

The Impact of Business Cycles on the Effect of FDI on Domestic Investment in Iran by Markov-Switching Approach

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Abstract

Foreign direct investment flows affect domestic investment in various dimensions. The specific feature of the effect of FDI on domestic investment relates to its complementary or substitution effect on domestic investment. In assessing the impact of FDI on domestic investment the key question is whether the FDI flow will lead to an increase or decrease in domestic investment?. So that the aim of this paper is to investigate the effects of foreign direct investment on domestic investment in Iran with a focus on business cycles during the period 1984- 2017. The boom and stagnation periods were estimated using the Markov-switching model. Then, using the ARDL method, the impact of boom times

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and recession on the effect of FDI on domestic investment was investigated. The results showed that FDI had a significant negative impact on domestic investment in both periods of boom and recession. But the impact of FDI and the cross-cutting effect of FDI during the recession are much stronger than the total impact of FDI and the period of economic boom on domestic investment. FDI, therefore, has a stronger crowding in effects on domestic investment during the recession compared to the boom period. Government stability also had a direct impact on domestic investment, While Interest rates, consumer price indices and trade had a negative impact on Iran's domestic investment.

Keywords: Foreign Direct Investment, Domestic Investment, Boom, Recession, Markov-Switching Model.

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