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Countries in the Gulf Cooperation Council (GCC) receive low inflows of foreign direct investment (FDI) as a share of gross domestic product (GDP) compared to their global peers. This report explores the underlying reasons for this historical trend, examining the countries’ abundance of domestic capital and the substantial barriers to foreign investment that have acted as inhibiting factors thus far.

In recent years, the GCC countries have made an effort to become more attractive to FDI, which they have positioned as a central component of their economic diversification programs. However, despite extensive efforts, challenges persist. While these vary across the countries, they can be grouped under several common themes: uncertain regulatory landscapes, protective approaches to some sectors, and an expectation of more patience with regards to capital gains than most investors are accustomed to.

We argue that, to attract additional FDI, GCC countries need to prioritize regulations and policies that aim to de-risk investment. Such initiatives are most effective when deployed as part of a highly targeted scheme to advance specific economic objectives. A previous approach – of overarching, unfocused efforts to attract all possible investments in all potential sectors – has proved to have limited benefits for investors and host countries. The best way to attract FDI may be to focus on frontier sectors, which are based on emerging technology, generate high growth, and have few incumbent players to disrupt.
The Historical Context of Global FDI

Historically, foreign investment began when capital accumulated in world money centers and exceeded domestic investment opportunities. Foreign investment opened up new ways to generate wealth. The earliest example was that of the Phoenicians, who traded with the Greeks by sea and established outposts around the Eastern Mediterranean to export goods such as wood and textiles. These external outposts became accepted as a permanent presence in foreign countries.

A few centuries after the Phoenicians, the Silk Road trading routes were established between the Roman Empire, the Middle East, and the Pacific Ocean. These remained a key link between Asia and Europe until the Middle Ages, when maritime transport dominated international trade and investment. Extensive economic relations also spawned between China and Europe and between China and India.

From the early 15th century onwards, European states began to establish permanent colonies in locations they had previously only visited for trading purposes. In 1602, the Dutch East India Company, the world’s first multinational corporation, was established to pursue commercial activities in Indonesia.
Global FDI fell by 42 percent in 2020 to approximately $859 billion, from $1.5 trillion in 2019, primarily due to uncertainty induced by the COVID-19 pandemic. This was the lowest level of FDI since the 1990s and more than 30 percent below the 2009 level, after the global financial crisis. The decline was concentrated in developed countries, where flows dropped by 69 percent to approximately $229 billion. FDI into North America decreased by 46 percent to $166 billion, with cross-border mergers and acquisitions (M&A) declining by 43 percent. Announcements of greenfield investment projects also dropped by 29 percent, and project finance deals fell 2 percent.

The United States recorded a 49 percent decline in FDI, to an estimated $134 billion. The fall was concentrated in manufacturing, financial services and wholesale trade. Cross-border M&A sales of US assets to foreign investors dropped by 41 percent, mainly in the primary sector. Investment flows to Europe also fell dramatically, by two-thirds to $2 billion.

Europe’s overall FDI performance in 2020 masked a handful of positives. FDI flows to Sweden more than doubled, from $12 billion to $29 billion. FDI flows to Spain rose 52 percent thanks to several acquisitions, including the acquisition of 86 percent of Masmovil by US private equity firms Cinven, KKR, and Providence. Among other developed economies, flows to Australia fell (down 46 percent to $22 billion), but FDI increased to Israel (from $18 billion to $26 billion) and Japan (from $15 billion to $17 billion).

Although FDI flows to developing economies fell by 12 percent to an estimated $616 billion, they accounted for 72 percent of global FDI – the highest percentage on record.

Developing countries in Asia weathered the storm well collectively, attracting approximately $386 billion in FDI in 2020. But flows to members of the Association of Southeast Asian Nations (ASEAN) dropped by 37 percent to $107 billion, due to a decline in investment in the subregion’s largest recipients. China was the world’s largest FDI recipient, with flows rising by 4 percent to $163 billion.

Foreign investment in China’s high-tech industries increased 14 percent in 2020, and the value of cross-border M&A rose by 54 percent, mostly in ICT and pharmaceuticals. India also recorded positive growth (13 percent), boosted by investment in its digital sector.

Despite projections for the global economy to recover in 2021, FDI flows are expected to remain weak due to uncertainty over the COVID-19 pandemic. The United Nations Conference on Trade and Development (UNCTAD), in its 2020 World Investment Report, projected a slide in FDI of between 5 and 10 percent.
3 major trends that could dominate global FDI activity during the recovery from the COVID-19 pandemic:

1. Heightened uncertainty over medium-term economic prospects, which depresses investors’ willingness to commit capital and encourages government protectionism to prevent fire sales of national assets.

2. Reconsideration of existing supply chains, as multinational corporations weigh an increased desire for localized suppliers and diversified sources of production against the transaction costs of any shift away from existing relationships.

3. Widespread re-evaluation of whether business activities should be internalized within the firm or externalized through contractor relationships: Some firms might spin-off certain operations, while others might look to build capabilities in-house.

Dr. Abhishek Saurav, Economist with the Global Investment and Competition Unit of the World Bank Group’s Macro, Trade and Investment (MTI) Global Practice
FDI Types

There are three types of FDI prevalent in the global economy:

**Greenfield Investment**
A parent company creates a subsidiary in a different country, building its operations from the ground up.

**Cross Border M&A**
The parent merges with or acquires a company in a different country to facilitate and speed up international expansion.

**Project Finance**
Foreign sponsors acquire equity of more than 10 percent in a project company. This project company is usually financed with a loan structure that relies for repayment primarily on the project’s cash flow. The project’s assets, rights, and interests are held as secondary collateral.

FDI can also be differentiated by investor motivations, which provide a means of evaluating its potential macroeconomic impact. The widely used Dunning typology identifies four main motivations for international investment:

- **Natural resource-seeking**: an interest in accessing and exploiting specific natural resources within a fixed location.
- **Market-seeking**: a desire to access new domestic or regional markets, especially when those markets are particularly large or affluent.
- **Strategic asset-seeking**: an interest in acquiring specific assets that afford competitive advantage in a given market, such as brand equity or distribution networks.
- **Efficiency-seeking**: opportunities to acquire factors of production that increase competitive advantage in domestic or international markets.

All types of FDI can produce substantial benefits for host economies, but the relative value of each will vary according to the specific circumstances of each country. For example, a country that has high existing levels of natural resource-seeking investment may look to prioritize efficiency-seeking investments in order to help diversify its economy and drive new sources of growth.

FDI Benefits

The potential benefits of FDI are diverse. In particular, it can enhance several key economic production factors:

**Source of Finance**
FDI can finance economic development that would otherwise be unattainable or too expensive for the host economy.

**Economic Multiplier**
Foreign investment brings in a range of economic agents and activities that interact with local suppliers and consumer markets, stimulating indirect and induced economic growth.

**Human Capital Formation**
Foreign companies can boost human capital by training local workers and bringing in talented workers from abroad. This has been an area of increasing focus among GCC policymakers in recent years.

**Technology Transfer**
Foreign investors can bring technological know-how that is learned over time by local competitor firms, as human resources move between employers, and new products and services are rolled out. Technology transfer effects could help the GCC build capabilities in emerging high-value economic sectors.

**Competition**
Local branches of foreign companies could help increase private market competition in the GCC, which has historically been comparatively low due to the public sector’s dominance and the countries’ relatively young economic and political institutions.

**Trade**
The GCC is a central hub for shipping, aviation, logistics, and the exchange of goods. FDI inflows can be accompanied by significant increases in cross-border economic activity, helping the GCC maintain and expand competitive advantages derived from cooperation.

In previous years, the abundance of domestic capital blunted GCC countries’ need to make substantial efforts to attract FDI. The benefits outlined above were therefore mostly unrecognized. The historically untapped investor markets of the GCC are consequently ripe for foreign engagement and offer great future growth potential. To realize this potential, GCC countries should make the creation of a highly competitive investor value proposition the centerpiece of their national economic agendas.
Overview and History of FDI in the GCC

Prior to the discovery of oil, the GCC was one of the world’s poorest regions. The economy consisted mainly of pearl diving and subsistence agriculture in coastal areas, international trade in coastal cities, and a traditional nomadic economy in the interior lands.

Since the 1970s, GCC economies have undergone an unprecedented economic and social transformation. Proceeds from oil exports have been used to upgrade infrastructure, fuel job creation, and improve social indicators such as life expectancy and literacy rates. In addition, the GCC became an integrated region in terms of economic growth and employment, with a mass influx of foreign workers from other Arab and Asian states. GCC economies accumulated large official reserves, maintained relatively low external debt and remained important financial supporters of poorer countries.

The average GCC income per capita was approximately $12,000 by 2002, with a combined nominal GDP of about $340 billion.

One major economic issue is GCC economies’ dependency on oil as the main revenue source for national budgets. Oil price volatility has long been a threat to the region’s economic stability, and the GCC has historically been only weakly integrated into the global economy, which has been an obstacle to economic prosperity. Reforms and policy proposals have been implemented to reduce the GCC’s resource dependency.

They follow a plan of economic stimulation and signal a move from legacy natural resources to diversified economies that are more globally integrated and attractive to FDI. Key examples of such plans are Saudi Arabia’s Vision 2030 and UAE’s Economic Vision 2030, each of which outlines economic growth and development objectives for 2030.

Saudi Arabia’s economic vision for the year 2030 outlines 96 strategic objectives that the Kingdom hopes to achieve through 13 Vision Realization Programs. One of the objectives is the expansion of small and medium-sized enterprises (SMEs), so that they generate 35 percent of GDP, nearly double the current 20 percent. Another is to become one of the top 15 global economies, up from the current position of 19th.

Abu Dhabi, capital of the UAE, has set objectives for achieving an increasingly diversified and global economy by 2030, funded by the city’s acquired resource wealth. With a focus on sectoral GDP, the plan emphasizes the connection between economic sustainability and diversification. The emirate also wants to develop the private sector, so that the ratio of small, privately owned businesses to large businesses becomes similar to that in developed countries.

To help finance ambitious visions and drive economic development and diversification, the GCC economies agreed to implement a value-added tax (VAT) in 2016 as a response to the decrease in oil prices that had begun in 2014. To date, however, only the UAE, KSA, and Bahrain have implemented VAT.
FDI Historical Context

Historically, FDI into GCC economies has fluctuated with the rise and fall of commodity prices, however, it has failed to materialize as a consistent driver of economic opportunity in non-oil economic sectors. These sectors have had limited appeal to international investors for various reasons, including perceived regulatory and political risk and the limited maturity of key economic fundamentals such as infrastructure and human capital.

The abundance of mineral wealth and the commodity-based economic structure across the GCC has enabled the accumulation of significant domestic capital. With such readily available domestic capital, many GCC states have historically not needed to prioritize FDI as a source of development finance. Domestic funds have proven sufficient to maintain generous public spending levels and active government intervention in the economy. Indeed, the large size of the public sector in GCC countries still limits the region’s appeal to external investors, especially given the strong presence of state-owned enterprises in several economic sectors.

Strong economic development also limits potential investment in GCC countries from multilateral development organizations. Major funders, including the Asian Development Bank, International Bank for Reconstruction and Development, and International Development Association have no ongoing projects in GCC countries. The most active multilateral development organization in the GCC is the United Nations Development Programme, which had 44 ongoing projects across KSA, Kuwait, and Bahrain as of 2020. These are all small-scale projects, with a total value of less than $45 million.

In recent years, FDI inflows have decreased considerably from their peaks, declining by 46 percent from 2011 to 2017. Worldwide economic trends, including the eurozone crisis, reduced investor appetite for FDI in the first half of the decade and made it harder for GCC states to attract capital. Concerns over political stability in the broader Middle East and North Africa (MENA) region have also blunted the attractiveness of the GCC. These issues were compounded by the decline in oil prices that began in 2014. Oil prices have not regained their former levels, which has reduced investor interest in oil-based projects in the Middle East. Within the GCC, the UAE has proven to be an exception to this general trend. Thanks to an already diversified economy, its FDI inflows over the past 10 years have been consistently higher relative to GDP than those of its GCC peers, as well as being more stable.

Since 2017, the trend of decline has been reversed, and FDI inflows to most GCC countries have steadily increased. They nevertheless remain far below their previous levels.

FDI inflows to GCC, 2011 - 19
($ USD BN, inflation-adjusted)

- Bahrain
- Kuwait
- Qatar
- Saudi Arabia
- United Arab Emirates
- Oman

Source: World Bank (2020)
A New Approach to FDI

Over the past couple of years, GCC countries have started to view FDI as an essential component of their long-term economic development and diversification policies. This shift in mentality is due to a growing understanding that FDI can bring economic multiplier effects, innovation, and human and intellectual capital. These factors make it more valuable than a mere source of external financing. Simply put, without the non-financing benefits of FDI, the GCC will have to endure a longer and more challenging route to catch up with more-developed economies.

As this understanding grows, several GCC countries have introduced economic reforms to open new sectors to FDI and to assuage investor concerns over their economies and the overall region. However, the extent to which they are considered credible by multinational investors varies by country. The results of these policies are now visible in data. Since 2017, FDI inflows to the GCC region have increased steadily – a 26 percent rise from 2017 to 2019. However, total inflows in 2019 were still 32 percent below their previous high in 2011. The increase has been predominantly driven by the UAE and Saudi Arabia, but FDI in Oman and Bahrain have also grown relative to GDP.

Though the recent trend is encouraging, the GCC region is still not attracting enough FDI relative to benchmark economies and to the ambitions laid out in plans for growth, development, and economic diversification. The mismatch between ambition and actual FDI inflow suggests that significant barriers remain to investment and that considerable potential remains untapped. Realizing this potential requires a fresh and agile approach to attracting FDI that cuts to the core of investor concerns, coupled with specific policies.

Existing policies are struggling to directly address the causes of investor reluctance. Therefore, to benefit fully from FDI, GCC countries need to critically assess their policy tools and reorient their approaches. A critical assessment is especially important in the context of the COVID-19 pandemic, which has hurt the global economy and reduced FDI flows.
Impact Of The COVID-19 Pandemic

COVID-19 has had a catastrophic impact on global FDI inflows. Several organizations, including the Organization for Economic Co-operation and Development (OECD) and UNCTAD, have estimated that global FDI flows declined by 50 percent in 2020 due to COVID-19. This decline would be the largest collapse in FDI flows since World War II. There is much uncertainty about when – and whether – global FDI will recover; most estimates anticipate a mild recovery from 2021 but with absolute values remaining much lower than in previous years.

The impact of the collapse in FDI on GCC countries is not clear. Initial indications suggest it may be less severe than that on many other economies for two reasons. First, the GCC already had relatively low FDI inflows, leaving less room for further decline. Second, the pre-COVID upward trend in FDI inflows thanks to ongoing economic reforms may partially counteract the pandemic’s impact. However, there is still a high degree of uncertainty, and the full picture may not be evident until the latter half of 2021. Furthermore, global economic factors will likely make it harder to increase FDI in the immediate future, given the financial shock to several economies that might otherwise have been a source of significant inflows.

Faced with current uncertain events, the GCC countries should prepare for a wide variety of scenarios. They must develop strong, strategically targeted policies that enhance the long-term structural attractiveness of key economic sectors to foreign investors. One-off deal-making may continue to be a useful tool to attract FDI, but structural enhancements to the investment environment offer vastly greater potential in the medium and long term.

Source: World Bank (2020)
FDI offers various benefits to recipient nations, but its effectiveness is tightly linked to the factors that make a country attractive to investors. That suggests the need for a new, targeted approach to attracting FDI.
Factors Impacting Investment in the GCC

To invest in the GCC, foreign investors must believe that the region offers sensible value propositions within an acceptable risk threshold. Up to now, several factors have limited investor interest in the GCC:

**Political factors**

Although GCC countries exhibit substantial internal political stability relative to the broader MENA region, political risk – both real and perceived – remains a concern for investors. On the country level, perceived political risk is often manifested as uncertainty about the extent of the future support governments will provide to investment projects. GCC governments will find it difficult to credibly commit to providing a business-friendly investment environment when different political interests, levels of government, or business groups are seen as posing a threat to politically sensitive regulations over the long term. In interviews with the authors of this report, Professor Witold Henisz emphasized the importance of domestic political alignment in support of FDI attraction measures.

Internal disputes and lingering dissatisfaction among key stakeholders create the risk that key FDI attraction measures may be revoked in future in response to a difficult political climate. Credibly signaling to potential investors that all arms of government are aligned behind the success of foreign investment is key to mitigating the perceived political risks of international investment.

While each investment destination market has its own political environment, substantial bodies of research suggest that investment decision-making by multinational corporations is also driven by perceptions of risk in the wider region – whether or not political risk in the broader region poses a real threat to political stability in the destination market. While this may simply relate to heuristics within a particular firm, it may also be a risk-aversion strategy by firms concerned about political spillover, or it may be a calculated assessment that future regional expansion opportunities will be limited in an unstable political context, diminishing the attractiveness of the initial investment.

Prof. Henisz is the Deloitte & Touche Professor of Management, and Director of the Wharton Political Risk Lab at The Wharton School, University of Pennsylvania.

Source: ICRG (2020)
Macroeconomic factors
Despite periodic bursts of rapid growth in the GCC, some investors remain skeptical of the long-term trajectory and economic viability of the post-oil GCC economies – particularly as the public sector remains the primary engine of economic growth. However, investor interest could increase, as national economic transformation initiatives progress and yield measurable, on-ground progress.

Regulatory factors
The GCC has historically been an unviable investment destination for many prospective investors due to extensive restrictions on foreign investors’ ability to own businesses and engage in economic activities. However, there has been some liberalization in recent years in countries such as the UAE, KSA, and Oman.

The perceived weakness of legal structures in the GCC is another concern for potential investors. GCC countries are known for their quick and effective decision-making processes, which have allowed the region to succeed in many areas, including managing the ongoing COVID-19 pandemic. However, international investors also require regulatory stability to achieve long-term returns, and many have concerns that the legal systems in the GCC are insufficient to protect investments against potential disputes or sudden changes in regulation. To overcome such systemic barriers, geographically delimited zones with special regulatory and legal structures designed to appeal to foreign investors have been introduced in some places. Dubai International Financial Centre (DIFC) is one successful example of such a zone.

Dr. Jamison

“An unanticipated, dramatic shift in the regulatory environment without sufficient protections for the interests of foreign investors may be every bit as damaging to a firm’s commercial interests as an episode of political violence or regime change. She contends that the perceived weakness of investor protection and regulatory structures in the GCC is a missed opportunity for GCC states to further differentiate their risk environments from MENA states that are politically more risky.”

Infrastructure
The GCC has a solid infrastructure in air and maritime transportation and is developing capabilities in areas such as rail transportation and advanced mobility. As a result, infrastructure is generally unlikely to be a barrier to most FDI. However, certain high-value sectors such as pharmaceuticals may require more-advanced infrastructure, such as cold-chain logistics, which is still being developed in parts of the GCC.

Global trade
International trade structures, such as the World Trade Organization (WTO) and preferential trade agreements (PTAs), serve as mechanisms for making commitments to foreign investors about the treatment of their assets. They may thus reassure flighty investors and increase investment interest, especially in developing economies. These international commitments have greater credibility than domestic policy reform alone because reneging on them is costlier. Joining more international trade agreements would allow GCC economies to attract more FDI.
Many of these challenges are structural or even generational, and the solutions could be years or decades away. Investor perception is also likely to change slowly, as the GCC builds careful, disciplined credibility by honoring commitments to its investors, and existing investors are seen to enjoy consistent returns on their investments. Furthermore, other factors may also be politically difficult or impossible to change. For example, although some GCC countries have recently begun taking a more liberal approach towards foreign ownership of companies, the ultimate extent of such policies is not clear to the foreign investment community. Despite these challenges, a diverse and multifaceted toolkit is available to attract FDI. Improving on any of these factors could incrementally enhance FDI inflows.

Two underlying principles should guide FDI attraction efforts in GCC countries: sectoral targeting, and a detailed identification of demand.

Policies to attract FDI in specific sectors – or even subsectors – of the global economy are likely to produce the greatest additional value for GCC countries. Instead of offering identical terms to investment in all industries, GCC governments should target high-value-add sectors that are likely to have the greatest effect on domestic growth. These include rapidly expanding new economic activities, such as advanced battery manufacturing, as well as long-established sectors that are expected to continue to grow strongly, such as sustainable mass transit. GCC countries can optimize their sectoral targeting by focusing on emerging sectors – such as advanced e-commerce, agritech, and renewable energy – which are still developing their global value chains. In contrast, legacy sectors like traditional manufacturing and brick-and-mortar retail have already established global value chains: Uprooting these and relocating them to the GCC would be costly and challenging, so policies to attract those sectors would be less effective.

Private companies in sectors exhibiting natural monopoly characteristics, such as public utilities, telecommunications, and logistics, are often more risk-tolerant than players in other high-value sectors and may therefore be an attractive near-term investment attraction opportunity while de-risking activities are under development or in progress. In these sectors, demand is both high and inelastic, and fixed costs are high, favoring a few consolidated players. International firms may be particularly drawn to these opportunities in cases where GCC governments grant firms permission to operate in these spaces and provide them some degree of protection from competition.

Dr. Jamison

GCC countries can also look for opportunities created by the global trend towards localization and diversification. The COVID-19 pandemic may accelerate the trend of multinational corporations reconsidering their existing supply chains. They are trying to reduce their dependence on a single supplier or country of origin, which can make them appear fragile. This presents an opportunity for GCC countries to capture value even in industries with well-established supply chains.

Dr. Saurav
Policies to Encourage Sustainable FDI

Given the global competition, many countries use targeted policies to attract FDI, mainly by de-risking investment in a particular industry or sector. These policies are “net supportive” of economic development if the direct and indirect benefits of resulting FDI flows exceed the costs. Such costs may include fiscal costs, such as subsidies or foregone tax revenue, or economic costs, such as relaxed requirements for local hiring and purchasing.

FDI attraction policies can generally be categorized into five archetypes:

1. Fiscal Incentives
These include all tax incentives for investors, such as tax reductions and tax vacations. For example, a company may be granted a partial or complete waiver from corporate income tax obligations for a set period of time in exchange for a commitment to employ a certain number of local people. Failure to meet the employment target would negate the tax benefit while exceeding the target by a predetermined number might lead to greater tax benefits. Such policies have no or low upfront costs but may carry higher long-term costs in the form of lost tax revenue. The critical question to assess before awarding fiscal incentives is whether the investment would still happen in the absence of an incentive. If not, then the direct fiscal cost is zero. However, there may be indirect costs, if other prospective investors determine that they can make credible threats to withhold investment unless they, too, are awarded incentives. Fiscal incentives to attract FDI are widely used across the GCC, even though taxes in the GCC are relatively modest by global standards.

2. Financial Policies
This means all non-tax financial support that countries offer to foreign investors, including subsidized loans and grants and discounted land, infrastructure or utility prices. It may also include assurances of guaranteed demand for specific goods or services via public procurement programs.

3. Regulatory Policies
Special regulatory systems or rules can be made available to foreign investors, including exemptions from standard regulations or the creation of special legal regimes for foreign investments. Limited-scope special regulatory policies may be an effective measure to counteract perceptions of weakness in GCC legal institutions. Special economic zones, free zones, and other similar arrangements have in the past been successfully launched in the GCC and beyond to confer such benefits on investors without requiring wholesale legal and regulatory reform.

4. Outreach
Marketing and other outreach efforts can inform investors about the country’s opportunities, typically through an investment promotion agency. GCC countries have established dedicated offices for attracting FDI, but some are limited compared with international benchmarks.

5. International Engagement
Preferential trade agreements and bilateral investment treaties may enhance cross-border investment flows by reducing the fiscal and regulatory barriers facing investors and by offering additional protections and assurances beyond incentives offered by the host country’s legal system. The GCC still lacks free trade agreements with several critical investment markets. The use of bilateral investment treaties across the GCC is mixed, with UAE and Kuwait making extensive use of such arrangements, while the rest of the GCC lags considerably behind. Although not a trade agreement as such, the recently signed Abraham Accords between Israel and the UAE have already unlocked the flow of substantial investment resources. No single format of international agreement is required to stimulate FDI flows; rather, it can take many forms.

GCC governments may be well-placed to develop targeted “template regulatory environments” that exploit a lack of regulatory clarity in other jurisdictions to develop a compelling investment proposition. For example, new technologies such as unmanned aerial vehicles (UAVs) and autonomous vehicles have proven difficult for regulators worldwide due to security and consumer safety concerns, which has stalled commercial testing and development. This introduces regulatory risk around individual sectors and technologies in otherwise favorable regulatory environments. Similarly, the COVID-19 pandemic led to the development and emergency approval of the first vaccines based on mRNA technology, which had never previously secured approvals for use outside test settings. This and future vaccine innovations represent another area in which regulatory lag may provide an opening for GCC regulators to step in and fill a critical void. If GCC countries are able to craft and implement innovative sector-specific regulations in an agile manner, they can provide the investor certainty that other jurisdictions are unable to deliver.

Prof. Henisz
Dedicated policies to attract FDI are often more successful at increasing inflows in the short-to-medium term than general economic reforms. Nevertheless, governments can also increase their appeal to foreign investors through strategies that increase the appeal of a market to international firms, even without being exclusively focused on attracting FDI. These include:

6. Large-scale Development Projects

These are state-driven initiatives to jump-start economic activity in an entire region or sector. They can be a powerful tool for attracting investments in priority economic sectors, by offering opportunities that foreign firms cannot realize in their home markets.

One large-scale development project is NEOM, the mega-city planned for northwest KSA that emerged from the Vision 2030 initiative. NEOM shows how mega-projects can present a unique opportunity for foreign firms to build out emerging technologies in the GCC. NEOM will have an independent legal system, with unique tax and labor regulations designed to attract a cosmopolitan mix of businesses and workers. It is also designed for the development of a range of innovative technologies in areas such as energy generation, transportation, and security.

Mega-projects present unique opportunities for foreign businesses to test new products and services that may not otherwise be commercially viable, either because of a lack of initial demand or extended development timelines. They can also attract investors with decision-making that is quicker than the conservative or tardy practices of other jurisdictions.

Attracting pioneering technologies at an early stage benefits GCC economies by bringing growing businesses into the region. Such enterprises also serve as high-profile demonstrations of the benefits of investing in the GCC and are also likely to build on their early bridgeheads to expand their local footprint.

7. Alignment with Sovereign Wealth Funds

Many GCC countries have substantial sovereign wealth funds (SWFs), with mandates that encompass national economic development and the maximization of long-term returns. Aligning FDI attraction efforts with the investment strategies of these SWFs deepens the pool of capital that can be harnessed to kick-start industrial development. It also creates a powerful domestic constituency invested in targeted sectoral development programs.

Co-investment by a sovereign wealth fund alongside a foreign investor ensures that the host government has ‘skin in the game’ and a financial stake in the commercial success of inbound investments. Such a demonstration of commitment is a powerful signal to investors that their long-term interests are not threatened by changing priorities of the host government. The close alignment between the Singaporean government and the state-owned Temasek Holdings company is an archetypal example of how harmonizing FDI attraction policies with state-controlled investments can build investor confidence.

8. Reducing Broader Investment Barriers

Efforts to de-risk the investment environment can include the introduction of investment-friendly regulations or the removal of existing regulations that disincentivize economic activity. Such regulations apply to all firms, not just foreign investors. But pro-business regulatory reform removes barriers to expansion and helps ensure the sustainability of foreign investments, unlocking economies to international firms.

New Zealand’s successful efforts to reduce micro-regulatory barriers in the 1990s is an example of how improving the overall business climate can act as a powerful spur to international investment. The country’s successful integration into global value chains was driven in part by a reduction in the regulatory burden of processes such as obtaining construction permits and fulfilling import and export requirements.

Eliminating investment barriers is especially important to realize the full potential of special economic zones (SEZs) and large-scale development projects. While these projects offer attractive entry points for foreign firms considering an investment, they still constitute relatively small markets and may not offer sufficient size to appeal to global firms. Fully realizing the potential of SEZs or large-scale development projects requires the promise of eventual access to entire markets. For example, a financial services firm will be more motivated to set up in a finance-oriented free zone if there is a future pathway to expanding its operations across the entire country and region.
Existing and Upcoming FDI Initiatives In The GCC

Most GCC economies have been actively developing initiatives to stimulate FDI. Here are some notable existing and upcoming projects for each country:

**UAE**
- Dubai International Financial Centre and Abu Dhabi Global Markets offer an independent common law court and regulatory system.
- Many free zones in the UAE offer 50-year tax holidays for foreign investors.
- Dubai, Abu Dhabi, and Sharjah operate dedicated offices for conducting outreach to potential investors.
- In 2020, the UAE announced a liberalization of visa and citizenship laws for highly skilled workers.
- In 2020, the UAE allowed 100 percent foreign ownership of companies in certain sectors.
- Dubai International Financial Centre aims to triple in size by 2024.

**KSA**
- In 2016, Saudi Arabia allowed foreign ownership of companies in the retail sector.
- Since 2017, Saudi Arabia has been implementing wide-ranging economic reforms, seeking to encourage greater foreign investment.
- Saudi Arabia is continuing to implement reforms to attract FDI inflows, which are increasing.
- In 2020, a dedicated Ministry of Investment was established in Saudi Arabia in order to attract FDI.

**OMAN**
- Compared with Bahrain and UAE, Oman has had fewer FDI initiatives outside oil and gas.
- The Al-Duqm port signed contracts with UK (2016) and Indian (2018) military companies to develop drydock and ship-repair facilities. The drydock is now able to support 65,000-ton ships, including aircraft carriers.
- In 2020, Oman allowed 100 percent foreign ownership of companies in most economic sectors.
- Oman has identified mining (gypsum, potash, chromite, copper) as a key sector for FDI.
- Oman hopes to use mining to develop other sectors, such as shipping and manufacturing.
- The Al-Duqm port and ship repair yard is a major part of this plan.

**BAHRAIN**
- Bahrain has allowed 100 percent ownership of foreign companies in some sectors since 2001, and in most sectors since 2016.
- The Bahrain Economic Development Board is the main office responsible for handling FDI inquiries.
- The Central Bank of Bahrain has also taken a proactive approach in working to develop investor-friendly regulations in areas such as FinTech.
- In 2020, the country is seeking to use FDI to develop high-value industry hubs, in which the country can develop a long-lasting regional competitive advantage.
- The two main sectors being targeted are information technology and finance.
- The current focus of this plan is Bahrain FinTech Bay, which is currently the largest FinTech accelerator in the GCC region.

**KUWAIT**
- Kuwait has allowed 100 percent foreign ownership of companies in some sectors since 2013.
- A dedicated office, the Kuwait Direct Investment Authority, promotes investment in Kuwait.
- Kuwait has made use of public-private partnerships to attract foreign investment in certain projects and has a dedicated office for PPPs.
- Though ranked low in ease of doing business, Kuwait has been undergoing reforms to increase its ranking.
- Kuwait aims to gradually increase foreign investment by 50 percent as part of the Kuwait Vision 2035.
- Investors remain concerned about Kuwait’s political stability and the ability of the government to diversify the economy.

**QATAR**
- The Qatar International Court has offered an independent common law court and regulatory system since 2008.
- In 2019, Qatar legalized 100 percent foreign ownership of companies in most sectors.
- The Qatar International Court has offered an independent common law court and regulatory system since 2008.
- In 2019, Qatar legalized 100 percent foreign ownership of companies in most sectors.
- Qatar is now aiming to rapidly increase FDI following the restoration of diplomatic normalcy, and it recently launched an investment promotion agency.
- The Qatar Financial Centre aims to attract $22 billion of FDI by 2022.
- Qatar is seeking to attract FDI using PPPs.
Considerations for FDI Policy Implementation

Policies to attract FDI by reducing risk to international investors may in turn increase the risk borne by the implementing country. There are several considerations for GCC countries when designing policies to minimize structural risks:

**Ineffectiveness**
FDI policies may be ineffective and fail to achieve the desired level of inflows. This could result in a low return for the host country in exchange for the costs incurred and a failure to achieve its economic development objectives. This can occur if the FDI policies do not outweigh existing structural barriers to investment. For example, a large company may assess the annual cost of compliance with local employment quotas as $10 million. Offering tax incentives worth $5 million per year would therefore be ineffective in the absence of additional offsetting measures.

To avoid this kind of problem, GCC investment authorities should first recognize that “investment” and “investors” are not homogenous. Economic actors with varied business models operating in different sectors will not respond equally or predictably to FDI attraction policies. Authorities must therefore define their target investor base and understand the nuanced reasons behind why those entities have not invested previously. Investor needs may be too diverse and costly for GCC governments to offer attraction policies that meet all of them without incurring unacceptable costs. In such cases, attraction policies with the widest appeal and deepest relevance to investor objections should be prioritized.
Inefficiency
All efforts to attract FDI come with some cost and there may be cheaper ways for a country to achieve its objectives. A clear case of inefficiency would be if an FDI scheme offers fiscal or financial incentives to investors who would have invested anyway without these incentives; this may happen if a government miscalculates its incentives based on precedents.

For example, Amazon recently chose to split its second North American headquarters (HQ2) between New York City and the Washington, DC area, after receiving over 200 bids from cities across North America. Many sites offered far more generous incentive packages than the winning bidders, but these two sites were chosen for reasons such as their extremely high levels of human capital, the quality of their infrastructure and connectivity, and their access to markets. Some observers speculated that these factors were already strong enough that Amazon would have made the same decision even if it had been offered less-generous incentives. The winning cities might have given away billions of dollars in tax revenue on the assumption that the competition for Amazon’s HQ2 was far stronger than it appears to have been in hindsight.

Many GCC countries have exemptions that are available for a wide range of investors, such as free zones and tax holidays, and these have been successful at attracting investors. However, because these exemptions are not specifically targeted, some businesses take advantage of the cost savings they offer when they would have made investments – and paid full tax – even in the absence of such incentives.

Precedent
If special concessions were historically granted for some investments, other investors too might feel entitled to demand concessions and special conditions. Unless properly managed, this can cause serious erosion of a country’s tax or regulatory base. GCC countries can mitigate this risk by heavily targeting FDI policies towards specific objectives. Concessions granted for clear and specific reasons are less likely to set a general precedent for investments in all parts of the economy.

Domestic Competition
If a country provides too much assistance to foreign investors, there is a risk that domestic businesses could be disadvantaged relative to foreign competitors.

Once again, ensuring that FDI policies are targeted at clear objectives can mitigate the risks of overcrowding and preferential treatment. Policymakers should always consider the level of support that existing domestic businesses need to thrive and set clear targets before offering incentives to foreign investors.

International Competition
Other countries can introduce similar policies to attract investors, reducing the effectiveness of the local FDI policy. Simply copying the investment strategies of others is unlikely to work absent exceptional circumstances, such as extremely high latent investment demand or a uniquely favorable geographic location.

GCC countries should avoid competing against one another in offering the largest fiscal or financial incentives to investors. In other jurisdictions, this kind of behavior has resulted in races to the bottom that have strained public finances. An extreme example is Kansas City in the United States, which is situated on the border of two states, Kansas and Missouri. The governments of Missouri and Kansas have offered increasingly generous incentives to companies on the opposite sides of the border, and many companies have moved just a few blocks to claim additional tax write-offs. This tug-of-war generated no economic value, but cost state budgets enormously in revenue losses. As a result of this “border war,” approximately 6,800 jobs moved from Missouri to Kansas, and approximately 5,500 moved from Kansas to Missouri, rendering the competition roughly a stalemate. The combined budgetary cost of this race to the bottom was $334 million – a significant amount for two relatively small states.

To avoid making this kind of mistake, GCC countries should develop and hone unique investment value propositions that cannot be easily replicated or offset by competitors. To craft a sustainable competitive advantage, the region can leverage its unique geographic position; large, young, and affordable labor base; and patient mindset with regards to capital.

Domestic Political Risk
Policies to increase FDI may produce domestic political fallout, especially if they clash with established cultural foundations or affect existing economic interests.

Domestic political risk is a significant hindrance to further economic reform in some GCC countries. Those with political barriers to further reform may benefit from narrowly targeted FDI incentives to achieve specific objectives. Such practices reduce the risk of negative impact on established domestic interests.

In summary, although FDI incentive schemes do carry risks, most threats can be reduced by designing the schemes to mitigate specific inefficiencies in a given domestic sector. Any costs incurred will then be justified on a case-by-case basis. This approach reduces the likelihood that an FDI scheme will be ineffective or inefficient.
Examples of Successful Targeted FDI Policies

This section will briefly showcase three schemes that have successfully attracted foreign investment into GCC countries:

- Dubai International Financial Centre, which uses a special regulatory framework to de-risk investment in financial services
- Khalifa Industrial Zone Abu Dhabi, a free zone that developed into a large economic hub following government investment in infrastructure
- Royal Commission for Al-Jubail and Yanbu, a bespoke planning strategy that successfully promoted economic clusters around specific industries
Dubai International Financial Centre – UAE

Dubai International Financial Centre (DIFC) has been operating since 2004. It allows companies to operate under an independent legal system with courts distinct from those of the local UAE system.

Regulatory weaknesses and inconsistencies remain a significant barrier to further FDI inflows to the GCC. DIFC mitigates this problem by allowing companies to operate under an independent common law regulatory framework. That means Dubai enjoys the benefits of an internationally respected legal system without needing to implement a wholesale legal reform of the emirate.

Thanks to DIFC, Dubai has become a competitive hub for financial services and is now ranked in the top 10 cities in the Global Financial Centres Index. More than $178 billion of assets and 820 companies are registered with DIFC.

DIFC has been a success because it correctly identified a barrier to investment (concerns about the regulatory and legal framework) and provided a way for financial services companies – a key target of Dubai’s FDI ambitions – to avoid that barrier.

Other GCC countries that are still developing internationally respected legal arbitration mechanisms might benefit from establishing similar legal structures to DIFC in targeted sectors. Abu Dhabi and Qatar have followed this route with Abu Dhabi Global Markets and Qatar Financial Centre, and other financial hubs in the GCC (for example the King Abdullah Financial District) might benefit too.
Khalifa Industrial Zone – UAE

Khalifa Industrial Zone Abu Dhabi (KIZAD) is an integrated free zone for industry and manufacturing located next to Khalifa Port, which lies halfway between Abu Dhabi and Dubai. The objective of KIZAD is to develop a long-term industrial, manufacturing, and logistics hub that is integrated with air, sea, road, and rail transportation.

The government of Abu Dhabi has invested significantly in developing its transportation and logistics infrastructure. Once complete, KIZAD will be the center of the UAE’s rail freight network. It features cold-chain logistics capabilities, which have allowed it to become one of the world’s largest hubs for vaccine distribution in the COVID-19 pandemic. KIZAD’s superior infrastructure differentiates it from other free zones in the GCC, and its vast size gives it the potential to become a major industrial hub capable of benefiting from economies of scale. So far, KIZAD has been a great success, attracting about $20 billion of investments.

Free zones and other fiscal incentives are most beneficial when they have a clear objective, such as encouraging the development of a particular economic sector. Furthermore, free zones should ideally be integrated into their countries’ broader economies to maximize any economic multipliers that investment may bring. KIZAD is a successful example of a special zone that fits these criteria and has developed into an advanced industrial and logistics hub.

Royal Commission for Al-Jubail and Yanbu (RCJY) – KSA

The Royal Commission for Al-Jubail and Yanbu (RCJY) is an autonomous organization of the KSA government, established in 1975 to develop the cities of Al-Jubail and Yanbu. Al-Jubail is located on the Arabian Gulf at the heart of the petroleum industry, while Yanbu is on the Red Sea.

The goal of RCJY is to diversify KSA’s sources of economic activity and minimize its dependence on raw hydrocarbon extraction. Each city has been developed into a manufacturing and urban industrial center, leveraging existing advantages in the petrochemical sector into broader economic development.

Both cities have been economic successes. Al-Jubail has attracted FDI of over $30 billion, while Yanbu has secured $8 billion. Dedicated planning regimes have helped develop a thriving natural gas export industry and fostered new steel, aluminum, plastics, and fertilizer industries. The cities have also attracted an educated and highly skilled local population that provides the human capital for business development. Al-Jubail and Yanbu have become leading examples of the economic transformation envisioned in the Vision 2030 agenda, and in 2017 Yanbu became the first “smart city” in KSA.

RCJY’s success is based on its dedicated planning regime, which operates in parallel to the regulatory framework that applies to other cities in the Kingdom. Infrastructure and regulatory structures are targeted to support specific industrial sectors, providing fertile ground for new economic activity.

Al-Jubail and Yanbu also illustrate the importance of identifying areas of comparative advantage, as they foster an ecosystem that concentrates human capital and economic activity into a regional hub. Once such a cluster has been established, it can support a value chain of local entities that surround flagship enterprises. Such concentration can also support a burgeoning ecosystem of secondary economic activity that goes beyond the initial areas of comparative advantage.
GCC states nowadays place significant emphasis on attracting FDI, mainly due to the range of benefits that investment can bring for long-term economic development and diversification. Recently, several GCC states have been actively seeking to encourage further investment. However, their policies have had only mixed success to date, due to a lack of clear focus on specific sectors or regions and an abundance of domestic capital.

Prioritizing the potential benefits of FDI will help each country choose the policy mix that best suits its goals and circumstances. To fully realize the opportunities of foreign investment, GCC countries should tailor policies to attract capital and well-articulated objectives.
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