# STUDY OF EXCHANGE RATE MOVEMENT, ECONOMIC GROWTH ON FOREIGN DIRECT INVESTMENT IN SULATANATE OF OMAN

**Dr.Soofi Asra Mubeen**[1],

**Dr.Anitha Ravikumar**[2]

Lecturers in Business Department,

Higher College of Technology, Al khuwair,

Muscat, Sultanate of Oman

## ABSTRACT:

The present paper aims at providing the impact of exchange rate movements, economic growth on FDI in Sultanate of Oman and to study the relationship between exchange rate, economic growth and FDI taking into consideration 15 years of data from 2000-2014. Data were collected through secondary sources and analyzed by using statistical tools like Correlation, Regression, ANOVA with SPSS and the results revealed through correlation analysis that exchange rate does not have control on FDI inflows into the country but the economic growth has influence on FDI inflows into Sultanate of Oman. The results of Regression Analysis showed that FDI inflow in to the country is due to Economic growth. The association between independent variables exchange rate, economic growth and dependent variable Foreign Direct Investment (FDI) calculated on the basis of ANOVA and it is found that economic growth has significant impact on attracting foreign direct investment and exchange rate does not stimulate on the foreign direct investment

**Key words:** Exchange rate, Economic growth, Foreign direct Investment.

## Introduction

The economy of Sultanate of Oman mainly depends upon oil and gas sector as more than 50% of the income of the economy is based on this sector[1], due to recent decrease in oil prices it has posed a major threat to the economy. Moreover, oil and gas reserves of the country are less when compared with its neighboring gulf countries. So, the Omani Government is trying to diversify the economy in order to reduce the overdependence on oil and gas sector.

[1] https://www.wto.org/english/.../s201-01_e.doc

Oman vision 2020 programme focusses on privatization and Industrialization to diversify the economy and also to increase the non-oil contribution to GDP to 81% by 2020.[2] Foreign investment is encouraged by the Government and the process of implementing a new foreign capital investment law with the assistance from the World Bank which allows a foreign investors to start a business without an Omani partner and the minimum capital restriction to start a business is also proposed to be removed soon.

Apart from all these positive developments, the country has amicable business environment, favorable location, tax incentives and custom duty exemptions and the major role in attracting FDI to the country is its political stability as FDI is an essential part of the economy. But exchange rate also plays a significant part in attracting FDI. When there is decline in the exchange rate, it will affect the wage structure and the production costs of the foreign companies doing business in a particular country.

**Table 1: FDI inflow into Sultanate of Oman**

| Year | Foreign Direct Investment in dollars in millions | Rate of change (%) |
|---|---|---|
| 2000 | 0.08 | - |
| 2001 | 0.01 | -7 |
| 2002 | 0.11 | 10 |
| 2003 | 0.02 | -9 |
| 2004 | 0.11 | 9 |
| 2005 | 1.54 | 143 |
| 2006 | 1.6 | 6 |
| 2007 | 3.33 | 173 |
| 2008 | 2.95 | -38 |
| 2009 | 1.49 | -146 |
| 2010 | 1.24 | -25 |
| 2011 | 0.87 | -37 |
| 2012 | 1.03 | 16 |
| 2013 | 1.62 | 59 |
| 2014 | 0.74 | -88 |

**Source: http://www.theglobaleconomy.com/**

Inflow of FDI from the year 2000 to 2014 to Sultanate of Oman is shown in Table 1. During the years 2007 and 2008, FDI inflow was 3.33 and 2.95 million US Dollars respectively which is very high when compared with the other years as shown in table 1. In all the other years, it was not only low but it was also fluctuating. In the year 2009, there was a decrease of 146% and in 2014 also

[2] https://books.google.com.om/books

there was a decrease of 88% in FDI. This decrease in FDI inflow may be attributed to overall global economic slowdown after the year 2008.

## Literature Review

Literature review pertaining to some of the studies related to the study of movements in Exchange rate, foreign direct investment and economic growth in Sultanate of Oman was collected and reviewed. Reviews collected were useful for identifying the research gap for the present study.

O'Meara. (2015) have made a cross country analysis about the principal determinants of FDI from a large sample of developed and developing countries. The analysis showed that traditional variables regarding size and scale of economic activity formed a major role in defining FDI. Economic freedom, tax incentives and human capital are those variables which have no impact on determining FDI. Key factors which affect FDI are market size, economic openness and quality of infrastructure, human capital and tax incentives which are at variance.

Bilawal,et.al.(2014) is of the opinion that macroeconomics in Pakistan is affected by changes in exchange rates. For data analysis, secondary data was collected from State Bank of Pakistan for 32 years period. The collected data was analysed using Correlation and Regression. The analysis showed a positive significant relationship between exchange rate and FDI. Exchange rate explained 67% of FDI inflows into the country.

Kastrati (2013) studied the theoretical and empirical literature on FDI. It showed the main trends in FDI theory and also listed out the theoretical determinants of FDI and FDI's impact on economic growth and international trade. The theoretical studies in FDI enable us to have a better knowledge of the economic mechanism and the behavior of economic agents at micro and macro level. The study also helped to determine the factors that prompt the foreign companies to invest abroad relatively instead of exporting or outsourcing production to national firms using eclectic paradigm.

Jin & Zang (2013) have analyzed about the impact of changes in exchange rate on FDI with reference to international and domestic research. They have developed a statistical model to test the impact and the results showed that RMB promotes FDI after the exchange rate reforms in 2005. They found that the present positive inflow of FDI into China was the result of changes in exchange rate, but in the long term proper appreciation of RMB and a more flexible exchange rate will have a positive effect on China's currency and microeconomic policies.

Jadhav,P (2012) have taken the factors such as economic, institutional and political factors to find out which factor attracts more FDI into BRICS economy. The study used a panel data of ten years from 2000- 2009. Holistic approach was used in this study and statistical tools like unit root test and multiple regressions was used. The analysis brought into light that economic factors played more significant role than institutional and political factors in BRICS economies. It further clarified that most of the investment in BRICS have been made for market seeking purpose.

Agarwal and Khan (2011) described about the economic growth rate of India and China and how FDI will influence economic growth rate. The study was carried out for a period of 17 years by using Linear Multiple Regression model. Growth model was also used by including factors such as Gross capital formation, FDI, human capital, GDP and labour force. In conclusion, they proved that economic growth in India has less impact on FDI than China as it can utilize FDI better than India.

Mottaleb & Kalirajan (2010), have used panel data from 68 lower income, lower middle income and developing countries and have found several factors which determines FDI inflow to those countries. A comparative study was made by them focusing on why some countries are better in attracting FDI while others are not. They have demonstrated that countries with larger GDP and high GDP growth rate, higher proportion of international trade and with more business friendly environment are more successful in attracting FDI.

Osinubi,et.al.,(2009) explored exchange rate, it's volatility and the consequent effect on foreign direct investment in Nigeria. Usage of Error correction model and OLS method of estimation models suggested that exchange rate volatility is not a worry for the foreign investors. The study further explained the positive relationship which existed between real inward FDI and exchange rate. The result further added that the structural adjustment programme had influenced real inward FDI in a negative way due to deregulations of exchange rate volatility.

Phillips & Ahmadi- Esfahani (2008) researched on the association of exchange rates with FDI and found no agreement with the type of association in neither theoretical nor empirical work. The authors have critically explained the body of work and found that theoretical studies could explore the complications of FDI but empirical evidence was reserved due to data problems.

Literature related to influence of exchange rate movement on FDI and Economic growth on FDI is based on the study in different countries for different years. The present study made an attempt to investigate the impact of exchange rate and economic growth on FDI.

## Scope of the Study

The study is being made to understand the relationship between exchange rate movement, foreign direct investment and economic growth in Sultanate of Oman from an academic point of view. The study helps in enlightening the impact and relationship of exchange rate movement, economic growth on FDI, which will further help the decision makers to create best ideas and draw suitable plans to improve the overall economic growth through FDI.

## Objectives of the study

1. To investigate the effect of exchange rate movements and economic growth on FDI in Sultanate of Oman.
2. To find out the relationship between exchange rate, economic growth and FDI in Sultanate of Oman.

## Hypothesis of the study

Hypothesis 1: Exchange rate positively effect on Sultanate of Oman's FDI.

Hypothesis 2: Sultanate of Oman's Economic Growth has positive effect on FDI.

## Research Methodology

**Research Design:** Descriptive Research Design was used for this research.

**Sample Unit:** 15 years i: e from 2000 to 2014 data of FDI, Exchange rate and Economic growth has been taken for the present study.

**Sources of Data:** Data is collected by Secondary Source which includes reports and official Publications, Books, Articles, Journals, Internet etc.

**Data Analysis Method:** The data collected from sample is analyzed by using statistical tools like Correlation, Regression, and ANOVA for analysis of the data SPSS is used.

## Results and Discussion

Correlation, Regression Analysis and ANOVA are used to find out the relationship of the two independent variables Exchange rate and Economic growth and dependent variable Foreign direct investment.

**Table 2- Correlation Analysis**

| | | ECO | FDI | Exchange |
|---|---|---|---|---|
| eco | Pearson Correlation | 1 | .519* | .166 |
| | Sig. (2-tailed) | | .047 | .554 |
| | N | 15 | 15 | 15 |
| FDI | Pearson Correlation | .519* | 1 | .130 |
| | Sig. (2-tailed) | .047 | | .644 |
| | N | 15 | 15 | 15 |
| ex | Pearson Correlation | .166 | .130 | 1 |
| | Sig. (2-tailed) | .554 | .644 | |
| | N | 15 | 15 | 15 |

*. Correlation is significant at the 0.05 level (2-tailed).

Table 2 show the correlation value of exchange rate as 0.130 with a p-value of 0.644 shows that they are not correlated at 5% level of significance, which in turn shows that exchange rate does not show any influence on FDI inflows into the country. Correlation value of Economic growth which is calculated as 0.519 with a p-value of 0.047 shows that Economic growth has a strong influence on FDI inflows in Sultanate of Oman.

**Table 3- Regression Analysis:**

| | R | R square |
|---|---|---|
| **Regression** | .130 | .017 |
| | .519 | .270 |

Table 3 reveals the relationship of independent variables Exchange rate and Economic growth with the dependent variable foreign direct investment (FDI) in Sultanate of Oman. R square value which is 0.27 shows that 27% of the FDI inflow in to the country is due to Economic growth whereas the R square value for exchange rate which is only 0.017 which shows that only 1.7% of the FDI inflow in to the country is due to exchange rate.

**Table 4 – ANOVA**

| Variables | Model | F value | Sig. |
|---|---|---|---|
| Exchange rate | Regression | .224 | .644 |
| Economic growth | | 4.801 | .047 |

Dependent Variable: FDI, Predictors: ex, eco

It is inferred from Table 4 that the association between independent variables exchange rate and Economic growth and dependent variable Foreign Direct Investment (FDI) calculated on the basis of ANOVA. The result shows that exchange rate is insignificant as the F-value is 0.244 with its corresponding significant value of 0.644 which is more than the significant level of 0.05.

But the ANOVA which is performed for finding out the association between Economic growth and foreign direct investment shows that economic growth influences significantly (F value = 4.801, p value= 0.047) the value of Foreign direct investment inflow into the country. This shows that economic growth has significant impact on attracting foreign direct investment and exchange rate does not have any influence on foreign direct investment.

**Hypothesis 1:** Exchange rate has no impact on FDI and exchange rate has no significant relationship with FDI as shown in correlation, regression and ANOVA Analysis.

**Hypothesis 2:** There is a significant relationship between economic growth and FDI which is evident from correlation analysis.

## Conclusion

The paper studies the effect and relationship of exchange rate movements, economic growth on FDI in Sultanate of Oman. From the results of ANOVA, Correlation and Regression, It is found that there is positive effect of economic growth on foreign direct investment (FDI), but that does not hold true in case of Exchange rate. It can be concluded that only economic growth influences FDI and exchange rate has no effect on FDI so, the government can create acceptable conditions for business and control the economy and should try to attract more foreign investors to improve FDI as FDI is considered as an important aspect for the economic growth.

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## Abbreviations

FDI= Foreign Direct Investment, GDP = Gross Development Product, BRICS = Brazil, Russia, India, China and South Africa,