An analysis of the determinants of investment in developing countries a case study of Iran (1970-93)

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Declaration

I hereby certify that this thesis has not been submitted previously as part of the requirements of another degree and that it is the result of my own independent research.

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ABSTRACT

This study attempts to identify the major determinants of private investment , along with the effects of such investments on other macroeconomic factors, in developing countries, using Iran as a case study. In this regard we identify a number of macroeconomic variables which played a major role in enhancing private investment in developing countries, and Iran in particular, between 1970 and 1993. An empirical investment model, a simultaneous investment model by industry and a macroeconomic model are applied to study the investment behaviour in this country. Lack of economic data, differences in economic structure, and different economic concepts between developed and developing countries, were the major issues that made this study more complicated .

The adopted empirical investment model is based on the Blejer and Khan (1984) and the Greene and Villanueva (1990) approach, which are related to investment behaviour in developing countries. The model enables us to show the effects of public current and capital expenditure, funded by oil export revenue, on private investment and other macroeconomic factors. The simultaneous investment function for major economic activities, indicates that domestic investment was affected by output, capital stock, bank financing, oil exports and public investment rather than the official (fixed) or real exchange rate in the parallel market and/or interest rate. The Harvie and Kearney (1995) macroeconomic model is amended to study the crowding out, or crowding in, effects of public current and capital expenditure on private investment in developing countries, focusing upon Iran as a case study. This model also examines the effects of the interest rate, real exchange rate and world income on the behaviour of major macroeconomic variables in the product, money and asset markets, and especially private investment.

The estimation results indicate that private investment was negatively affected by an increase in the interest rate, but positively by the major components of aggregate demand such as private consumption and public current and capital expenditure. These results also suggest that both public current and capital expenditure crowd in private investment.

The simulation results suggest a number of alternative government policies for achieving economic development goals and enhancing private investment. The policies presented are: 1. A two tier interest rate policy should be administered by the government, a lower interest rate for investment purposes, accompanied with a higher interest rate for savings, term deposits and bank credits. 2. Allocation of a higher proportion of oil export revenues for public investment only in infrastructure fields and/or financing private investment. 3. Pursuing a unified floating exchange rate policy.

The experience of billions of petro-dollars investment in various public enterprises in the 1970s, and nationalisation of hundreds of large scale private industries after the revolution, centralised the economy, aimed at pursuing the strategic goal of economic development. Eventually, however, the government also realised that the contribution of private investment was a prerequisite for sustainable economic development. This experience implied the need for a number of microeconomic reforms. Liberalisation of the economy including that of trade, privatisation of nationalised industries, reform of public enterprises, floating the exchange rate and the attraction of foreign direct investment are a concise summary of these essential microeconomic reforms.

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