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Impacts of Foreign Direct Investment on Economic Growth in the Gulf Cooperation Council (GCC) Countries

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This paper examines and analyses evidence pertaining to foreign direct investment FDI in the six countries (Kingdom of Saudi Arabia, United Arab Emirates, Oman, Qatar, Kuwait and Bahrain) comprising the Cooperation Council for the Arab States of the Gulf (GCC) countries. The purpose of the paper is to test to what extent these countries have recognized the importance of FDI in the process of growth and hence what are the measures adopted aiming at attracting foreign capital and encouraging foreign investment. Based on evidence, the paper goes on to identify the determinants of FDI in the GCC countries. This paper uses recent growth theories and statistical techniques to empirically test for the association between FDI and economic growth in the GCC countries. Results obtained from data analysis indicate a weak relationship between FDI and GDP in the panel of the GCC. This result supports the endogenous growth hypothesis, at least for this group of countries.Keywords: foreign direct investment, economic growth, GCC countries and determinants of FDI.

Key Words: DPP., FDI and GCC

1. Introduction

Foreign direct investment (FDI) has been recognized as an important resource for economic development. Many people argue that the flows of FDI could fill the gap between desired investments and domestically mobilized saving (Todaro and Smith, 2003, Hayami, 2001). It also may increase tax revenues and improve management, technology, as well as labor skills in host countries (Todaro and Smith, 2003, Hayami, 2001). Additionally, FDI may help the host country to break out of the vicious cycle of underdevelopment (Hayami, 2001). There have been extensive studies on the effects of FDI on economic growth, either at the firm level or at national level. The researches in this area have been intensified during this last decade due to the increased role of FDI in total capital flows. The direction of the flow is from the North (developed countries) to the South (developing countries).

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There is conflicting evidence in the literature regarding the question as to how, and to what extent, FDI affects economic growth. FDI may affect economic growth directly because it contributes to capital accumulation, and the transfer of new technologies to the recipient country. In addition, FDI enhances economic growth indirectly where the direct transfer of technology augments the stock of knowledge in the recipient country through labor training and skill acquisition, new management practices and organizational arrangements.

The GCC countries has seen a marked increase in FDI inflows in recent years, reflecting the countries' strong economic prospects, reduction of trade barriers, and improved policy and regulatory environment that's more attractive to foreign investors. GCC countries also implemented a number of measures aimed at boosting the attractiveness of their investment environments. The measures included: reduction in corporate tax rates –including tax holidays-; expediting the issuance of visas; creating a one-stop shop to reduce time needed to approve and register investments; marketing available investment opportunities, and eliminating or reducing minimum capital requirements. On the downside, GCC countries still lags behind most countries in the Middle East in terms of privatization. National labor support laws in GCC countries may have also hindered FDI inflows into the region.

3-The area of the study and its characteristics

The GCC, a political and economic alliance and trade bloc, was created in 1981 with the objective of integrating and coordinating among member states in all fields and formulating similar regulations in the economy, finance, trade, legislation and administration. As part of the overall plan for greater economic integration, GCC members implemented a Customs Union in January 2003, unifying tariffs throughout the GCC. In addition, the six members of the GCC launched a Common Market in January 2008 (many operational details are yet to be finalized) and are aiming for a single currency and monetary union by 2010. The GCC region holds around half of the world's known oil reserves. The GCC accounted for around 18% of global oil production and 39% of oil exports in 2006. Total net foreign assets of the GCC are expected to exceed USD 2 trillions 2008. High energy prices provide governments in the region with a good opportunity to address long-standing structural reforms. There is a clear shift from the public to the private sector as the main engine of growth. Growing domestic investments and economic diversification should help reduce dependence on hydrocarbons. Regardless of the positive outlook for the near term, the GCC countries have their share of economic challenges and risks. Despite increased diversification efforts, the region still relies on hydrocarbon industries. This makes the region vulnerable to energy price swings and geopolitical risks. The region is also faced with an ever growing inflation problem (close to double digits in the UAE and Qatar). From a global perspective, the GCC is still a small but important player, with a nominal GDP of 1.5% of the world total, comparable to ASEAN countries. With a total population of around 38 million, the GCC remains small among its economic peers. However, in terms of growth rates, the GCC has surpassed Middle East and Latin American growth averages. In addition, GDP per capita income, especially in the UAE and Qatar, is among the highest in the world.

Unemployment among GCC nationals and business environment constraints, especially governance and transparency, remain key structural challenges.

4-Literature review

Empirical evidence from Alfaro, Chanda, Ozcan, Sayek (2002) suggests that FDI plays an important role in contributing to economic growth. However, the level of development of local financial markets is crucial for these positive effects to be realized. The World Bank's 2001 edition of global development finance talks about the importance of "absorptive capacities" and the success of FDI, like macroeconomic management (as captured by inflation and trade openness), infrastructure (telephone lines and paved roads), and human capital (share of labor force with secondary education and percentage of population with access to sanitation), but financial markets are not mentioned. Sadik and Bolbol (2001) investigate the effect of FDI through technology spillovers on overall total factor productivity for Egypt, Jordan, Morocco, Oman, Saudi Arabia and Tunisia over a 20-year period. They find that FDI has not had any manifest positive spillovers on technology and productivity over and above those of other types of capital formation. On the contrary, there are some indications that the effect of FDI on total factor productivity has been lower than domestic investments in some of the countries over the period studied, indicating a possibly dominating negative crowding out effect. Most studies generally indicate that the effect of FDI on growth depends on other factors such as the degree of complimentarily and substitution between domestic investment and FDI, and other country-specific characteristics. Buckley et. al, (2002) argue that the extent to which FDI contributes to growth depends on the economic and social conditions in the recipient country. Countries with high rate of savings, open trade regime and high technological levels would benefit from increase FDI to their economies. However, FDI may have negative effect on the growth prospects of the recipient economy if they result in a substantial reverse flows in the form of remittances of profits, and dividends and/or if the multinational corporations (MNCs) obtain substantial or other concessions from the host country. Bengoa and Sanchez-Robles (2003) argue that in order to benefit from long-term capital flows, the host country requires adequate human capital, sufficient infrastructure, economic stability and liberalized markets. The view that FDI fosters economic growth in the host country, provided that the host country is able to take advantage of its spillovers is supported by empirical findings in De Mello (1999) and Obwona (2001). Borensztein et al., 1998 go further to suggest that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. They use a model of endogenous growth, in which the rate of technological progress is the main determinant of the long-term growth rate of income.

The other theme of empirical research of FDI-growth relationship concentrated on identifying determinants of FDI flow and analyzing the effects of these determinants on the attractiveness of the host country to, and the volume and type, of such flows. Two sets of factors are frequently cited. The first set includes the size of the recipient market, relative factor prices, and balance of payments constraints (Bhasin et al., 1994; Love and Lage-Hidalgo, 2000; Lipsey, 2000). The second set includes institutional factors

such as degree of openness and trade policies, legislative environment and law enforcement (Lee and Mansfield, 1996), and the degree of economic and political stability (Bajorubio and Sosvilla-Rivero, 1994; Lipsey, 1999). Recognizing the importance of FDI to their growth, many countries are using specific incentives to attract FDI to flow in. Tax breaks and rebates are examples of such incentives (Tung and Cho, 2001).

The factors that determine foreign direct investment include growth of GDP (Addison and Hesmati, 2003; Hisarciklilar et al, 2006), population (Hisarciklilar et al, 2006), degree of openness (Onyeiwu, 2003) political stability (Mellahi 2003) infrastructure (Onyeiwu, 2003; Mellahi, 2003; Hisarciklilar et al, 2006).Other determinants include education, research and development, country risk and domestic investment (Moosa, 2006), and risk instability (Chan and Gemayel, 2004). It is interesting to note that there are a number of factors that determine both the growth of GDP in a country as well as the growth of FDI. Research has shown that the amount of FDI depends on a number of other factors. Emphasizing the size of the domestic market a study by Hesmati & Addison 2003, shows that FDI seeking a base to produce for the domestic market in the host country is attracted to a country in which real income and therefore domestic purchasing power is growing. However, when analyzing location drivers, Hisarciklilar et al (2006) concluded that the market does not comprise of the host economy but also regional trade and trade with the rest of the world.

5- Objectives of the paper

The main objective of this study is to determine the effects of FDI on economic growth of the GCC countries during the period 1999-2007 using panel data analysis. The purpose of the paper is to test to what extent GCC countries have recognized the importance of FDI in the process of growth and hence what are the measures adopted aiming at attracting foreign capital and encouraging foreign investment. In particular we consider and test for the relationship between FDI and economic growth, i.e. growth of gross domestic product (GDP) in the six GCC countries studied as one heterogeneous panel. Based on evidence, the paper goes on to identify the determinants of FDI in the GCC countries.

6-Statement of the problem and Rationale of the study

Governments in developing countries perceive FDI as a key source of economic development (UNCTAD 1998). This has been demonstrated by the intense competition by countries to attract FDI at a scale hitherto unseen in international business. Rolfe and White (1992) noted that potential foreign investors are now faced with a dizzying array of host government incentives. Similarly, in GCCs, according to recent economic development plans and political rhetoric, the future prospect of social, economic, and political developments of the country is perceived as being ultimately related to its ability to attract more FDI. The GCC region has seen a marked increase in FDI inflows in recent years. Over the last two years combined, FDI inflows were 33% higher than their accumulated figure from the previous 15 years. The lifting of barriers to FDI has been a

primary factor behind the rise in inflows. GCC countries have individually adopted long-term visions defining their ultimate economic objectives. The main criterion for meeting such aspirations relies on the diversification of the sources of income away from oil. They aim to reduce the oil sector's share of GDP and have explicitly stated the need to foster FDI inflows to achieve their targets.

7-Trends in Global and GCC FDI

In the United Nations Conference on Trade and Development (UNCTAD) – World Investment Report-2001, FDI grew to 1.3 trillion US dollars. This is tremendous when considering that FDI was only 58 billion in 1982. Thus, there is a clear and growing global trend by transnational corporations to locate and invest across borders. In the year 2007, world has witnessed an improvement in the total foreign direct investment by 17.8% compared to 2006. In 2006 the figure was 1305.9 billion dollars and in 2007 the figure became 1537.9 billion dollars. The recent profile of the FDI flow into GCC countries is summarized in tables 1 and 2 which show that FDI flow has been an important form of investment in most of GCC countries. As a percentage of gross capital formation, FDI flow has accounted for more than the world average in two of the six GCC countries (Qatar and Bahrain), while reporting a high share in the other GCC countries in most of the years presented. On the other hand, except for the United Arab Emirates, FDI stock has accounted for an important share compared to the value of GDP in these countries, and that was apparent in the case of Bahrain, in which FDI stock reached more than 74% and 70%, in 2000 and 2004 of the level of GDP respectively.

The 2008 World Investment Report, released last September by UNCTAD, shows FDI inflows to GCC countries at $43 billion in 2007, up $7 billion from the year before (table 1). Among member countries, Saudi Arabia was the preferred destination for FDI inflows in 2007, attracting $24 billion, or more than half of the total, followed by the UAE with $13 billion. Way down the list was Kuwait with a very small share of $123 million. From an international perspective, however, FDI inflows into the GCC remain modest, accounting for 2.3% of total world inflows in 2007 compared to 2.6% in 2006. This small share suggests that the GCC still has a way to go in improving its relative attractiveness compared to other emerging markets. For example, a relatively small country like Hong Kong, with a gross domestic product (GDP) equivalent to 25% of the total GDP all GCC countries combined, attracted $60 billion in FDI in 2007, 40% more than the GCC level.

Table 1: **GCC FDI inflows by country ($ million)**					
Country/ Year	2003	2004	2005	2006	2007
Kuwait	67	20	234	122	123
Bahrain	517	865	1,049	2,915	1,756
Oman	528	18	1,688	1,623	2,377
Qatar	625	679	1,298	159	1,138
UAE	30	840	10,900	12,806	13,253
Saudi Arabia	778	1,867	12,097	18,293	24,318
All GCC	2,545	4,289	24801	35,918	42965
Source: World Investment Report of UNCTAD 2008.					

Table 2. GCC and world FDI flows and FDI stocks, selected years.						
FDI flows as a percentage of Gross Fixed Capital formation				**FDI stocks as a percentage of GDP**		
Region/economy	2002	2003	2004	1990	2000	2004
Bahrain	14.9	27.8	41.1	13.0	74.1	70.5
Kuwait	0.2	- 1.9	- 0.5	0.2	1.7	0.7
Oman	1.0	15.5	- 0.5	16.2	12.6	14.0
Qatar	15.5	13.9	13.4	1.0	10.8	14.6
Saudi Arabia	1.3	2.0	4.3	13.8	8.9	8.2
United Arab Emirates	9.0	0.2	4.6	2.2	2.0	4.6
World	10.6	8.3	7.5	8.4	18.3	21.7
Developed economies	10.9	7.9	6.1	8.2	16.3	20.5
Developing economies	9.5	8.8	10.5	9.8	26.2	26.4
Source: constructed from UNCTAD (2005), Annex table B.3.						

In general, FDI has been strongly present in the economies of the GCC countries and, therefore, the relationship between FDI and economic growth in these courtiers warrants careful analysis, as this relationship has not been studied widely, to the best of our knowledge.

8- Measures and policies of attracting FDI in GCC

Bahrain	Eased rules on non-GCC firms to own buildings and lease land; established a one-stop shop to facilitate licensing procedures; and permitted foreign ownership to increase from 49 to 100 percent of businesses in all but a few strategic sectors (e.g., oil and aluminum).
Kuwait	Passed a law allowing foreigners to own 100 percent of Kuwaiti companies and reduced corporate taxes from 55 percent to 25 percent. Established Foreign Investment Capital Office to process foreign direct investment applications.
Oman	Allowed 100 percent foreign ownership of companies in most sectors; reduced income tax disparity between Omani and foreign companies by raising the single rate for the former from 7.5 percent to 12 percent and lowering the rates for the latter from 15–50 percent to 5–30 percent; redefined "foreign" company as one with more than 70 percent foreign ownership instead of currently 49 percent; and allowed foreign, non-GCC, firms to own buildings and lease land. Opening up the service sector to full foreign ownership in line with WTO agreements, starting in 2003 with the information technology sector.
Qatar	Allowed 100 percent foreign ownership in agriculture, industry, health, education, and tourism sectors, and streamlined investment approval procedures. Reduced maximum corporate tax from 35 percent to 30 percent.
Saudi Arabia	Enacted a new Investment Law and established the associated investment authority (SAGIA) to facilitate foreign direct investment processing, including the establishment of a one-stop shop. Allowed for 100 percent foreign ownership of business in most sectors, including gas, power generation, water desalination, and petrochemicals. Cut the highest corporate income tax on foreign investment from 45 percent to 30 percent. Permitted non-Saudis to own real estate for their business or residence, except in the two holy cities.
United Arab Emirates	Launched several new free trade zones intended to establish the emirate as a global center for trade in gold bullion, research and development of technology, and financial activities. Relaxed restrictions for foreign investment in specific real estate projects.

9- Methodology and data

This study uses a panel data in which countries are the units of observation. The regression tools used in the estimation process are those specifically designed for panel data such as the Ordinary Least Square method (OLS). Data used have space as well as time dimension. The space dimensions are 6 countries composing GCC region while the time dimension is that each unit (countries) contains several years of time series of annual data.

Data used is secondary data. For FDI it is taken from World Investment Reports of UNCTAD, the GCC governments official publications and reports, ESCWA (United

Nations Economic and Social Commission for Western Asia), and Central banks publications. Data for Gross Regional Domestic Product is in the form of real growth whereas for FDI, data used is approved FDI. Data used for real GDP is also secondary data taken from World Economic Outlook Reports. All variables used are based on annual data in the year of 1996 to 2007 from 6 countries in the region.
We sue the Ordinary Least Square (OLS) estimates to test for the relationship between FDI and real GDP growth.

10-The theoretical channels through which FDI affects growth

Foreign direct investment can affect growth and development directly by contributing to gross fixed capital formation, and through several indirect channels which constitute the externalities associated with FDI. The direct channel does not favor FDI over other types of investment and would not in and of itself justify costly incentives for attracting it without providing the same incentives to domestic direct and foreign portfolio investment. Through the indirect channels, however, FDI is often argued to additionally affect various parts of the host economy, and in turn spur growth. We briefly introduce the main indirect channels below.

Starting by what we call the crowding channel, FDI by a multinational corporation may trigger an additional need for financing which could be sought in domestic capital markets, in order to complement the initial foreign direct investment. The potential additional domestic portfolio financing can be a positive externality leading to crowding in, but may also have negative financial crowding out effects on domestic investments when the supply of domestic financial resources are scarce. Along the same lines, when FDI brings in a product already produced in the local market, the foreign affiliate enters into a competitive position with domestic industry and may crowd out some of the demand for local investment. Notwithstanding issues of efficiency and competition, this will in isolation have a negative impact on domestic gross fixed capital formation. The reverse case of crowding in can also be true in case the FDI introduces a new product into the host economy and creates a demand for locally produced intermediate goods which did not exist before. Finally, in the case of scarcity of skilled labor in the host country, FDI may also draw skilled labor away from domestic industries, which will then lead to a negative impact on domestically owned economic activities, in turn inducing additional negative crowding-out effects on local investment. Whether the crowding channel leads to a positive or a negative spillover can thus not be determined a priori.
We refer to the second channel as the linkages channel. FDI may play an important role in transferring new technology to the host economy, which in turn may lead to higher productivity and growth. This positive spillover in principle comes about through outsourcing and through interaction of the multinational corporation with local suppliers and costumers and by imitation of technology and know-how by local competing producers. Since a multinational will be interested in protecting its competitive edge among firms in the same industry, but has an interest in improving the efficiency and product quality of upstream suppliers, the linkages channel should be expected to work through backward linkages in particular, rather than through horizontal technology transfers or even forward linkages.

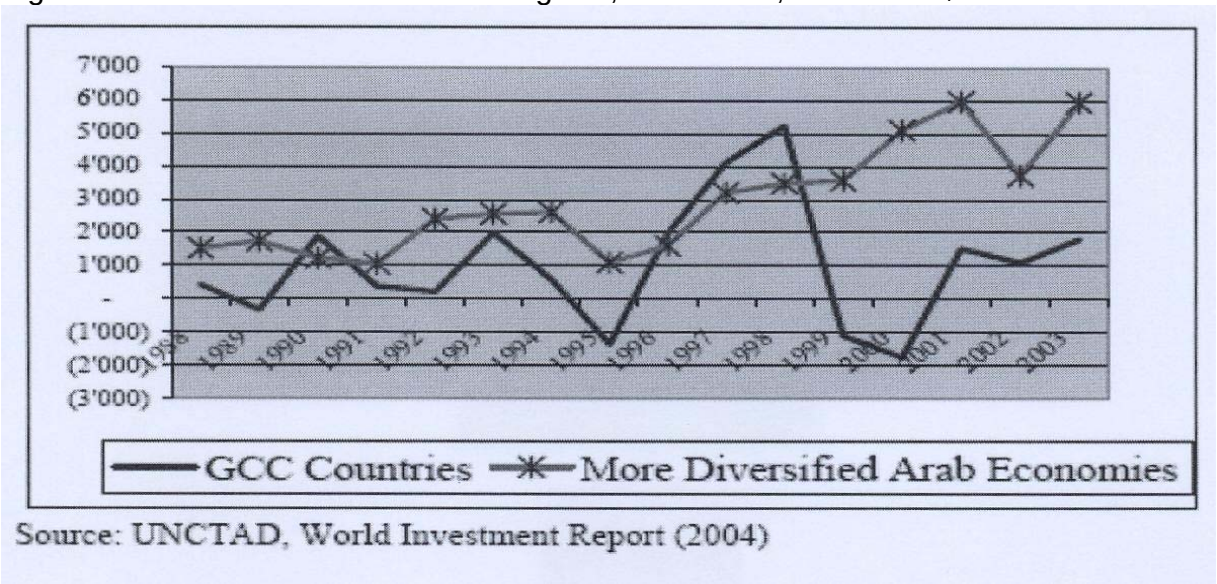
The third and final channel is the human capital channel. FDI can have a positive impact on human capital development through the training and transfer of skills, managerial know-how and expertise to local employees and staff of upstream suppliers.

The overall impact of FDI on the host economy hence depends on the relative quantitative importance of these potential spillovers. For the unambiguously positive linkages and human capital channels to work, a certain level of "absorptive capacity" of the host country in terms of level of technology of the host economy, educational level of the work force, level of infrastructure, financial and institutional development, etc., is now generally considered necessary. For example, a lack of financial development will prevent domestic and foreign firms from gaining financial resources for the desired technological upgrading which may be triggered by the linkages channel. Well functioning financial markets on the other hand will allow an efficient allocation of technology enhancing investments. Moreover, lack of sufficient schooling of the domestic work force may hinder the smooth transfer of skills from a multinational to the employees of downstream suppliers triggered by the human capital channel. The gap may simply be too wide to bridge. Thus, in lack of sufficient levels of absorptive capacity, and in cases where the crowding channel is negative, FDI may have a negative impact on growth in the host country. But if the level of absorptive capacity is sufficient for FDI to have positive spillovers through the linkages and skills channels, these latter channels may outweigh the crowding channel and lead to a positive impact of FDI on growth. In consequence, the benefit of attracting FDI to GCC countries cannot be determined by theory alone, but ultimately becomes an empirical question.

11- The Empirical Evidence and Implications for GCC Countries

Several empirical studies have been conducted with the aim of discerning the impact of FDI on host economies. These studies can be divided into two overall categories: those looking for an overall, or unconditional, linear effect of FDI on growth by including FDI flows in growth, technology or productivity regressions; and the studies which assume that the impact of FDI on growth is non-linear and depends on absorptive capacity. These studies most often interact the FDI term with some selected component of absorptive capacity. While unconditional studies of the effect of FDI on growth have been done for GCC panels, there have to our knowledge less been purely GCC country studies conditioning the effect of FDI on absorptive capacity so far. We hence base our analysis below on the results of broader developing country panel studies. Studies which have sought to estimate the unconditional effect of FDI on growth (or some component or indicator of growth) which find ambiguous and not very stable results. It thus seems that while there might be a level effect of FDI on GDP, the average GCC countries has not in the recent past been benefiting from FDI inflows in terms of growth. When turning to data panel of GCC and world reports, we can observe that, the FDI inflows to GCC countries are very law in amount and percentage compare to other developing countries (See Figure1).

Figure 1: FDI inflows into Arab Sub-Regions, 1988-2003, Millions of $ US



Source: UNCTAD, World Investment Report (2004)

Consequently, the combined FDI inflows in the GCC member countries increased from 18.159 in billions of U.S. dollars in 1996 to 247.550 in billions of U.S. dollars in 2005 (Table 4). Thus, the value of FDI inflow to the GCC region in 2005 was approximately 13.6 times the value of the inflow in 1996 (Table 4). The largest accumulation of FDI inflow during the past decade is found in U.A.E. (428.390 in billions of U.S. dollars) and the smallest accumulation is found in Kuwait (1.830 in billions of U.S. dollars; see Table 5). The total combined accumulated FDI inflows in the GCC region during 1996-2005 amounted to approximately 602.751 in billions of U.S. dollars (Table 5). Obviously, the magnitude of the impact of the economic restructuring in the GCC region is large.

Table 3: FDI inflows and real GDP growth to GCC countries (1996-2007 $ million)		
Years	FDI	Real GDP growth
1996	634	4.1
1997	2825	8.0
1998	2630	3.4
1999	(1105)	1.8
2000	(1723)	6.5
2001	549	4.2
2002	336	1.8
2003	2545	4.3
2004	4289	4.3
2005	27266	7.9
2006	35918	7.9
2007	42965	7.3
Source: World Investment Report of UNCTAD. and World Economic Outlook Reports 2000 and 2008		

Table 4: Mean Values of FDI Inflows in the GCC countries by year, 1996-2005					
Year	Mean*	Std. Deviation *	Minimum *	Maximum *	Sum *
1996	356.0588	1101.04615	-1129.00	4256.00	18159
1997	805.7143	1152.46094	20.00	3044.00	39480
1998	823.3600	1541.67612	-1129.00	-4289.00	-41168
1999	-263.1765	750.26213	-985.00	3044.00	-13422
2000	-300.1176	988.79486	-1884.00	-4289.00	-15306
2001	344.3725	612.12936	-780.00	1184.00	17563
2002	562.9796	652.85372	-1884.00	1307.00	27586
2003	1693.9592	1825.47800	-67.00	4256.00	83004
2004	3339.7660	3699.36961	-67.00	8359.00	156969
2005	5157.2917	5091.17978	24.00	12000.00	247550
Total	1215.2238	2725.00885	-1884.00	12000.00	602751
* Numbers are in millions of U.S. dollars. ***Source*:** United Nations Conference of Trade and Development (UNCTAD), World Investment Report, 2006.					

Table 5: Mean Values of FDI Inflows in the GCC countries by country, 1996-2005					
Country	Mean*	Std. Deviation*	Minimum*	Maximum*	Sum*
Bahrain	595.9873	564.62233	81.00	2048.00	47083
Kuwait	26.5217	189.02564	-417.00	347.00	1830
Oman	163.6000	212.22447	16.00	715.00	8180
Qatar	467.3421	397.12856	113.00	1496.00	17759
KSA	1081.6196	2148.63074	-1884.00	4628.00	99509
UAE	2549.9405	4032.04860	-985.00	12000.00	428390
Total	1215.2238	2725.00885	-1884.00	12000.00	602751
* Numbers are in millions of U.S. dollars. Source: United Nations Conference of Trade and Development (UNCTAD), World Investment Report, 2006.					

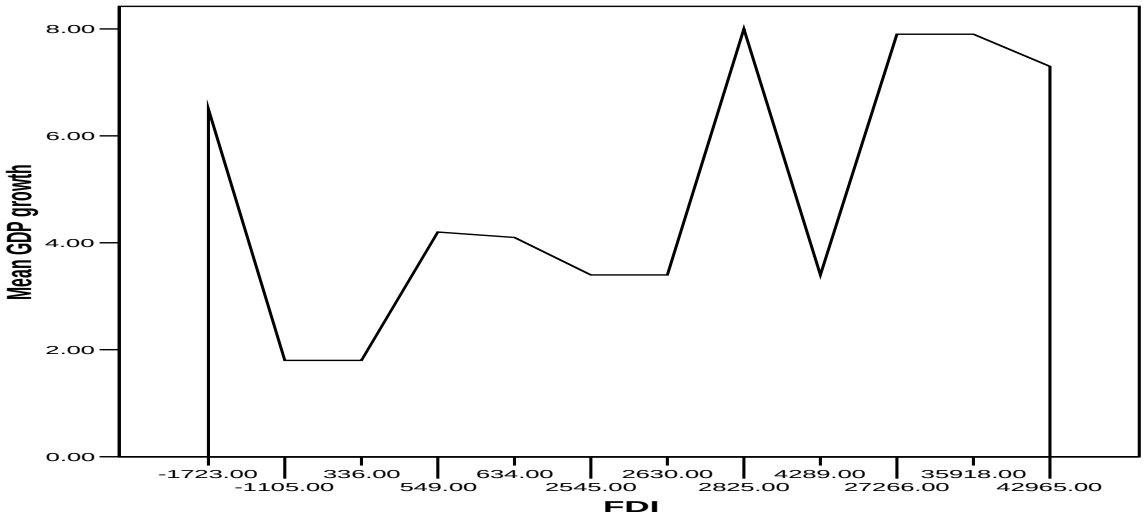
Table6: Regression analysis	
Variables	Coefficients
Constant	4.002 (6.209)
FDI	0.662 (2.796)*
Source: own calculation based on tables 4 and 7	

Notes:

1. Dependent variable: GDP growth.
2. Values in parentheses are t- ratios.
3. * means significant at the 1% level.

Table (6) reports the ordinary least squares (OLS) estimates of the unconditional, linear effect of FDI on growth by including FDI flows in growth (see table 3), where figures in the parentheses are the t-ratios of the estimated parameters. The explanatory variable in this equation is FDI. We observe from table (6) that the regression equation is significant at 1% level. The coefficient of FDI is significant at 1% level and there is positive relation between real GDP growth and FDI in GCC countries. Consistent with the most literature in this area 38% of the variation in real GDP growth in GCC is interpreted by FDI inflows. But still the impact of FDI in real GDP growth in GCC is weak given adjusted R square which is 0.383, implying a weak relationship. Also we can observe this relation from figure (2), where there are no similarity trends between growth and FDI.

Figure 2: Relation between FDI and GDP growth in GCC countries (1996- 2007)



12- Conclusion and recommendations

GCC countries receive only a small fraction of total FDI flows to developing countries, both in absolute terms and relative to GDP. Only Saudi Arabia, and recently also UAE, appears to have performed well above the average ratio as compared with the rest of the region's countries in its ability to attract FDI. Moreover, FDI inflows to the GCC countries have not increased during the 1990s, as has been the case for other developing regions, implying that the GCC has been increasingly lagging behind in attracting FDI during the FDI boom years. This negative trend may be turning; however, as more diversified developing economies seem to be able to increasingly attract FDI inflows. Finally, FDI to the GCC countries contributes only very modestly to gross fixed

capital formation in the region, as the overall build-up of capital formation continues to be mainly financed by domestic public and private funds. Moreover, short of this level of absorptive capacity, FDI may even exhibit negative externalities

GCC countries should be selective in attracting FDI. In contrast to other developing countries, GCC countries have abundant financial recourses and domestic investment could finance their development. However, influx of FDI has great potential to yield higher growth through higher efficiency in physical and human capital and through positive externalities such as facilitating transition and diffusing technology as well as introduction of alternative management practices, organizational arrangement, and improved entrepreneurial skills. The new wave of globalization sweeping through the world has intensified the competition for FDI among developing countries. Thus concentrated efforts are needed at both national and regional level in order to attract significant FDI flows to the GCC countries and improve prospects for sustained growth and development. GCC countries should work together to design and formulate adequate policies to attract stable investment flows (see table 7).

Table 7. Comparative Ranks of Doing Business in the GCC Countries

Countries	Kuwait		Saudi Arabia		UAE		Oman	
Years	2005	2006	2005	2006	2005	2006	2005	2006
Ease of Doing Business	40	46	35	38	68	77	52	55
Starting a Business	97	104	164	156	152	155	70	81
Dealing with Licenses	108	109	50	44	80	79	123	127
Registering Property	85	69	3	4	8	8	13	14
Getting Credit	76	83	59	65	117	117	143	143
Protecting Investors	18	19	96	99	114	118	58	60
Closing a Business	49	63	77	87	131	137	60	60

Source: Doing business website

The economies of the GCC states can no longer rely on their domestic strengths. There is a need to compete against other regions in terms of attracting FDI. This makes their economies more competitive at the global level. In order to attract more FDI, GCC states should:

- Create transparent and clear legal systems to protect property rights.
- Provide better governance.
- Facilitate licensing and documentation, and eliminate hidden non-tariff barriers.
- Improve infrastructure (electricity, telecommunications and roads).
- Liberalize the labor market.

- Develop and liberalize financial markets and financial intermediaries.
- Adopt and integrate a well-planned investment promotion strategy to attract an increased share of foreign investment, especially investments that will lead to exports.

Finally, after creating an attractive environment for the FDI, it is also important to have clear policies that aim at channeling this FDI towards sectors that increase welfare and foster growth such as manufacturing, information technology, health, media, tourism, and financial services. Creating clusters is one possible form of driving FDI to desired directions.

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