one of the most important indicators that measure the degree of progress or underdevelopment of countries. The table below shows the per capita gross income of some countries according to the Atlas method (current US $)

**Table no. 1 Per capita income**

| Country | Year | Value |
|---|---|---|
| High income countries | 2018 | **44.146** |
| Lower middle-income countries | 2018 | **2.245** |
| Upper middle-income countries | 2018 | **8.859** |
| Low income countries | 2018 | **7.90** |

*Source: World Bank Blogs: https:// blogs. World Bank (World Bank Blogs)*

From the table, the vast difference of per capita GDP between developing and developed countries is evident.

Labor productivity: The economies of developing countries are characterized by low level of productivity compared to the economies of developed countries where labor productivity is clearly low in all areas of economic activity. Regulatory and non-economic factors are represented by the limited size of the markets in these countries and the duplication of the economic system through specialization or the importation of an economic system that is foreign to the capitalist system.

Foreign Trade:

- Exports and imports: The volume of exports and imports in developing countries is much lower than the volume of exports and imports in developed countries due to the weak productivity of the productive sector in these countries and its dependence on some extractive industries. Additionally, the economies of these countries have not reached a level where their exports achieve full coverage of their imports. These countries should open the way for foreign investments to enhance export capacity and stimulate foreign trade.

- Specialization in the production and export of raw materials: The production of agricultural raw materials and mining controls the structure of economic activity in most developing countries and the industrial activity in these countries is limited to the processing of raw materials or some manufacturing industries such as spinning and weaving and some handicrafts and crafts. Some countries extract raw materials, such as oil and copper, as in the Arab Gulf countries, including Iraq. This activity is of interest to the foreign direct investors. The table below shows the main products of some developing countries.

**Table no. 2 Major products for some developing countries**

| Country | Products | Percentage of total exports |
|---|---|---|
| Iraq | Petroleum | 92% |
| Venezuela | Petroleum | 92% |
| Colombia | Coffee | 70% |
| Cuba | Sugar | 80% |

- Economic dependence and increasing the volume of indebtedness: Economic dependence is represented by the control of foreign agencies on the processes related to foreign trade and to organizing the primary production in developing countries to suit the economic interests of developed countries (Nasser and Awadallah, 1997). It has been widespread for decades and has become a balance of payments crisis for developing countries.

- Developing countries' share of FDI: Developing countries are engaged in the process of revitalizing FDI and will continue to be favorable destinations for FDI. They will remain the subject of the developmental effects of foreign investments in terms of filling the financing deficit, supporting productive efficiency, export capacity and technological empowerment under discussion.

### *4.2 Social and Demographic Characteristics*

1. High population growth rate: There is a contradiction in the number of population and the level of development experienced by developing countries, which distinguishes the developing countries from the developed countries. Developing cannot provide the minimum requirements for human development such as food, health care and work.

2. Deteriorating health status: Health care levels in developing countries are lower than in developed countries due to the relative differences in financial resources available to these countries to ensure adequate health care.

**Table no. 3 Deteriorating health status**

| Bloomberg Global Healthcare Efficiency Index 2018 | WHO ranking of health organization performance | Expenditure on health in GDP% | Health expenditure US $ per capita | Life expectancy (years) | Country |
|---|---|---|---|---|---|
| 2 | 6 | 4 | 2280 | 83 | Singapore |
| 3 | 7 | 9 | 2354 | 83 | Spain |
| 51 | 37 | 17 | 9536 | 79 | USA |
| 54 | 125 | 9 | 780 | 76 | Brazil |

*Source: Global happiness and quality of life report 2019*

3. The problem of chronic unemployment: Unemployment is generally prevalent in developing countries in all forms of disguised unemployment, seasonal, technical and cyclical unemployment. In the rural and urban areas, individuals work less than their full production capacity. The second form is open unemployment by individuals who are able to work, but they do not find suitable jobs, as these are not available. Advanced for the year / 2018 by TRADING ECONOMICS:

**Table no. 4 Unemployment status**

| Country | Year | % Ratio |
|---|---|---|
| Jordan | 2019 - 06 | 19.2 |
| Iraq | 2017 - 12 | 28.1 |
| Iran | 2019 - 06 | 14.7 |
| Italy | 2019 - 08 | 13.1 |
| France | 2019 - 08 | 10.7 |
| Canada | 2019 - 09 | 13.1 |

*Source: //ar.tradingeconomics.com*

### *4.3 Political and Cultural Characteristics*

There are political and cultural factors affecting the process of attracting foreign direct investment in developing countries as follows:

1. External dependence: Most developing countries depend on the developed world through the import of technology, educational, cultural and intellectual systems. They may also include political systems, consumption patterns, and lifestyles. However, they are often inappropriate for the cultural and behavioral specificity prevailing in these countries. Achieving their development depends on the degree to which they depend on the outside world and the suitability of patterns imported from developed countries to the specificity of developing countries.

2. The limited public participation in the developing country is one of the most important factors that contribute to the survival of the phenomenon of economic underdevelopment in those countries.

### *4.4 Environmental characteristics*

The analysis of the environmental situation in developing countries focuses on identifying environmental issues in order to realize the need for these countries to increase their awareness of the preservation of the environment and adopt comprehensive development strategies with a view to improve the environmental sector. As a result of living conditions, poverty and ignorance developing countries bear the consequences of development reached by developed countries such as water scarcity and pollution, air pollution, and climate change. This is reflected negatively on the raising levels in developing countries of water scarcity and air pollution, which was subjected to developing countries as a result of polluting industrial projects. Millions of people were exposed to death and chronic diseases as a result of water consumption and contaminated air pollution, hence the lack of productivity of individuals in those countries.

## 5. CONCLUSIONS

The study reached the following conclusions:

1. There are many definitions and concepts of FDI due to the multiplicity of parties interested in discussing this issue, but there is a general agreement on the concept of foreign investment, which is the possession of a foreign entity with full or partial ownership assets in a host country.
2. FDI has an important role to play in supporting the economic growth of the host countries because of the administrative and regulatory expertise it provides, the transfer of modern technology and the stimulation of local competition.
3. To achieve the desired positive effects and objectives of foreign direct investment in the legislation regulating the entry of these investments and the exercise of their manufacturing, extractive and service activities.
4. There is debate about the environmental motivations of foreign direct investment in developing countries, as these investments endanger the environment and the population of the developing countries.

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