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An Analytical Study of Foreign Direct Investment in the Gulf Cooperation Council (GCC)

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ABSTRACT: The aim of this paper is to identify the key determinants in the Gulf Cooperation Council (which will be referred as GCC) for Foreign Direct Investment (FDI) inflows. Using the understandings of financial econometrics, the study discusses a significant positive association between FDI in Non-oil industries, while on the contrary, the negative association with the Oil industries. Natural resources are a path for some countries to attract FDI but it does not achieve the main benefits of FDI, which is introduction of new technology and offering job opportunities. Existing literature argues the suggestion that resource-rich countries attract less FDI because of resource (oil) price volatility. Statistical Models in Economic are used to analyze the data in achieving the conclusion. This study examines that natural resources discourage FDI in GCC countries, and helps identify policy reform priorities to support diversification and growth in the GCC through foreign investment.

KEYWORDS: FDI, GCC, Natural resources, oil industries, GDP, trade

Introduction

■ **Most countries in the Gulf Cooperation Council (GCC) have made limited progress in diversifying their economies away from hydrocarbons**. On average for the region during 2000–2017, oil revenues were close to 80 percent of government revenues, oil exports amounted to 65 percent of total exports, and oil GDP represented 42 percent of total GDP.

This picture was broadly unchanged during 2011–2017. There is a need to diversify the economies of the GCC to reduce exposure to volatility and uncertainty in the global oil market, help create private sector jobs, and increase productivity and sustainable growth (Callen et al., 2014).

Higher foreign trade and investment can play a large role in boosting diversification and growth. Several studies link greater trade openness to higher per capita income (Frankel & Romer, 1999; Feyrer, 2009; Cerdeiro & Komaromi, 2017), while FDI can boost growth by triggering technology spillovers, promoting knowledge, creating a more competitive business environment, and enhancing productivity (OECD, 2002; WEF, 2013). Further reducing barriers to foreign trade and investment to broaden and upgrade their export bases can help GCC countries better integrate into global value chains and make their economies more productive (IMF, 2017b).

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FDI World

An entity based in another nation makes an investment in the form of controlling ownership in a company in another country. This investment is known as a foreign direct investment (FDI).

The acquisition or creation of income-generating assets abroad involves management of the business or organization. The aspect of control sets FDI apart from portfolio foreign investment, which is the acquisition of securities from one nation by citizens of another. Standard definitions of control employ the globally accepted 10% level of voting shares, although this is a gray area because control in widely owned corporations sometimes results from a smaller block of shares. Power over management, technology, and even key inputs may grant de facto control, which is what happens in reality.

As management, technology, and organizational skills are frequently transferred along with money, FDI represents more than just a transfer of ownership.

FDI are presented in three types:

1. **Horizontal:** When a corporation does the same tasks both domestically and overseas (for instance, Toyota assembles vehicles in both Japan and the UK);
2. **Vertical:** the addition of several activity stages from overseas. Backward vertical FDI is when international integration shifts back towards raw resources (as in Toyota buying a tire manufacturer), whereas forward vertical FDI brings the company closer to the market (for instance, Toyota purchasing an American auto distributorship);
3. **Conglomerate:** a company to which a foreign, unrelated firm is joined. This is the most uncommon type of FDI since it includes attempting to cross two hurdles at once: joining a new market and a foreign nation. This results in the analytical conclusion that diversification and globalization are frequently opposing strategies rather than complementary ones.

FDI in general can be shown in terms of total takeover to the business or throughout entering the greenfield.

As Honda did in the UK, a greenfield entrance entails building everything from the ground up, but a foreign takeover refers to the purchase of an already-existing foreign corporation, as Tata's acquisition of Jaguar Land Rover demonstrates.

The phrase "mergers and acquisitions" (M&As) is frequently used to refer to foreign takeovers, yet on a global scale, mergers represent less than 1% of all foreign purchases with a 2x2 matrix of options, including greenfield wholly owned ventures, greenfield joint ventures, wholly owned takeovers, and joint foreign acquisitions, this choice of entry mode interacts with ownership strategy to give foreign investors options they can tailor to their own capabilities and foreign conditions.

Two of the key manifestations of the globalization of the economy and the internationalization of businesses are international commerce and foreign direct investments (FDI). A significant portion of empirical research views FDI and global commerce as complimentary. The area was a global outlier; FDI inflows decreased by 35% globally as a result of the coronavirus (Covid-19) pandemic's wide range of unfavorable effects. This was a result of both continuous policies as well as an acceleration of their implementation in 2020 in response to the fiscal pressures brought together by the health crisis and the ensuing drop in oil prices. These policies aim to attract foreign investment to help diversify economies that are dependent on oil.

FDI in GCC

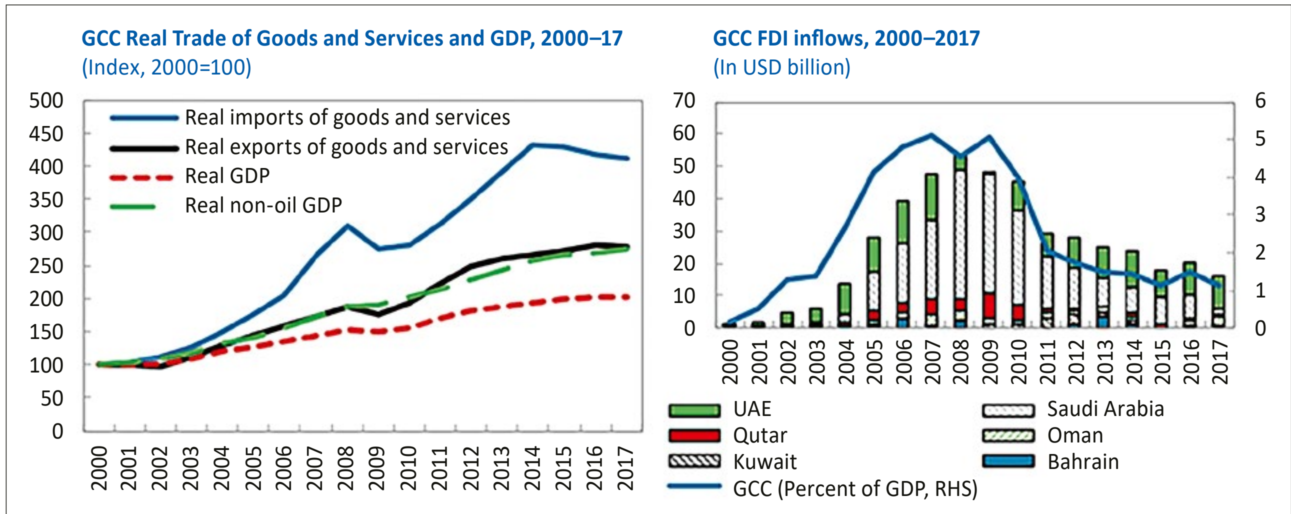
The union of GCCs was created in 1981 for political and economic cooperation aiming at the integration and coordination of the member states in all fields. In 2003, GCCs created a Custom Union, where they implement common custom tariff, while a monetary union is in the process. Moreover, all GCCs are members of the Greater Arab Free Trade Area (GAFTA) and of the World Trade Organization (WTO).

The GCC is an important union of states that attracts the world's attention because it is one of the main producers of the world's oil. Therefore, these states play a significant role not only in the energy market but also in the global market. These states differ from the developed and emerging countries. They are predominately segmented markets and they are very sensitive to regional political events, while their idiosyncratic characteristics are a special subject under the view of international cooperation and convergence.

The choice of location is a crucial factor for foreign investments (Dunning & Lundan, 1998). Although the GCCs are rich in natural resources, open to trade, and possess wealth, they attract less FDI, according to the IMF (2018). This remark raises concerns on whether this area may be a friendly business environment under the view of the structural components of the quality of governance and the financial environment.

FDI inflows into the area have stagnated in recent years, despite the fact that commerce between the GCC and the rest of the globe has grown significantly. In comparison to the worldwide averages of 4.8 percent and 3.8 percent, respectively, the GCC's commerce in goods and services has increased at an average real rate of 7.5 percent since 2000, or nearly double the pace of real GDP growth. The surge in oil prices from 2003 to 2008 caused a rapid rise in oil export revenues, which in turn caused a sizable increase in imports of products and services during that time. Using statistical models in economic, the global financial crisis halted this increase in trade, but it has since returned substantially, partly due to strong domestic demand and improvements in general circumstances. FDI inflows into GCC nations, on the other hand, have stopped after soaring in the early 2000s and are now, on average, below 2% of the region's GDP (Figure 1).

Figure 1. GCC: Trade and FDI



Sources: World Economic Outlook; Country authorities; and IMF staff calculations.

FDI inflows in the GCC increased by 12.4% to US$27.7bn in 2020, led by strong increases in inflows into Saudi Arabia, Oman and the UAE, according to the UN's annual World Investment Report (WIR), released on June 21st 2020. A combination of resistance from countries whose corporation tax is less than 15%, carveouts for important industries and difficulties in ratification by the US Congress are likely to limit progress towards this goal in Europe.

The region was a global anomaly; FDI inflows shrank by 35% worldwide on the back of the multifarious negative impacts of the coronavirus (Covid-19) pandemic. This reflected both ongoing policies designed to enlist foreign investment to help diversify oil-dependent economies, and acceleration of their implementation during 2020 in response to the fiscal strains caused by the health crisis and associated oil-price slump.

The UAE remained by far the preferred destination, attracting 71.7% (US$19.9bn) of inward investment–up 11.2%, year on year, and exceeding outflows (US$18.9bn) for the first time since 2013, although more than half was accounted for by state-owned Abu Dhabi National Oil Company's sale of a US$10.1bn stake in its gas-pipeline network.

In the GCC, Saudi FDI increased by the most, up by 20.2% to US$5.5bn, validating the huge drive under way to harness foreign capital to realize Vision 2030 goals. Nonetheless, the figure remains less than one-fifth of that recorded a decade ago. The more dramatic change last year was in outflows, which shrank by almost two-thirds, to US$4.86bn, as the Public Investment Fund (a sovereign wealth vehicle) re-focused on domestic investments.

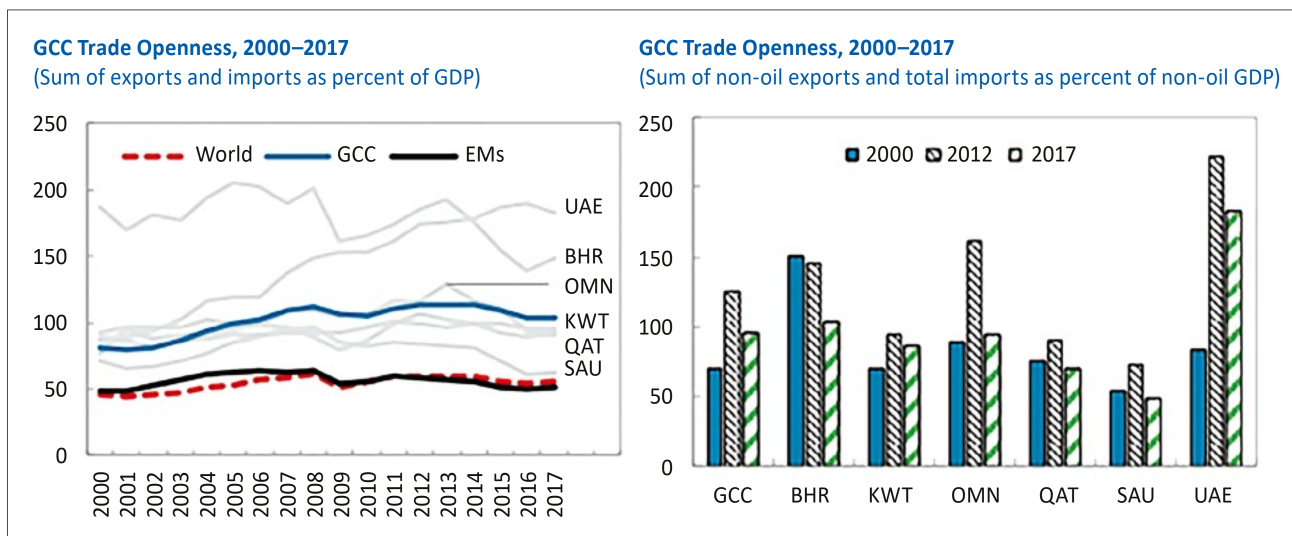
Of the smaller economies, only Oman's FDI inflows increased, by an impressive 19.7% to US$4.1bn, partly reflecting its weak fiscal position and increasing use of public-private partnerships (PPPs) for infrastructure development. FDI inflows to Bahrain, with the UAE the most open of the Gulf economies, shrank in line with the global downturn, by 33%, to US$1bn. Meanwhile, Qatar's inflows were registered as negative for the third consecutive year, by US$2.4bn, assumed to reflect withdrawals triggered by the recently ended economic boycott by several regional states. Kuwait,

which routinely attracts very low levels of FDI owing to a highly unattractive investment environment, also recorded negative inflows.

The upward regional trend is expected to continue in 2021 and beyond, as new laws passed last year–notably, the UAE's FDI Decree, permitting 100% foreign ownership of onshore companies, and Saudi Arabia's Private Sector Participation Law, setting out a clear framework for privatization as PPPs bed in, and as global investment picks up.

Duration models-limited dependent variables are used to analyze the GCC trade openness. The GCC nations are quite active in commerce. In 2017, the ratio of exports and imports of goods and services to GDP was greater than 100%, which is much higher than the average of 50% for emerging countries (Figure 2). This is mostly caused by the region's abundant hydrocarbon resources, which are exported primarily, and a lack of local production diversification, which forces imports.

Figure 2. GCC: Trade Openness



Sources: World Economic Outlook; and IMF staff calculations.

FDI in GCC & natural resources

The Gulf Arab states are characterized by abundant natural resources, especially hydrocarbons. Where Gulf territories store approximately 34 percent of the confirmed crude oil reserves and about 20 percent of confirmed natural gas deposits. The Gulf Arab states produce more than one fifth of the world's crude oil production and more than 8 percent of natural gas as at the end of the year 2014. Moreover, the Gulf states are rich in various minerals. It is not surprising, therefore, that natural resources play a key role in the economies of the Gulf states and that their revenues will have the largest share of their revenues and the consequent economic changes that correspond to the structural nature of the country's revenues and expenditures and their association with commodity price fluctuations.

In recent years, many studies have tended to test the relationship between FDI and natural resources where they took care of the role that natural resources play in attracting investments and the nature of the outstanding between these two variables. In fact, these studies have found different and contradictory results in some quarters, resulting in different and contradictory proposed policies the quality of the natural resource used and the variation of also periods, may be the cause of this contradiction in the study as well as the disappearance of the countries covered by these studies. Studies dealing with the lingering between direct foreign investment and natural resources found that this lingering trend to be stuck negative. Natural resources cause uncertainty in the macroeconomics. Consequently, natural resources are crowded for two reasons: 1) the increase in natural resources increases demand in Non-commercial sector leading to higher inflation (Warner & Sachs, 1997). 2) Natural resources are characterized by fluctuations in their prices and this also causes exchange rate fluctuations. And so, High inflation and exchange rate fluctuations lead to increased economic uncertainty, which

leads to less foreign investment (Asiedu, 2004). The graph 4 shows the relation between revenue from natural resources (crude oil and natural gas only) and direct foreign investment in GCC. As shown in chart 4, the period of the largest flows for FDI in the Gulf states, it was also experiencing the highest rise in rents from oil and gas natural as a proportion of GDP and this was in 2008, While at other intervals there was a positive relationship between the two variables, especially when rents from natural resources increased in 2003, 2004 and 2011, where net FDI flows were modest. In general, countries rich in natural resources, in addition to receiving less FDI, the quality of these investments is weak. FDI in countries rich in natural resources usually is not associated with any positive impact or extension in technology transfer and job opportunities.

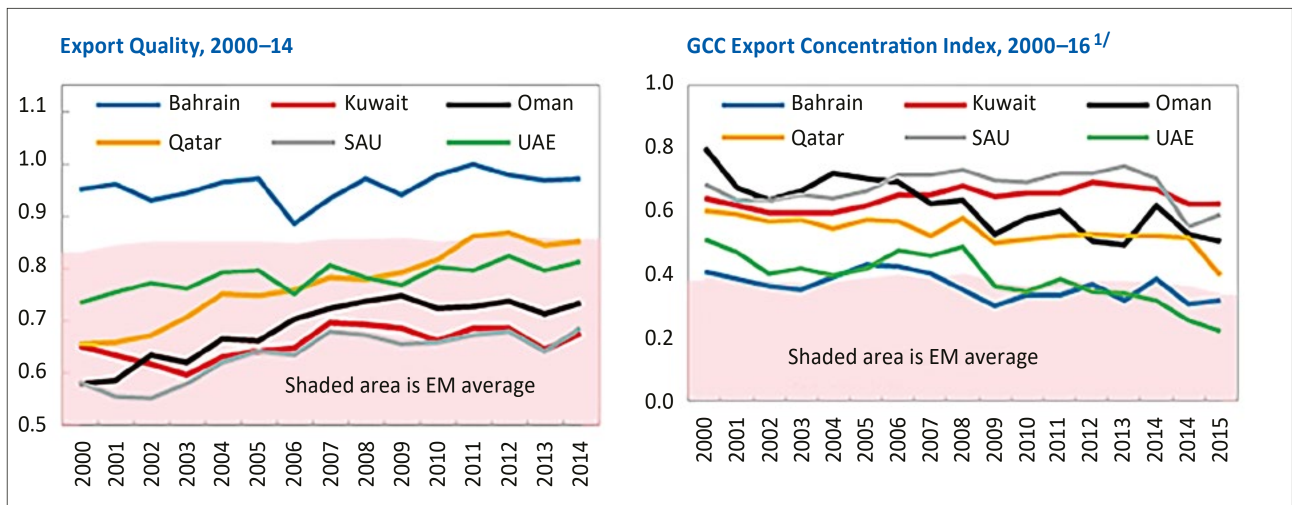
FDI in other fields in GCC

Most hydrocarbon exports come from the GCC nations. With some of the greatest hydrocarbon reserves in the world, the majority of GCC nations (apart from the UAE and Bahrain) rely heavily on oil and gas exports, with Kuwait, Qatar, and Saudi Arabia accounting for between 70 and 80 percent of global gas production.

Exports of items other than hydrocarbons have grown, with some moving from raw resources to intermediary goods. Although they still make up a modest portion of non-oil commerce globally, non-oil exports (including re-exports) climbed from 16 percent of non-oil GDP in 2000 to 32 percent in 2017. This strong development has been centered on downstream businesses with high capital requirements, such as aluminum, petrochemicals, and refined hydrocarbons, which take full advantage of the region's competitive edge in cheap, plentiful hydrocarbons. In line with this, the proportion of exported raw resources has decreased in favor of intermediate and consumer products. Re-exports of goods account for a non-negligible portion of total GCC exports of goods and services (roughly a fifth), which is primarily attributable to their extremely high share in UAE exports. This paper, however, does not concentrate on this area of international trade as it aims to evaluate the export opportunities from the point of view of producing significant value added for the GCC economies.

An important provider of petrochemicals, aluminum, and various minerals, the GCC is growing in importance. For instance, SABIC of Saudi Arabia is among the biggest producers of petrochemicals, while ALBA of Bahrain is among the biggest producers of aluminum. In 2017, Oman overtook China as the top gypsum exporter in the world. In terms of primary commodities like fuel, metals, and minerals, the area continues to retain a revealed comparative advantage (RCA). In 2016, there were 31 products with RCA in Qatar and 172 in the United Arab Emirates. According to sectoral distribution of exports, Saudi Arabia leads the region in exports of plastic and rubber, Bahrain, Oman, and the UAE lead exports of metals and minerals, and the UAE lead exports of stone and glass. Small and

Figure 3. GCC: Quality and Concentration of Exported Goods



Sources: IMF, Export Diversification and Quality Dataset; national authorities.

Sources: UNCTAD.

1/ Lower index indicates lower concentration and higher diversification

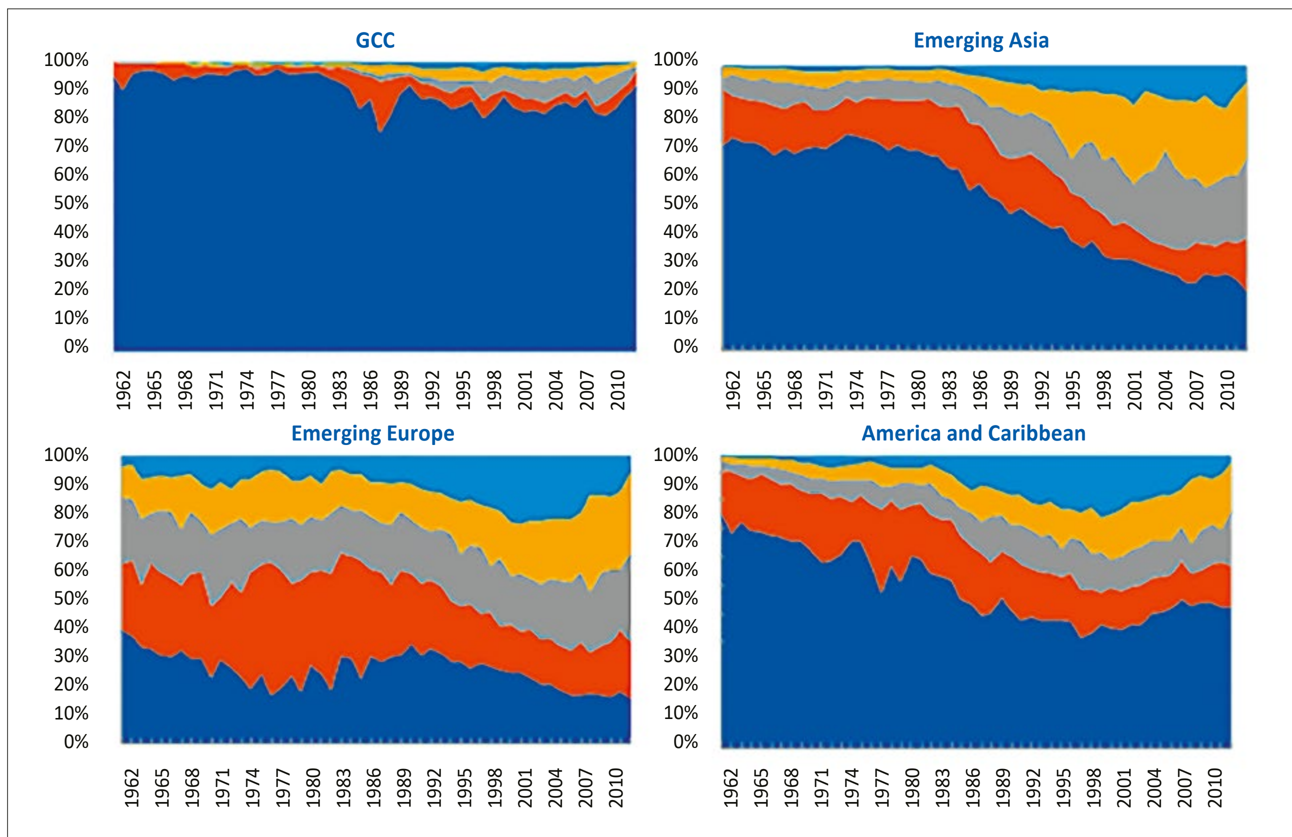
dispersed over several categories are the remaining non-oil exports. GCC nations have had less success exporting other produced commodities, which is indicative of their minimal direct participation in global value chains.

Non-oil export value added and diversification are still comparatively low. Over the previous 15 years, export quality, a proxy for value added, has grown in all GCC nations, albeit to various degrees, but usually remains low in comparison to averages for developing market nations (Figure 3). With the exception of the UAE and Oman, most GCC economies had a modest decline in export concentration indices during the same time period, and when measured against other developing markets, GCC non-oil exports appear to be more concentrated overall.

The substantial hydrocarbon resources as well as the lack of export diversification and expertise may help to explain the GCC's poor integration into global value chains (GVCs). Although the UAE has advanced more than other nations in diversifying its economy, data indicates that most GCC economies, including other oil-producing nations and nations in the region, have lower indicators of economic complexity, diversity, and export quality than many other emerging market economies. Like many other developing market commodity exporters, the GCC participates only minimally in the final stages of GVCs, which results in a relatively modest percentage of foreign additional value in the GCC exports, which are dominated by hydrocarbons.

The majority of the GCC's trade in services is made up of tourism and transportation services. One of the areas' fastest-growing industries is still tourism. Tourism exports from the GCC made for around half of all service exports in 2016. Given that they are the top destinations for leisure and religious travel, respectively, the UAE and Saudi Arabia account for more than 75% of travel revenue. With a 35 percent share, transportation is

Figure 4. GCC: Product Complexity of Exports [1/]



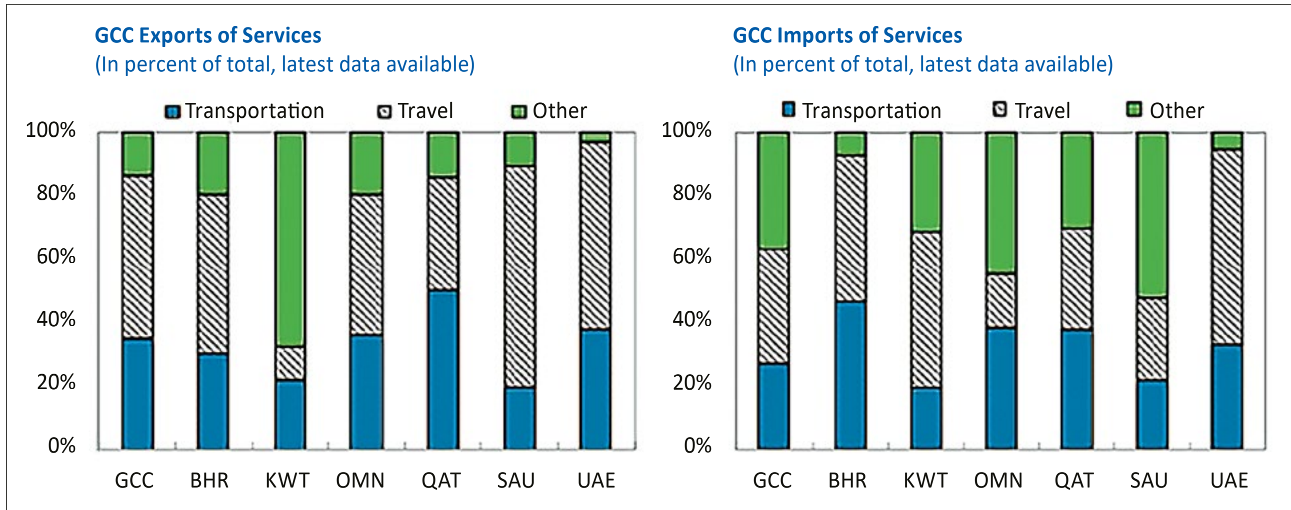
Sources: Ding, Xiaodan and Metodij Hadzi-Vaskov, 2017, "Composition of Trade in Latin America and the Caribbean", IMF Working Paper No. 17/42 (Washington: International Monetary Fund).

[1/] This chart shows the distribution of exports for different regions according to the level of product complexity: top area corresponds to the share of exports that belong to the top (fifth) quintile in terms of product complexity index (PCI), and the bottom area corresponds to the share of products in the bottom quintile of the distribution of the product complexity index (PCI).

the second-largest traded service in the area. Similarly, travel accounts for the majority of service imports into the GCC, followed by transportation (Figure 5).

Recent years have seen a decline in FDI inflows (Figure 6). While changes have been put in place to entice foreign investment, these have been done so against the background of the global financial crisis' lasting effects and the region's growing geopolitical unrest and uncertainty. Even if the GCC nations are capital-rich, attracting FDI may provide them access to overseas markets, superior management techniques, and technological know-how, which will improve their domestic economy's capabilities and raise productivity (as described by the World Bank, 2013).

Figure 5. GCC: Trade in Services by Type

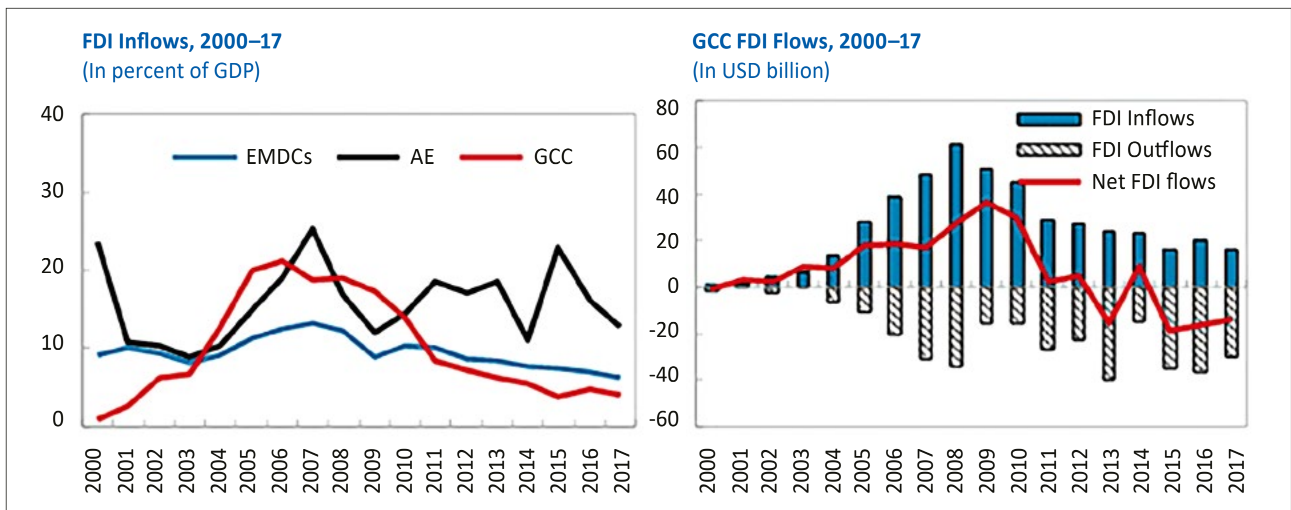


Sources: UN Comtrade; and IMF staff calculations.

Discussion

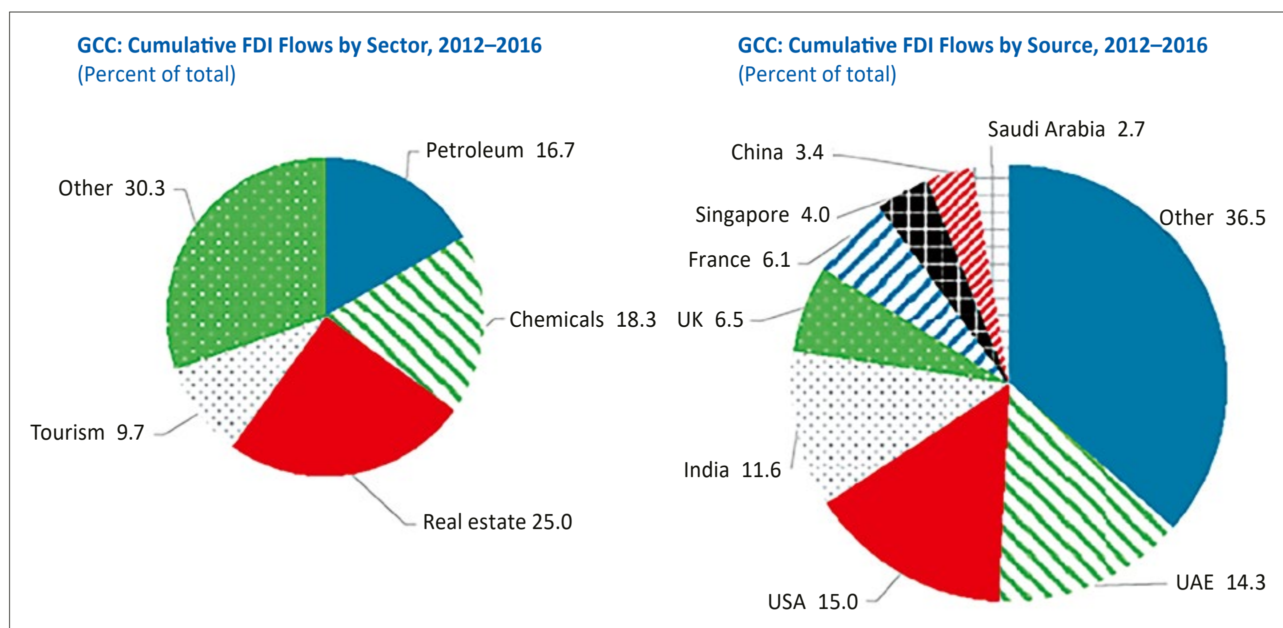
FDI inflows into the area have been concentrated in two GCC nations and biased toward particular industries. Data Collection obtained from the Arab Investment and export credit guarantee cooperation along with IMF staff calculations were used to get the diagrams below. Greenfield investments have been predominantly financed by FDI inflows, with 60% of the inflows focused in three industries: real estate, petroleum, and chemicals (Figure 7). Saudi Arabia and the UAE have drawn approximately 80% of all FDI inflows, which is reflective of their size.

Figure 6. GCC: FDI Flows



Sources: Country authorities; and IMF staff calculations.

Figure 7. GCC: Foreign Direct Investment



Sources: Arab Investment and Export Credit Guarantee Corporation, 2017; and IMF staff calculations.

Even if the geographical diversity of the sources of FDI is wide, the majority of it comes from only a few nations. More than a quarter of FDI inflows in recent years have come from the US and India, while a sizable amount of FDI inflows into other GCC nations have come from the UAE (Figure 7). Intra-GCC FDI flows have been concentrated in the real estate, oil, and tourist industries between 2003 and 2016.

The governments of the GCC provide a range of incentives to entice FDI. These include cash incentives, help with business registration and startup, exemptions from import taxes on machinery and raw materials, and duty-free access to other GCC markets. The government of Kuwait has set up a unit to speed up the licensing and registration processes for foreign investors with the aim of awarding licenses in 30 days. The new FDI legislation in Kuwait permits tax breaks, a reduction of customs taxes, land and property allocations, and the hiring of necessary foreign employees. A five-year renewable tax vacation, subsidized plant facilities and utilities, and a ten-year period of no customs charges on machinery and raw materials are just a few of Oman's FDI incentives.

Conclusion

The main findings of this paper is that natural resources measured by oil rents have a negative association with FDI inflows; this negative impact is robust even when other FDI determinants of FDI are included. FDI inflows decreased between 0.15 and 0.92% when oil rents increased by 1%. In addition, the results show that trade openness and labor force are the main factors that encourage FDI, while political instability and corruption deter FDI inflows into GCC countries. However, recently with the governments encouraging the investors with some incentives, the possibility to gain better FDIs are increasing recently.

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