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FOREIGN DIRECT INVESTMENT REPORT 2011

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Preface

This report, which was prepared by the Economic Development and Globalization Division within ESCWA, focuses mainly on the performance of ESCWA member countries in terms of attracting foreign direct investment (FDI). The report reviews the latest developments in the institutional framework governing the activities of FDI enterprises and aims to provide readers in general and policymakers in particular with an overview of the latest large-scale FDI activities in ESCWA member countries.

In addition, it contains a short study on the impact of FDI inflows on welfare in Arab countries. Econometric models are used to evaluate the impact of FDI flows on economic growth in the Arab region and assess its impact in different subregions.

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Executive summary

After almost a decade of accelerated growth, foreign direct investment (FDI) inflows to the ESCWA region reached a peak in 2008. In 2009, the FDI inflow to the region dropped, due mainly to the impact of the global financial crisis that hit the global economy in the autumn of 2008. Total FDI inflows to the region declined by 14 per cent in 2009, from US$84.2 billion to US$72.5 billion. Despite the decline, countries in the ESCWA region performed better in 2009 compared with other developing countries. The ESCWA region managed to increase its share in the total FDI received by developing countries steadily from 6 per cent in 2003 to almost 15 per cent in 2009.

Inflows of FDI to the ESCWA region are dominated by three countries, namely Saudi Arabia, Qatar and Egypt. Of those, Saudi Arabia received some US$35.5 billion of FDI in 2009, which put it in the global top ten for inward FDI. Regionally, Qatar occupies second place, with an inflow of some US$8.7 billion in 2009, while Egypt is in third place with US$6.7 billion. In 2009, those three countries accounted for 72 per cent of total FDI inflows to the ESCWA region. The two least developed countries combined, by comparison, received only 4 per cent of total FDI inflows.

The decline in FDI to the region in 2009 can be largely attributed to falling oil prices, declining profit margins within the petroleum sector, sharp corrections in the real estate sector and the political instability witnessed in several ESCWA member countries. All of these developments occurred within the broader global context of slowing economic growth in both developed and developing economies, less accessible and more expensive funding, increased nervousness of big companies and banks in terms of investing in and financing new ventures, and a failure to boost cross-border mergers and acquisitions.

Despite previous expectations for a fast recovery in FDI inflows, the political unrest in certain member countries in the region is set to have a negative impact in the near future. The preliminary figures for 2010 imply that there has been a further slowdown in FDI and the expectations for 2011 should be moderate. In Egypt, for example, preliminary figures hint that the FDI inflows for the first quarter of 2011 dropped by 25 per cent. The same situation is also expected in Bahrain and Yemen, as FDI inflows are expected to drop during the first half of 2011. In general, the performance of FDI inflows in the ESCWA region will depend to a great extent on the performance of the three leading countries. However, the region is expected to recover and continue to receive increasing amounts of FDI. This applies particularly to those member countries that have oil resources, modern infrastructure and constantly work on upgrading the investment environment.

Moreover, the ESCWA region still faces various challenges, including further upgrading of the institutional framework, improving the infrastructure, investing in education and adopting appropriate policies in order to direct investments towards the most productive sectors. All of these challenges need to be addressed in a suitable and timely manner in order to enjoy the more widespread economic and social benefits of foreign investment. Furthermore, ESCWA member countries need to focus both on increasing FDI inflows and, equally, on the types of inflow that can generate employment and technology transfer. This can be achieved, among other things, by directing more FDI inflows into the real economy, particularly the agricultural and manufacturing sectors that currently receive a lower share. However, taking into consideration the economic endowment, economic reform and liberalization policies adopted during the past few years, the medium and long-term outlook for many ESCWA member countries remains promising.

The econometric model included in this report examines the impact of FDI inflows on welfare in 18 Arab countries, with specific emphasis on subregional comparisons. The results support the main conclusions from the literature related to the FDI-growth nexus. Specifically, FDI has a significantly positive impact on income in the region within a favourable environment of macroeconomic stability, political stability, openness to trade and the absorptive capacity of the recipient country. Moreover, the impact of FDI on growth is more pronounced for non-hydrocarbon producers in the region than for hydrocarbon producers. In addition, the growth elasticity to FDI inflows is highest in the Maghreb countries, followed by the more diversified economies of the ESCWA region and finally in the countries of the Gulf Cooperation Council.

Introduction

During the decade to 2008, the ESCWA region witnessed a steady increase in FDI inflows, thereby reflecting the improved macroeconomic and institutional environment in many countries. FDI inflows to the region increased from US$20 billion in 2004 to US$72 billion in 2009. The FDI inflows declined in 2009, owing to the global financial and economic crisis. For the first time since 2001, FDI in the region experienced a negative growth of 14 per cent compared with the previous year.

The current political situation in the region will have a negative impact on FDI flows in the region in the short term, particularly in those member countries that are directly affected by these global events. However, there is no doubt that in the medium and long term, ESCWA member countries will continue to attract foreign capital, given their sustained efforts aimed at increasing their competitiveness and at creating business-friendly environments. What remains to be seen is the degree to which they will benefit from such flows and manage to diversify their economies and move towards more equitable development.

Chapter I deals with the overview of FDI inflows in the world in general and in ESCWA member countries in particular, and provides a review of the prospects of FDI for 2010 and 2011. Chapter II analyses FDI at the national level according to three subgroups, namely the countries of the GCC, the more diversified economies (MDEs) and the least developed countries (LDCs). It provides a country-by-country review of progress made in terms of increasing national shares in the global FDI inflows. Chapter III investigates the impact of FDI inflows on welfare in Arab countries, with specific emphasis on subregional comparisons; and chapter IV presents a summary of the outcome of the report and provides a set of recommendations aimed at policymakers in ESCWA member countries.

I. OVERVIEW OF FDI INFLOWS AND CONDITIONS

During 2008 and 2009, the world economy went through a period of unprecedented challenges, characterized by financial instability and recession. In 2009, the global economy contracted by 2.2 per cent; industrial production and fixed investment declined by 12 per cent and 9.8 per cent respectively; while unemployment soared and consumer confidence reached an all-time low.[1]

While developing countries have not been spared from the effects of the crisis, they have managed to cope with it better than the developed world, both in terms of economic growth and attracting FDI. Developing countries have avoided the recession and recorded growth of 1.2 per cent in 2009.[2] ESCWA member countries outperformed developing countries in other regions and experienced average growth of 3.4 per cent; estimates for 2010 indicate that the region achieved average growth of 4.5 per cent.[3]

The global financial crisis severely impacted FDI flows, which declined in 2008 and continued their downward trend in 2009. FDI inflows plummeted in 2009 in all three major groups of countries, namely developed, developing and transition economies. Global FDI inflows declined by 37 per cent in 2009, reaching US$1,114 billion, whereas inflows to developing countries declined by 24 per cent after six years of growth to reach US$478 billion (see table 1). However, the impact of the crisis varied according to region and country and, consequently, resulted in different geographical patterns and trends of FDI flows. Among developing countries, those in Latin America suffered the sharpest decline; while counterparts in South, East and Southeast Asia recorded declining rates that were lower than the average for developing countries.

TABLE 1. FDI INFLOWS BY REGION, 2007-2009
(*Millions of US dollars*)

Region	2007	2008	2009
World	2 099 973	1 770 873	1 114 189
Developing countries	564 930	630 013	478 349
Africa	63 092	72 179	58 565
Latin America and the Caribbean	163 612	183 195	116 555
South, East and Southeast Asia	258 830	282 440	233 050
Southeast Europe and the Commonwealth of Independent States (CIS)	90 968	122 588	69 948
ESCWA	70 083	84 264	72 566

Sources: United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2010*. Data for the ESCWA region are based on the sources cited in table 2 below.

A. FUTURE PROSPECTS FOR FDI

As the world economy started to recover and stabilize in 2010, FDI flows were also expected to recover. Historical evidence shows that FDI flows decline during downturns, but that these trends tend to be short-lived. For this reason, a global economic recovery paves the way for an upward trend in both global and regional FDI flows. According to UNCTAD, global FDI flows are expected to pick up to more than US$1.2 trillion in 2010, before gaining momentum to reach US$1.3-1.5 trillion in 2011.

The developing world continues to attract significant levels of FDI. According to the World Bank and UNCTAD, FDI inflows are expected to shift further towards emerging markets in the near future. Globally, the weight of developing countries is expected to continue to grow, both as a destination and as a source of FDI. Prospects for FDI inflows to ESCWA member countries are expected to improve in 2010 and beyond,

[1] World Bank, Multilateral Investment Guarantee Agency (MIGA), World Bank Group, *World Investment and Political Risk, chapter 1: World Investment Trends*.

[2] Ibid.

[3] ESCWA, 2011, *Survey of Economic and Social Developments in the ESCWA Region 2009-2010* (E/ESCWA/EDGD/2011/1).

provided that the debt crisis in Dubai and other developments at the global level do not affect the rebound of investor access to international credit markets.[4] However, the current political turmoil in some countries across the region could further delay the recovery of FDI. In the meantime, Governments of most ESCWA member countries remain committed to their ambitious infrastructure development plans aimed at attracting investors.

Nevertheless, given the long-term nature and relative stability of FDI, it is expected to remain the main source of private capital flows to developing countries. Besides benefiting from a global FDI upswing from 2003 to 2007, which stemmed from strong global macroeconomic performance, high corporate profits and financial liquidity, developing countries have sought to become more attractive for investment by improving macroeconomic fundamentals and the overall business environment. All of these factors, coupled with the development of global supply chains, intensified competition and new investment opportunities, are expected to sustain the foreign investment revival once global markets stabilize.

B. FDI INFLOWS TO THE ESCWA REGION

After achieving robust growth during the last decade, FDI inflows to the ESCWA region declined in 2009. Total FDI inflows to the region declined by 14 per cent, from US$84.2 billion to US$72.5 billion dollars. Given the difference in their economic structure, ESCWA member countries have been differently affected by the considerable decline in FDI in 2009. The top receiver within the region and among the top ten FDI receivers in the world was Saudi Arabia. It continued to receive sizeable foreign capital from regional and international investors throughout 2009, even though it suffered a mild decline in inflows. Qatar came second in 2009, with FDI inflows of US$8.7 billion, while Egypt took the third place among ESCWA member countries with inflows of US$6.7 billion. On the other hand, the two least developed countries in the region (the Sudan and Yemen), which need external development finance owing to the nature of their economies and lack of domestic financial resources, received only about 4 per cent of the ESCWA regional total in 2009.

Despite the decline in FDI inflows in 2009, the ESCWA region as a whole witnessed a less dramatic drop than other developing regions (see table 2). While total inflows were 14 per cent lower in 2009 than in 2008, ESCWA member countries still performed better on average than developing countries in other regions. The FDI to GDP ratio decreased compared with the previous year owing to higher falls in FDI inflows relative to GDP.

TABLE 2. FDI INFLOWS TO ESCWA MEMBER COUNTRIES, 2007-2009
(*Millions of US dollars and percentage of GDP*)

	FDI inflows (*millions of US$*)			FDI/GDP (*percentage*)	
Country	2007	2008	2009*	2008	2009
Bahrain	1 756	1,794	257	8.5	1.3
Kuwait	116	-51	145	0.0	0.1
Oman	3 332	2 359	2 211	3.9	4.1
Qatar	4 700	4 107	8 722	4.1	10.4
Saudi Arabia	22 821	38 151	35 514	8.0	9.6
United Arab Emirates	14 187	13 700	4 003	5.2	1.7
GCC economies	46 912	60 078	51 793		
Egypt	11 578	9 495	6 712	5.8	3.6
Iraq	972	1 856	1 070	2.1	1.6
Jordan	2 622	2 829	2 385	13.3	10.4
Lebanon	3 376	4 333	4 804	14.7	14.3

[4] International Monetary Fund (IMF), *Regional Economic Outlook, Middle East and Central Asia* (May 2010), available at http://www.imf.org.

TABLE 2 (*continued*)

Country	FDI inflows (*millions of US$*)			FDI/GDP (*percentage*)	
	2007	2008	2009*	2008	2009
Palestine	28	52	33	0.8	0.5
Syrian Arab Republic	1 242	1 467	1 434	2.7	4.84
More diversified economies	19 818	20 030	17 610		
Yemen	917	1 555	129	9.2	0.5
The Sudan	2 436	2 601	3 034	4.5	5.5
Least developed countries	3 353	4 156	3 163		
Total, ESCWA member countries	70 083	84 264	72 566	5.6	5.3

Sources: Compiled by ESCWA, based on the following: Central Bank of Bahrain, *Statistical Bulletin, Balance of Payments* (November 2010), available at http://www.cbb.gov.bh/; Central Bank of Egypt, *Balance of Payments, Monthly Statistical Bulletin* (December 2010), available at http://www.cbe.org.eg; Central Bank of Jordan, *Monthly Statistical Bulletin* (*2010*), available at http://www.cbj.gov.jo; Central Bank of Kuwait, *Quarterly Statistical Bulletin, Balance of Payments*, available at http://www.cbk.gov.kw/; Central Bank of Lebanon, *Balance of Payments* available at http://www.bdl.gov.lb/; Central Bank of Oman, *Annual Report 2009*, available at www.cbo-oman.org/; UNCTAD, *World Investment Report 2009 and 2010*; Saudi Arabian Monetary Agency (SAMA), *Quarterly Statistical Bulletin, Third Quarter 2010*, available at http://www.sama.gov.sa; Central Bank of Sudan, *Economic and Financial Statistics Review*, available at http://www.bankofsudan.org/; Central Bank of Syria, *Quarterly Bulletin* (first quarter, 2010), available at http://www.banquecentrale.gov.sy/index.html; Central Bank of the United Arab Emirates, *Annual Report 2009*, available at http://www.centralbank.ae; and Central Bank of Yemen, *Balance of Payments*, available at http://www.centralbank.gov.ye/mbop.pdf. GDP data were compiled from national sources.

* Denotes provisional figures.

There are several country-related issues that explain the decline in FDI in the region, including falling oil prices, declining profit margins within the sector, sharp corrections in the real estate sector and political instability. Other reasons can be attributed to the worldwide decline in FDI and refer mostly to the slowdown in economic growth in both developed and developing economies; less accessible and more expensive funding; increased nervousness of big companies and banks in terms of investing in and financing new ventures; and a failure to boost cross-border mergers and acquisitions (M and A). It is interesting to note that, according to UNCTAD, most of the drop in FDI in 2008 and 2009 owed to substantial declines in M and A deals rather than in greenfield operations.

C. INVESTMENT ENVIRONMENT IN THE ESCWA REGION

It is important to consider the conditions for FDI within a broader context, given that policymakers and Governments across the world were confronted with major challenges in 2009, ranging from an unstable financial sector and rising unemployment to tightening of fiscal policies and rising public debt.

According to the World Bank's *Doing Business 2010* report, reformers in the ESCWA region focused on easing business start-ups, dealing with construction permits and trade across borders, as well as improving the efficiency of commercial dispute settlements. Many countries in the region have been intensifying their reform practices, thereby improving their business environment. Overall, economies in Egypt, Jordan, Saudi Arabia and the United Arab Emirates have climbed the scale on the ease of doing business, whereas the Sudan and the Syrian Arab Republic remained among the countries ranked very low on the same scale.

In that regard, Saudi Arabia performed particularly well and its consistent reform programme propelled it to a ranking of 13 among the 183 economies covered by the World Bank report on ease of doing business. On the world scale, Saudi Arabia, Bahrain, the United Arab Emirates and Qatar are among the top 50 countries on ease of doing business, while the United Arab Emirates and Egypt ranked among the top 10 reformers in 2008/2009. Table 3 shows the various aspects of the *Doing Business* report, highlighting the world rankings of ESCWA member countries in the past two years.

The report reveals that, on a general scale of doing business, Saudi Arabia was ranked first in the ESCWA region in 2009 and 2010, followed by Bahrain, the United Arab Emirates, Qatar, Kuwait and Oman.

By contrast, Palestine, the Syrian Arab Republic and Iraq continued to lag behind as the least business-friendly countries in the region.

TABLE 3. DOING BUSINESS IN ESCWA MEMBER COUNTRIES, 2009 AND 2010

Country	Ease of doing business		Starting a business		Dealing with construction permits		Protecting investors		Enforcing contracts		Closing a business	
	Rank 2009	Rank 2010	Rank 2009	Rank 2010	Rank 2009	Rank 2010	Rank 2009	Rank 2010	Rank 2009	Rank 2010	Rank 2009	Rank 2010
Bahrain	18	20	49	63	14	14	..	57		117	..	26
Egypt	114	106	41	24	165	156	70	73	151	148	128	132
Iraq	..	153		175	..	96	..	119	..	139	..	183
Jordan	101	100	131	125	74	92	113	119	128	124	93	96
Kuwait	52	61	134	137	82	81	24	27	94	113	66	69
Lebanon	99	108	98	108	121	125	88	93	118	121	121	124
Oman	57	65	76	62	133	130	88	93	105	106	63	66
Palestine	..	139	..	176	..	157	..	41	..	111	..	183
Qatar	37	39	57	68	27	28	88	93	98	95	31	33
Saudi Arabia	16	13	28	13	50	33	24	16	137	140	57	60
Syrian Arab Republic	137	143	124	133	132	131	113	119	174	176	84	87
The Sudan	147	154	107	118	135	139	150	154	143	146	181	183
United Arab Emirates	46	33	113	44	41	25	113	119	145	134	141	143
Yemen	98	99	50	53	33	51	126	132	41	35	87	89

Source: World Bank and IFC, *Doing Business Report 2009* and *Doing Business Report 2010*.

Note: Two dots (..) indicate that data are not available or are not separately reported.

Despite the financial crisis and the challenges it brought to policymakers, ESCWA member countries managed to introduce a number of reforms in 2009.[5] Kuwait, Qatar and the United Arab Emirates injected liquidity into the banking sector. On the other hand, Egypt, Saudi Arabia and the Syrian Arab Republic provided tailored financial support to the national budget aimed at overcoming the repercussions of the international financial crisis. In 2009, seven ESCWA member countries, namely Egypt, Iraq, Jordan, Oman, Qatar, Saudi Arabia and the Syrian Arab Republic, adopted measures and policies that had a direct impact on promoting FDI inflows, including liberalizing several economic sectors that were previously closed to foreign investors, such as the banking sector and air transport; facilitating investment procedures; and providing investment incentives. In the same year, nine ESCWA member countries, namely all six GCC countries, along with Egypt, Jordan and the Syrian Arab Republic, adopted policies and measures that had an indirect effect on promoting FDI inflows.

In addition, nine ESCWA member countries concluded 19 bilateral investment agreements and three ESCWA member countries concluded eight double taxation avoidance agreements, all aimed at promoting FDI inflows. In February 2009, the Arab Union for Free Zones was established in Jordan as part of the League of Arab States in order to offer a forum for the exchange of expertise among Arab countries and to enhance cooperation between different free zones and strengthen their role.

All of the above indicates improvements in the business environment, implying that the majority of ESCWA member countries have taken serious steps to upgrade the investment environment as one of the crucial factors aimed at attracting foreign investors.

[5] Arab Investment and Credit Guarantee Corporation, 2009, *Investment Climate in the Arab Countries*.

II. COUNTRY PERFORMANCE

A. GCC ECONOMIES

1. *Bahrain*

While Bahrain managed to avoid recession, growth slowed sharply in 2009. According to forecasts by the International Monetary Fund (IMF), growth of 3.5 per cent is expected in 2010, following the growth of 2.9 per cent achieved in 2009. After a period of remarkable performance, Bahrain suffered a drop in FDI of 85 per cent in 2009 and was among two ESCWA member countries to suffer the sharpest decline. FDI inflows plunged from US$1.8 billion in 2008 to US$257 million in 2009. As a result, the share of FDI to the country's GDP declined sharply in 2009 to 1.3 per cent, compared with an average rate of 8 per cent in the previous few years.

The country introduced several measures aimed at improving the investment environment, which are likely to help to increase FDI inflows to the country in the future. Moreover, Bahrain managed to further consolidate preliminary approval for building permits in the one-stop shop, thereby reducing the time required to obtain building permits.[6]

As in many other ESCWA member countries, FDI inflow to Bahrain had achieved an accelerated growth rate in the previous decade, increasing from US$517 million in 2003 to some US$2.9 billion in 2006, representing more than a five-fold increase. However, this inflow declined in 2007 by more than 40 per cent to US$1.7 billion, rebounded in 2008 to US$1.8 billion and declined once again in 2009.

The economy of Bahrain is vulnerable both to worldwide shocks, such as the global financial crisis that hit the world economy in 2008, and to regional economic conditions, particularly in the GCC area. FDI inflow to the country is not expected to rebound in 2010 or 2011 owing to prevailing political instabilities in the country. Within that context, the latest preliminary data from the Central Bank of Bahrain indicate that FDI inflow to the country dropped sharply in 2010 to US$156 million.[7]

FDI inflows as a percentage of GDP reached 9.5 per cent in 2007, fell to 8.1 per cent in 2008 and dropped further in 2009 to a modest 3.5 per cent. The sectoral distribution of the FDI inflows indicates that the service sector, particularly financial services and tourism, receive the highest share, followed by real estate and the manufacturing sector, particularly the aluminium industry.

2. *Kuwait*

According to the IMF, Kuwait's economy contracted by 2.7 per cent in 2009.[8] However, the rebound of the global economy and of oil prices in 2010 is expected to boost economic growth, which is predicted at 3 per cent for 2010.

In 2009, Kuwait was one of the few ESCWA member countries with positive growth rates for FDI inflows, with total inflows reaching US$145 million. Despite the sharp increase, after the negative inflow in 2008, Kuwait remains one of three ESCWA member countries (along with Palestine and Yemen) that received the smallest amount of FDI.

While the importance of oil to the national economy cannot be overstated – accounting for more than 90 per cent of total national revenues – the country is following a diversification strategy to expand the role of key non-oil sectors, including finance and banking, logistics, industry, trading, transport and telecommunications. While the non-oil sector constitutes a small portion of the overall economy, it is growing swiftly and could attract significant FDI in the future.

[6] World Bank, *Doing Business in the Arab World 2010*.

[7] Central Bank of Bahrain, *Statistical Bulletin* (March 2011).

[8] IMF, *Regional Economic Outlook, Middle East and Central Asia* (April 2010).

In December 2009, the Council of Ministers issued resolution No. 1067/8, which paved the way for foreign investment in environmental activities. Additionally, Kuwait established a new legal procedure to enable companies on the verge of insolvency to restructure. Equally, improvements in customs administration and human resource training have helped to reduce the time required to clear goods, which adds to the general ease of doing business in the country.

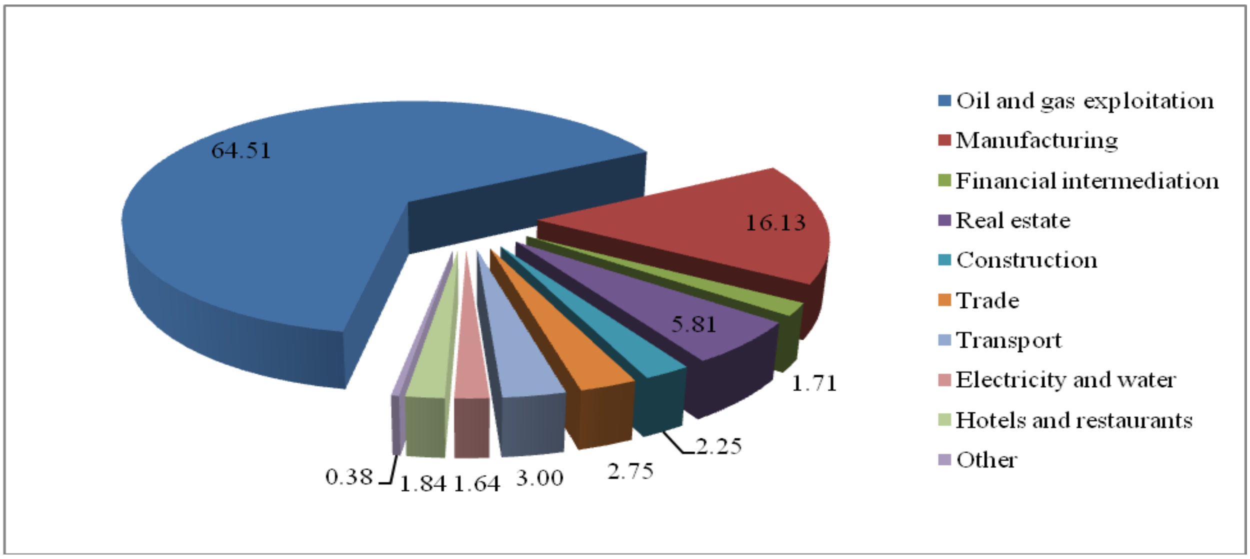
The political situation in the country has had a significant effect on the national economy over the past few years, which delayed the adoption of a fiscal stimulus programme in 2009 and obstructed the Government's goal of economic reform. Currently, there is a backlog of important legislation, most of which is necessary to expand the private sector and increase foreign investment, including laws related to privatization and competition.[9] Despite some progress, significant challenges remain, particularly in terms of opening up the energy and real estate sectors and improving public administration performance.

3. *Oman*

Following the global financial crisis, the economy of Oman has shown an ability to overcome the consequences of the sharp decline in oil prices, which dropped from US$101 per barrel in 2008 to US$56.7 per barrel in 2009. Despite this significant decline, the national economy registered a positive growth of 3.7 per cent in 2009.[10] In 2010, the economy is expected to grow by 6.1 per cent, which is 0.5 per cent more than the estimated GDP growth within the ESCWA region.[11]

According to data provided by the Ministry of National Economy and based on a survey of FDI enterprises, FDI inflows to Oman dropped by some 42 per cent in 2009. This drop followed a similar decline of 26 per cent in 2008, which can be attributed to the repercussions of the global economic and financial crisis. Intraregional FDI inflows reached 32 per cent in 2008 and dropped to 27 per cent in 2009. This drop stemmed largely from a decline of about 10 per cent in FDI inflow from the United Arab Emirates, which is the leading ESCWA member country investor in Oman. Inflow from Kuwait also dropped in 2009 by approximately 17 per cent.

Figure I. FDI inflows to Oman by sector, 2008
(*Percentage*)



Source: Oman Ministry of National Economy, *Foreign Investment 2005-2008.*

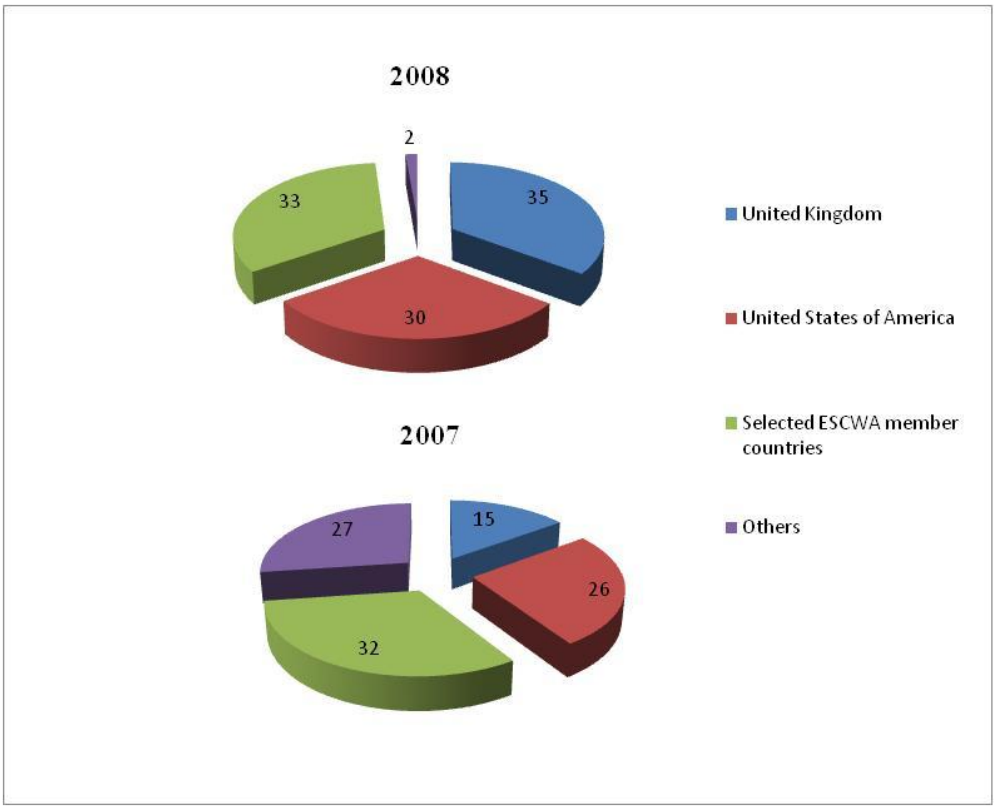
9 *Oxford Business Report on Kuwait 2010*.

10 Centre for Investment Promotion and Export Development, Oman.

11 IMF, *Regional Economic Outlook, Middle East and Central Asia* (May 2010).

The oil and gas sector captured the lion's share of total FDI inflows to Oman in 2008, reaching 64.5 per cent of the total, followed by the manufacturing and real estate sectors. Over the years, it has been noticeable that the oil and gas sector attracts most of the FDI, while the remaining inflows are spread throughout other sectors. Compared with 2007, there has been a major decline in FDI inflows to the financial intermediation sector, which represented 22 per cent of total FDI in 2007, and subsequently plunged to a mere 1.7 per cent of the total in 2008.

Figure II. FDI inflows to Oman by source, 2007 and 2008
(*Percentage*)



Source: Oman Ministry of National Economy, *Foreign Investment 2005-2008.*

In 2008, the major source of FDI to Oman came from the United Kingdom of Great Britain and Northern Ireland, with total inflows reaching US$770 million, representing almost 34 per cent of total FDI. The British investments focused on oil and gas exploration and financial intermediation. The United States of America was the second largest country of origin of FDI inflows to Oman, with total inflows of US$665 million, or 29 per cent of the total; and 96 per cent of those investments were concentrated in the oil and gas exploration sector.[12] The United Arab Emirates was the third largest investor in Oman, with US$447 million and 19.5 per cent of total FDI; its investments were directed mostly towards the petroleum industry and financial sector.

It is important to note that, collectively, the United Kingdom, United States and United Arab Emirates accounted for 86 per cent of total FDI in Oman in 2008. There is a rising trend in FDI originating from the United Kingdom, while investments from the other two countries suffered sharp declines in 2008 compared to the previous year. Nevertheless, those three countries were also the top three investors in Oman in 2006 and 2007.

[12] Global Arab Network, *Oman: 12% Growth in Foreign Investments, British FDI Comes First* (9 April 2010), available at http://www.english.globalarabnetwork.com/201004095447/Economics/oman-12-growth-in-foreign-investments-british-fdi-comes-first.html.

Encouraging and attracting FDI is a top priority of Oman's diversification strategy. There have been significant amendments in laws and procedures to make the investment climate more conducive and attractive, especially with respect to securing foreign ownership (up to 100 per cent) and lowering the income tax rate for national and foreign companies to one of the lowest in the region, at 12 per cent.[13] Oman eased business start-up by introducing online company name registration and payment at the registry with a prepaid card. This has reduced the number of days required to start a business from 14 to 12, and the number of related procedures from seven to five.[14]

The country has also made progress in easing procedures and in creating a favourable business environment. As indicated above, the country was ranked sixth among ESCWA member countries in the *Doing Business* reports of the World Bank for 2009 and 2010. In order to provide the best investment environment and upgrade the infrastructure of the country, the Government has formulated a detailed plan to expand and modernize Muscat International Airport and Salalah Airport. Four new domestic airports are to be built in Sohar, Duqm, Adam and Ras al Hadd; and two smaller airports in Haima and Shaleem.

4. *Qatar*

Qatar is one of the few economies which have shown a high degree of resilience to the global crisis as a result of a robust increase in gas output, pre-arranged financing for hydrocarbon and petrochemical projects and several supportive measures taken by the Government.[15] According to the IMF forecast, real GDP growth is projected at 18.5 per cent in 2010, which represents the highest in the world, following a remarkable growth of 9 per cent in 2009.

Qatar experienced more than a two-fold increase in FDI inflows in 2009 and was the second largest FDI recipient in the ESCWA region, after Saudi Arabia. According to UNCTAD, FDI inflows reached US$8.7 billion and accounted for 10.4 per cent of the country's GDP. Qatar's liquefied natural gas project and associated industrial plans were the major beneficiaries of these investments.

The Government's sustained commitment to ambitious infrastructure plans is expected to support the increase in FDI inflows in 2010. The latest *World Investment Report* by UNCTAD notes that such investment policy measures as the full opening of new sectors to FDI have improved the business environment and resulted in a significant increase in FDI inflows.

In order to further upgrade the investment environment, Qatar issued Law No. 1 of 2010 as an amendment to Law No. 13 of 2000 regulating non-Qatari capital investments. The new law allows foreign investors to increase their share to more than 49 per cent of total ownership in the following sectors: consultancy, information technology, education, sports and entertainment, and delivery of services. Law No. 3 of 2010 was issued to amend Companies Law No. 5 of 2002, in particular to amend regulations relating to the acquisition of companies. Recently, Qatar also reviewed its tax rates on companies, unifying and reducing them to 10 per cent.[16]

5. *Saudi Arabia*

Thanks to its large accumulation of foreign reserves, Saudi Arabia was one of the few countries with high potential to counter the negative spillover effects of the world financial crisis and to ensure a relatively fast recovery. The upturn in the oil sector – which represents Saudi Arabia's main growth engine and attracts

[13] In order to qualify, companies must generate annual profits in excess of US$78,000 and operate in specific sectors, including tourism, banking and investment, as per the Income Tax Law promulgated by Royal Decree No. 28 of 2009.

[14] World Bank, *Doing Business in the Arab World 2010.*

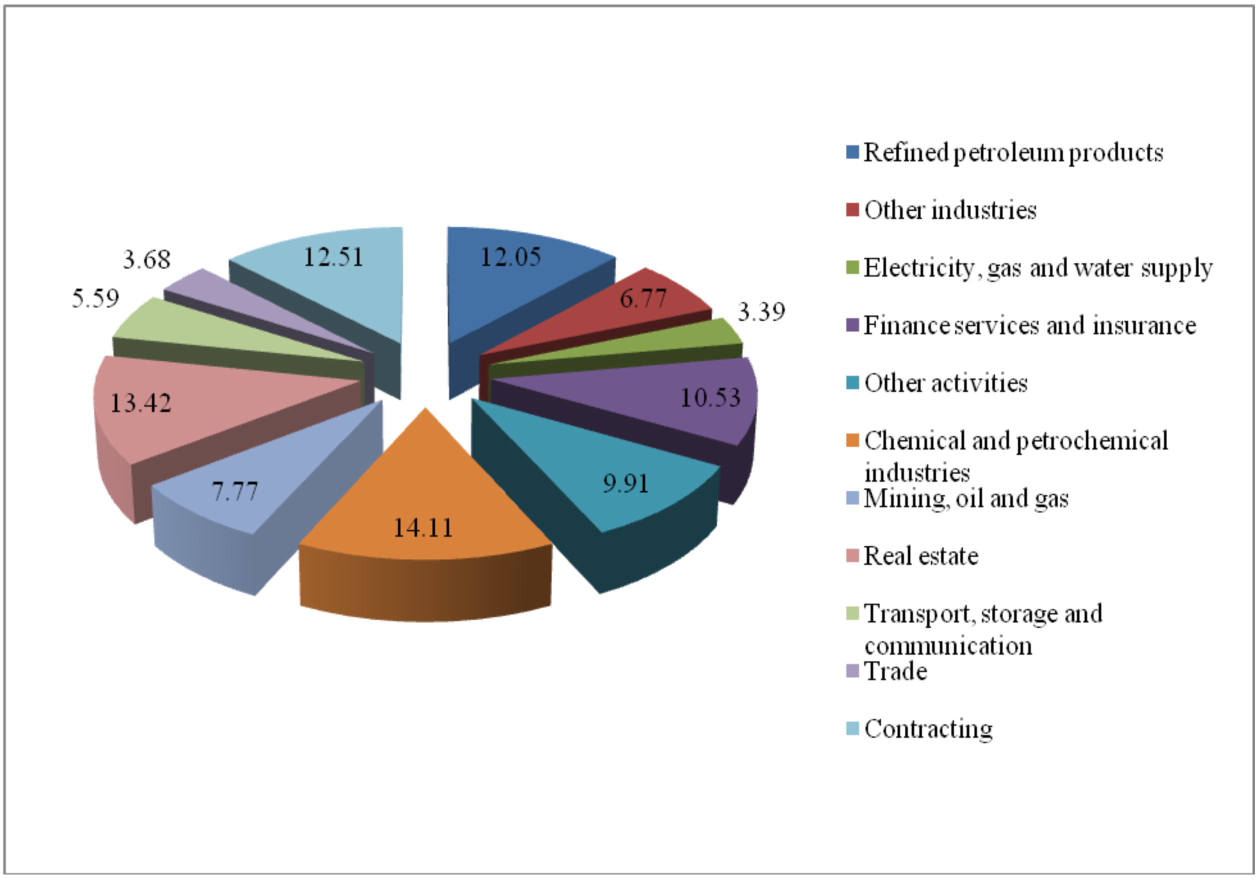
[15] Bank Audi, *Qatar Economic Report* (July 2010).

[16] Inter-Arab Investment Guarantee Corporation, 2010, *Investment Climate in the Arab Countries*.

the most FDI – is expected to boost the economy with healthy growth performance in 2010. Real GDP growth is forecast at 3.7 per cent, following practically zero growth in 2009.[17]

Despite the crisis, Saudi Arabia received US$36.45 billion in FDI inflows in 2009.[18] Even though this figure represents a decrease of almost 4.5 per cent compared with 2008, Saudi Arabia was ranked as the eighth largest receiver of FDI in the world in 2009. The main reasons for the decline in FDI to Saudi Arabia in particular and the ESCWA region in general can be attributed to the tightening of credit markets that has affected cross-border M and A and development projects, which in turn were expected to involve significant levels of foreign investment.

Figure III. FDI inflows to Saudi Arabia by sector, 2009
(*Percentage*)



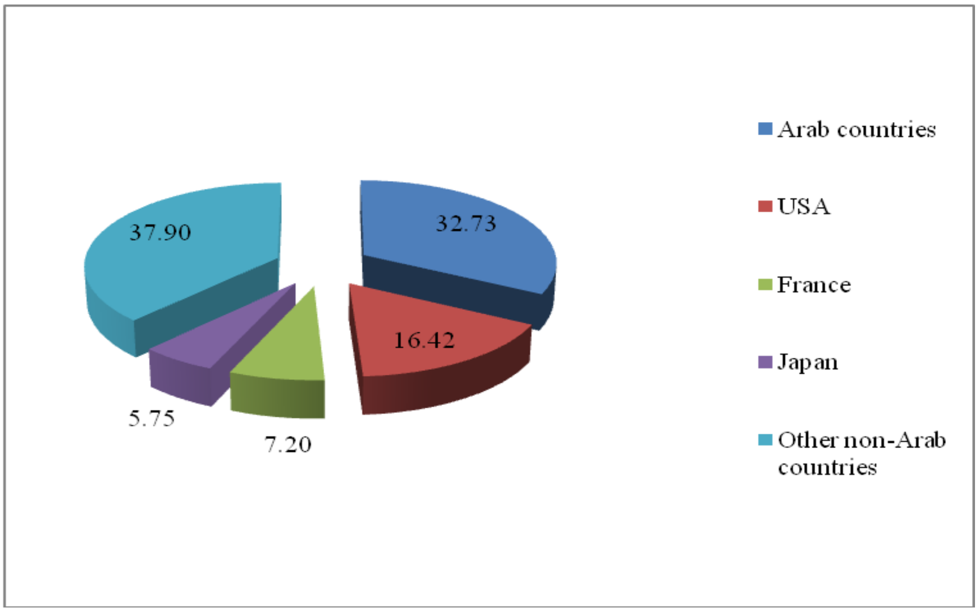
Source: Saudi Arabian General Investment Authority (SAGIA), 2010, *Annual Report of FDI.*

With regard to the sectoral breakdown of FDI in Saudi Arabia, investments in industry and services constitute a major share of total foreign investment. The petroleum industry is the largest receiver of FDI, followed by real estate and mining, then the oil and gas industry. Most sectors kept their relative shares of total FDI compared with the sectoral breakdown of the previous year, with the exception of the real estate sector, which received some US$4.6 billion in 2009, as opposed to US$6.9 billion in 2008, representing a decline of 33 per cent.

[17] IMF, *Regional Economic Outlook, Middle East and Central Asia* (April 2010).

[18] SAMA, *Quarterly Statistical Bulletin, Third Quarter 2010.*

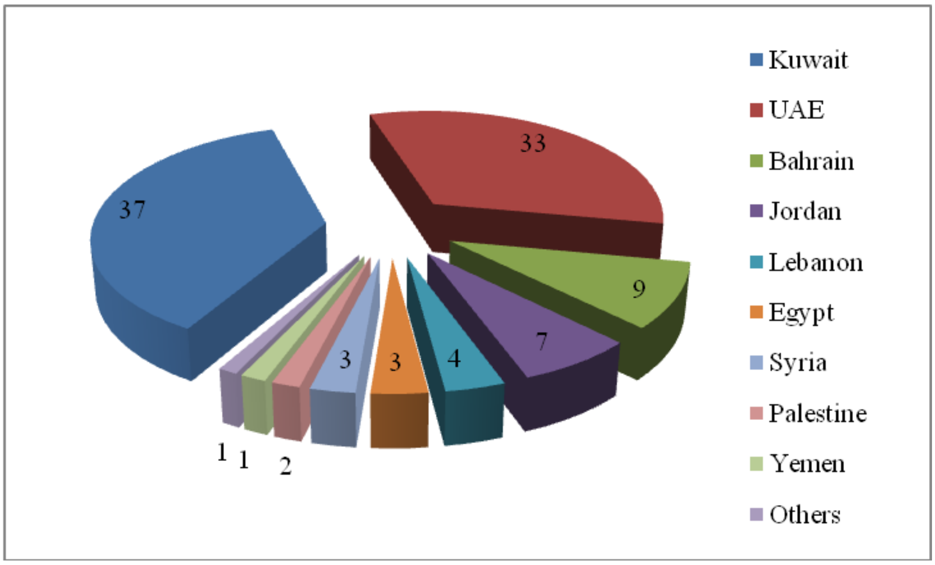
Figure IV. FDI inflows to Saudi Arabia by source, 2009
(*Percentage*)



Source: SAGIA, 2010, *Annual Report of FDI*.

The FDI breakdown by source indicates that the largest investors in Saudi Arabia in 2009, as in the previous few years, were the United States, Kuwait, the United Arab Emirates, France and Japan. FDI inflows from the United States amounted to US$5.8 billion, followed by Kuwait with US$4.3 billion, United Arab Emirates with US$3.8 billion, France with US$2.6 billion and Japan with US$2 billion. This breakdown indicates a comparatively diversified investor base, with non-Arab investments comprising some 67 per cent of total FDI in 2009. Taking into consideration the major investors and compared with the previous year, only investments from the United States increased (by 11.5 per cent), whereas those from Japan, France and Arab countries decreased by 37 per cent, 15 per cent and 9 per cent respectively.

Figure V. FDI inflows to Saudi Arabia from the Arab region, 2009
(*Percentage*)



Source: Arab Investment and Export Credit Guarantee Corporation, 2010, *Annual Report of FDI*.

Analysis of intraregional investment indicates that almost 70 per cent of all Arab investment in Saudi Arabia in 2009 came from two countries, namely Kuwait, which invested US$4.3 billion, and the United Arab Emirates, which invested US$3.8 billion, compared with US$5.8 billion in 2008. The scenario was similar in 2008, when those two countries constituted some 80 per cent of total Arab FDI in Saudi Arabia. Generally speaking, there is a positive trend in FDI inflows from other Arab countries as they become increasingly interested in business opportunities in Saudi Arabia and its investment-friendly business environment.

While Saudi Arabia ranks very high as an FDI-receiving country, the national investment authority, the Saudi Arabian General Investment Authority (SAGIA), believes that foreign investment inflows are still below potential and is striving to double the levels of FDI annual inflows in the coming years. National plans for the development of new cities, including King Abdullah Economic City, represent great potential for attracting long-term FDI. During the first half of 2010, the Ministry of Finance approved 1,420 contracts for various projects valued at a total of US$19.1 billion.

Saudi Arabia climbed the scale of ease of doing business by three positions in 2010 (it was ranked sixteenth in 2009). It established a one-stop centre, thereby cutting down the business registration waiting time to four day, and introduced a faster system for obtaining construction permits.[19] Additionally, entrepreneurs can now complete registration with only one procedure at the new one-stop shop in Riyadh.

6. *United Arab Emirates*

The macroeconomic performance of the United Arab Emirates weakened in 2009, with a negative growth of 0.7 per cent. The underlying causes ranged from the drop in oil prices, the slump in exports, a substantial drop in FDI and tourism, and correction in the real estate sector. As a result of the weaker global growth outlook, a number of entrepreneurs operating in the United Arab Emirates postponed or re-phased investment and development projects, which had an impact on the short-term growth outlook. A modest improvement is expected in 2010, with the economy forecast to grow by 1.3 per cent.[20]

FDI in the United Arab Emirates suffered a significant decline of 71 per cent, from US$13.7 billion in 2008 to US$4 billion in 2009, representing one of the largest drops in the ESCWA region.[21] This decline was due to both the Dubai World debt crisis, which had a negative impact on the national economy, and the overall decline of FDI inflows into the ESCWA region. Among ESCWA member countries, the United Arab Emirates was arguably the most severely affected by the global economic and financial crisis. The crisis hit the stock markets, the banking system and the real estate sector in particular. As a result of the severe drop in FDI inflows in 2009, the country lost its position as the second-highest receiver of FDI in the ESCWA region. However, the country's FDI performance is expected to rebound quickly thanks to efforts aimed at settling the debt portfolio, recovery of the real estate sector and stability in the financial sector. Political stability in the country could make it attractive to regional investment, particularly from countries that are facing political instability.

In order to create a more attractive business environment, the United Arab Emirates has focused on improving its online system for approval of commercial building permits. The streamlining has cut four procedures and 33 days from the process of dealing with construction-related approvals.[22] Towards the end of 2009, a decree was issued to amend certain provisions of Federal Law No. 8 with regard to corporate law, aimed at reducing the cost of setting up new businesses. This move reflects Government efforts to boost the investment environment and leverage the standing of the country as a highly competitive economy. The decree limits bureaucratic procedures so that investors are not obliged to possess a bank certificate in order to

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[19] Under the new procedure, builders are allowed to begin construction with a temporary building permit after just one day and can obtain a definitive permit after just one week. See World Bank, *Doing Business in the Arab World 2010.*

[20] IMF, *Regional Economic Outlook, Middle East and Central Asia* (May 2010).

[21] Central Bank of the United Arab Emirates, *Annual Report 2009.*

[22] World Bank, *Doing Business in the Arab World 2010.*

set up a private business in the country, thereby speeding up the entire process. At the beginning of 2010, the Ministry of Economy started the process of developing new legislation as part of modernizing the legislative system and enhancing the business environment. The new laws will cover several issues, including foreign investment, competition, certificate of origin, industrial affairs regulation and commercial fraud. Additionally, the Minister of Justice announced a plan to expand the network of specialized courts, including economic and commercial courts.

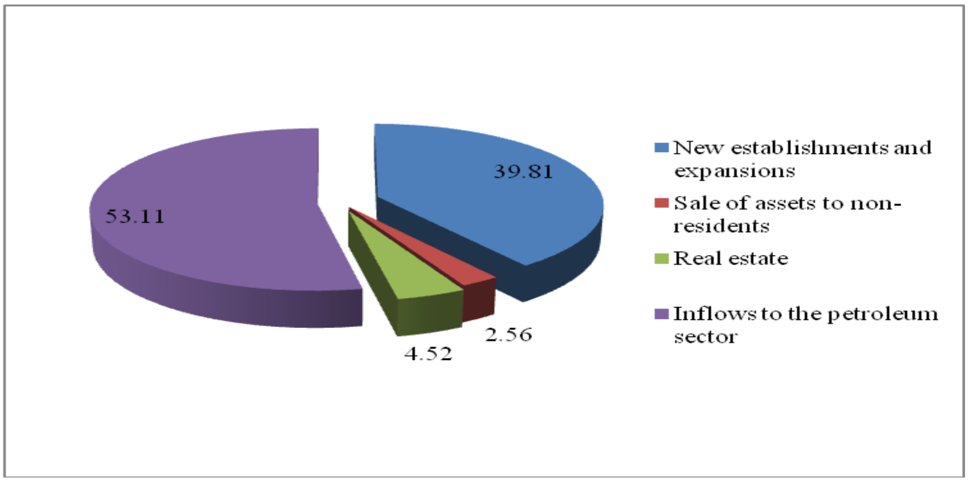
B. More diversified economies

1. *Egypt*

Egypt was not spared from the worldwide trend of decelerating FDI in 2009. FDI inflows decreased from US$14.3 billion to US$11.7 billion, while net inflows declined from US$9.5 billion in 2008 to US$6.7 billion in 2009. These figures translate into a decline of almost 30 per cent. The quarterly data show that FDI inflows to Egypt reached their lowest point in recent years during the last quarter of 2009. The latest available data imply that FDI in Egypt has picked up compared with 2009 and, in the first three quarters of 2010, reached 85 per cent of total inflows from the previous year. The short-term outlook indicates that FDI inflows were negatively affected by the uprising in the country of 25 January 2011, accounting for an estimated 25 per cent drop in FDI during the first quarter of 2011. The medium and long-term outlook is more promising, due to progress made in reforming investment policy and creating a more investment-friendly environment. Moreover, Egypt has many economic sectors that are able to attract a higher share of FDI, particularly the service, real estate and manufacturing sectors, and the country has opened most sectors to FDI inflows.

With respect to the sectoral distribution of FDI inflows in Egypt, the oil sector received US$3.6 billion of net inflows in the fiscal year 2009/10, compared with US$5.3 billion the previous year. These inflows represent 53 per cent of total net inflows for that period. While the concentration of FDI inflows in the oil sector has been notable in recent years, this has decreased in both absolute and relative terms compared with the fiscal year 2008/09. Certain incentives for the diversification of FDI and more productive investment in the non-oil sector are needed if Egypt is to become less dependent on one sector. The establishment of new companies and expansions in the fiscal year 2009/10 accounted for US$2.7 billion, which led to an increase in its relative share in total FDI inflows from 28.5 per cent to 39.8 per cent. The sale of assets to foreigners reached US$173 million, while the inflows to the real estate sector reached US$305 million, representing an increase of 121 per cent compared with the previous year.[23]

Figure VI. FDI inflows to Egypt by sector, fiscal year 2009/10
(*Percentage*)

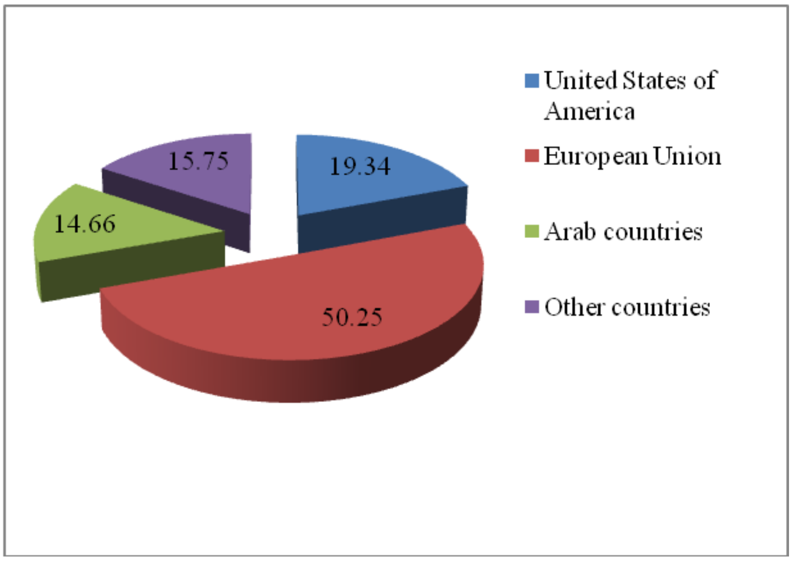


Source: Central Bank of Egypt, Ministry of Investment.

[23] Central Bank of Egypt, Ministry of Investment: www.investment.gov.eg/en/Investment/pages/foreigninvestment.aspx.

In addition to the significant decline in the level of FDI inflow in 2009, there was a noteworthy shift in the sources from which those inflows originated (see figure VII).

Figure VII. FDI inflows to Egypt by source, 2009
(*Percentage*)



Source: ESCWA, based on Central Bank of Egypt, *Monthly Statistical Bulletin* (August 2010).

Data for 2009 indicate that half of total inflows came from the European Union, primarily from the United Kingdom (55 per cent) and Belgium (26 per cent). Most British investment targeted the hydrocarbon sector, where several attractive discoveries had been made in the previous year and explorations were ongoing. An oil and gas exploration company from Ireland, Circle Oil, made a major discovery of oil and gas in the onshore North West Gemsa Concession in Egypt in January 2009.[24]

With regard to this shift in the source of FDI, the share of investment originating from the European Union increased from 36 per cent in 2008 to 50.25 per cent in 2009. While the United Kingdom and Belgium were the leading investors in Egypt in 2009, it is of note that the share of FDI inflow also increased from other countries, including Cyprus, Italy, Spain and Turkey. Despite extremely modest figures compared with total foreign investment volume, investments from China and India are starting to gain importance, which reflects the global trend of growing investors from emerging economies.[25] On the other hand, FDI from the United States represented 33 per cent of all inflows in 2008, yet only 19 per cent in 2009.

Total Arab FDI in Egypt in 2009 was US$1.71 billion, which is barely half the amount of FDI received from the United Kingdom alone. The share of investors from Arab countries decreased in relative terms from 18 per cent in 2008 to 14.66 per cent in 2009; almost 60 per cent of all Arab investments in Egypt came from the United Arab Emirates, followed by Saudi Arabia and Jordan. However, it is important to note that Egypt's more traditional Arab investors were affected by the crisis and, consequently, were more cautious in 2009. Investments from Saudi Arabia, Kuwait and Qatar more than halved in 2009, whereas investments from Jordan, Lebanon and the United Arab Emirates increased by 138 per cent, 39 per cent and 24.7 per cent respectively.

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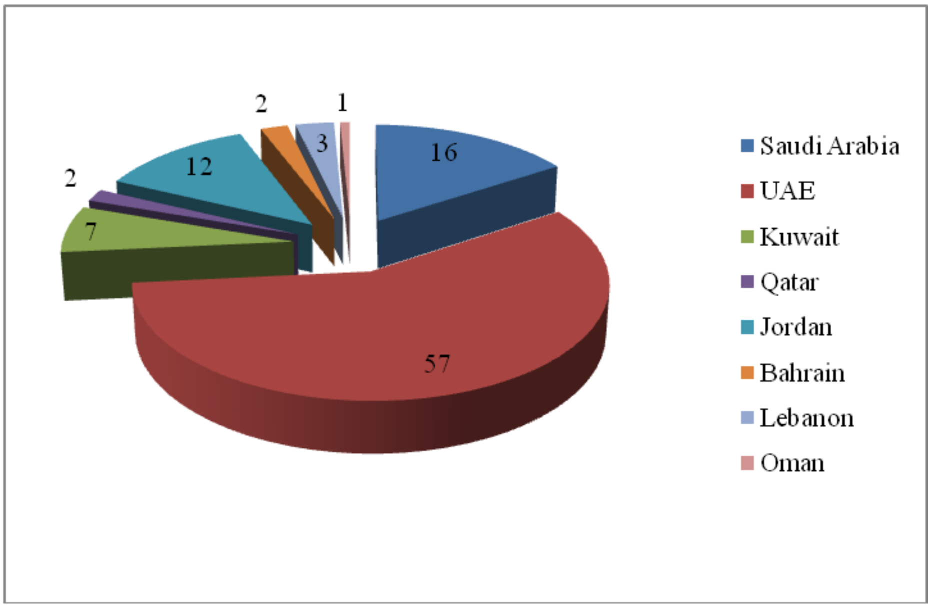
[24] Economist Intelligence Unit, Country Risk Service.

[25] In 2009, FDI from China reached US$53.5 million and from India US$48.8 million, which is one twentieth of the investment volume originating from the United States in the same year.

Figure VIII. FDI inflows to Egypt from the Arab region, 2009
(*Percentage*)



Source: ESCWA, based on Central Bank of Egypt, *Monthly Statistical Bulletin* (August 2010).

Egypt is highly ranked on the International Finance Corporation scale on ease of doing business, which could be one of the reasons that made it one of the top FDI receivers in the ESCWA region. Investors have benefited from a sound macroeconomic environment for several years. The Government has managed to streamline several procedures, such as reducing the number of days for obtaining licences from 28 to 25, and lowering the number of hours required for paying taxes from 711 to 480.[26]

There have been many other improvements aimed at start-ups, from the establishment of a one-stop shop to the introduction of an automated system for tax registration and removing restrictions on the minimum capital requirements of limited liability companies. Additionally, specific procedures relating to particular sectors have been improved, such as the Unified Building Law of May 2008 and its executive regulations in 2009. It streamlines procedures, shortens the time required for obtaining construction permits and sets a 30-day deadline for acquiring a building permit.[27] Foreign investments in specialized or free zones benefit from a wide range of incentives for labour-intensive projects that have high added value and are related to port services.[28]

Several other actions concerning investor protection and streamlining business procedures were undertaken in 2010, including the online incorporation of limited liability companies and establishing dispute settlement centres for investors. Egypt has also expanded the range of information available from the private credit bureau, which will add to the general transparency of business practice. In June 2010, the Ministry of Investment announced that it had prepared a set of new legislation aimed at developing the legal framework governing the investment climate; developing and modernizing non-banking financial services; facilitating liquidation proceedings; unifying and standardizing procedures for granting licences to companies; and developing the legal framework for financial leases.

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[26] World Bank, *Doing Business in the Arab World 2010*.

[27] Ministry of Investment in Egypt, *Egypt Receives Doing Business 2010 Award, Minister Mohieldin Honored* (26 June 2010), available at http://www.investment.gov.eg/en/Highlights/Pages/award26-6-2010.aspx.

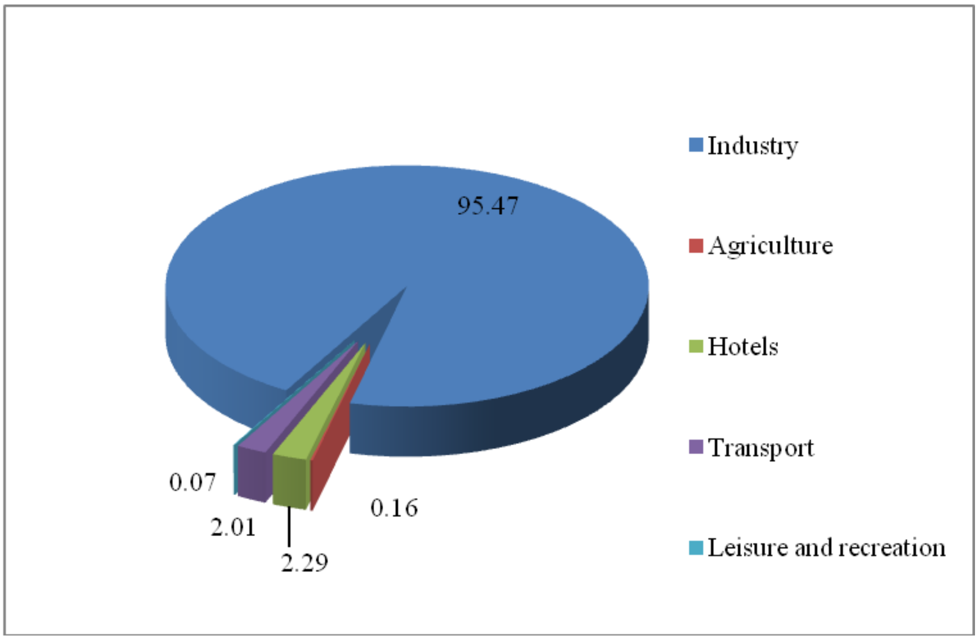
[28] Inter-Arab Investment Guarantee Corporation, 2010, *Investment Climate in the Arab Countries*.

2. *Jordan*

According to preliminary estimates released by the Department of Statistics, the economy of Jordan experienced a noticeable slowdown in 2009 owing to the global financial crisis; real GDP grew at a rate of 2.8 per cent in 2009, compared with 7.8 per cent in 2008.[29] According to IMF estimates, the economy is expected to grow by 4.1 per cent in 2010. Following the global and regional trend of decelerating FDI inflows, there was a significant drop in FDI in Jordan in 2009. The actual inflows decreased by 14 per cent, from US$2.8 billion in 2008 to US$2.4 billion in 2009.[30]

In the absence of a comprehensive survey of FDI inflows in Jordan, the data compiled by the Jordan Investment Board provide an overview of FDI which is benefiting from the Investment Promotion Law, which could be used as an approximation of the structure of total foreign investment (see figure IX). The sectoral breakdown of FDI for 2009 shows that there has been a sectoral shift in composition, with almost all foreign investment directed towards the industrial sector. By contrast, the industrial and tourism sectors shared total inflows almost equally in 2008.

Figure IX. FDI inflows to Jordan benefiting from the Investment Promotion Law by sector, 2009
(*Percentage*)



Source: Information supplied by the Jordan Investment Board, 2010.

When analysing the sources of FDI in Jordan, it is interesting to note that non-Arab investment in 2009 decreased by roughly 27 per cent, whereas investment from Arab countries grew by 29 per cent, despite the crisis and the slowdown in investment activity. Most non-Arab investment originated from the United Kingdom, at 11 per cent of total non-Arab investment, albeit decreasing considerably from the previous year from US$333 million in 2008 to US$180 million in 2009. However, investments from the United States and Israel doubled in 2009, while new investors from India, Sri Lanka and South Korea appeared.

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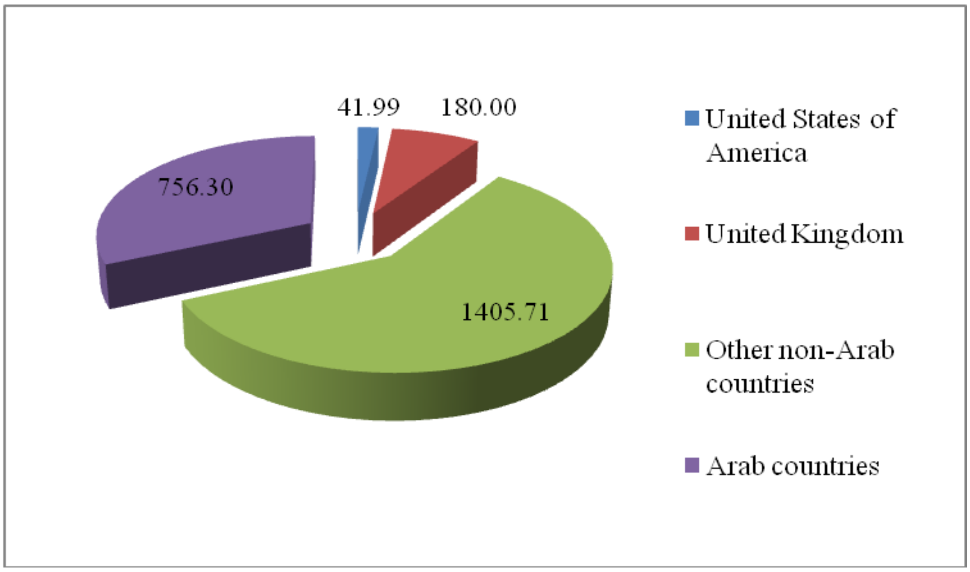
[29] Central Bank of Jordan, *Monthly Report* (May 2010).

[30] Central Bank of Jordan, *Monthly Statistical Bulletin* (2010).

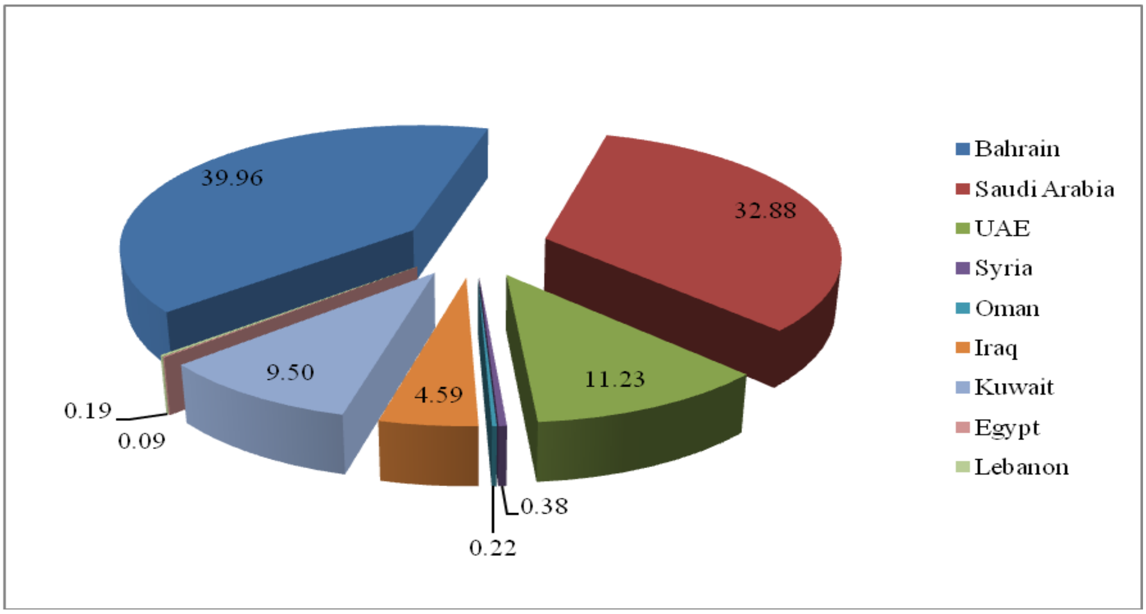
Figure X. FDI inflows to Jordan by source, 2009
(*Millions of US dollars*)



Source: ESCWA calculations, based on information supplied by the Arab Investment and Export Credit Guarantee Corporation.

Investment from Arab countries increased from US$586 million in 2008 to US$756 million in 2009, which, in relative terms, represents an increase from 21 per cent share of total FDI inflows in 2008 to 32 per cent in 2009. Most intraregional investment in 2009 came from Bahrain (40 per cent), Saudi Arabia (33 per cent), the United Arab Emirates (11.23 per cent) and Kuwait (9.5 per cent).

Figure XI. FDI inflows to Jordan from selected ESCWA member countries, 2009
(*Percentage*)



Source: ESCWA calculations, based on information supplied by the Arab Investment and Export Credit Guarantee Corporation.

In 2009, there was an increase of 29 per cent in intraregional FDI compared with 2008.[31] While FDI from the United Arab Emirates halved in 2009, increased investments from Bahrain, Saudi Arabia, the Syrian Arab Republic and Kuwait more than compensated for this decline. The highest amount of intraregional FDI in Jordan in 2009 originated from Bahrain, and amounted to US$302.20 million.

Despite the crisis and accompanying uncertainty, there have been encouraging signs of continued interest in Jordan from GCC countries. Jordan and Qatar recently agreed to create a fund valued at US$2 billion that will focus on joint public and private sector projects across a range of sectors. Equally, investors from Saudi Arabia have maintained their interest in Jordan, with an agreement by the Saudi-Jordanian Business Council in 2008 to set up a new US$500 million investment company in the first half of 2009.[32] While neither of these two funds was expected to generate much investment activity in 2009, owing to the global economic turmoil and the time-consuming process of identifying suitable investment opportunities, the continuing interest of both Saudi and Qatari investors in Jordan could contribute to reinforcing local confidence in the national economy.

The Government has been very persistent in reforming the economy and the regulatory framework in order to make the economy more receptive to foreign investment. The pillars of these efforts are as follows: (a) privatization of major State-owned companies; (b) liberalization of trade, elimination of trade barriers and creation of free trade zones; and (c) encouragement of private sector investment and partnership between domestic and foreign investors. Given that the majority of State-owned assets have already been privatized, most of the future projects are expected to be public-private partnerships rather than pure privatization deals.

Jordan has signed more free trade agreements than any other Arab country. That fact, along with investment incentives and low transportation costs for shipping to major markets, continues to attract investors to the country. FDI to Jordan concentrated on free trade zones, which are organized as either industrial or development zones. There are nine industrial estates that include foreign and foreign-domestic firms operating in different sectors. Main investment activities focus on the engineering, food, plastic and weaving industry sectors. Domestic investment laws grant specific incentives to industry, agriculture, tourism, hospitals, transportation and energy, and water distribution; and allow the Government flexibility in offering investment incentives to other sectors.

Recently, Jordan conducted six reforms in order to upgrade the business environment. It eased business start-ups by offering a single counter for company registration; extended the services of the new one-stop shop to medium-sized commercial construction services; established a commercial court division aimed at improving contract enforcement; and set up online systems for taxation purposes to enable the submission of customs declarations via the Internet, thereby reducing import and export times by three and two days respectively. Additionally, property transfer fees were reduced to 7.5 per cent from 10 per cent.[33] The need for separate approvals from the water authority, the electricity company and the Ministry of Telecommunications has been eliminated by the one-stop-shop, which has cut 20 days from the time required for dealing with construction permits.[34]

At the beginning of 2010, Jordan endorsed the Renewable Energy Law aimed at encouraging foreign investment in the hydrocarbon sector. As part of efforts to promote and facilitate FDI inflows, the Government passed the new income law (No. 28 of 2009), thereby lowering tax rates and eliminating 11 fees that had previously been applied on income.[35]

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[31] Jordan Investment Board, *Country Fact Sheet*, available at http://www.iaigc.net/UserFiles/file/en/CountryRisk/jordan.pdf.

[32] Economist Intelligence Unit, *Country Profile Jordan* (February 2009).

[33] World Bank, *Doing Business in the Arab World 2010*.

[34] Ibid.

[35] Inter-Arab Investment Guarantee Corporation, 2010, *Investment Climate in the Arab Countries*.

3. *Lebanon*

The economy of Lebanon has shown a significant degree of resilience and recorded a GDP growth of 9 per cent in 2009.[36]

Lebanon is one of the few ESCWA member countries (along with Qatar and the Sudan) to record an increase in FDI inflows in 2009. FDI inflows to Lebanon reached US$4.8 billion in 2009, representing a 10-year record high, up from 10.8 per cent in 2008. The fact that Lebanon managed to attract more FDI in 2009 is an indicator of the booming economic performance witnessed in the country during that year, which attracted investors despite the global economic slowdown. The reason behind this FDI growth lies in both improved domestic political stability and recovered regional liquidity. Lebanon also received part of the regional investment that moved from the United States and Europe during the global financial crisis. However, in 2010, FDI inflows dropped by 2 per cent to US$4.56 billion.[37] This decline can be attributed to, among other things, the political situation in the country as well as political events in several other ESCWA member countries.

No survey on FDI was undertaken in 2009 and, consequently, there are no statistics on FDI breakdown by sector and origin. Historically, the vast majority of foreign investments in Lebanon have come from Saudi Arabia, Kuwait, the United Arab Emirates and Qatar. These investments have been concentrated in retail, tourism and real estate projects.

Concerning the improvement in the regulatory and investment environment in recent years, Lebanon has made it easier to pay taxes by introducing electronic payment and eliminating the requirement for businesses to obtain permission to use accelerated depreciation. It has also eased business start-ups by not requiring company books to be stamped;[38] and by speeding up the process of starting up businesses, which currently takes 9 instead of 11 days.[39]

4. *Syrian Arab Republic*

The recent global downturn led to a reduction in economic growth in the Syrian Arab Republic to 4 per cent in 2009, compared with 5.2 per cent in 2008;[40] it is estimated to reach 5 per cent in 2010. FDI in the Syrian Arab Republic reached US$2.47 billion in 2009, representing an increase of 75 per cent compared with the previous year.[41]

According to a survey conducted by the Central Bureau of Statistics in collaboration with the Investment Commission in the Syrian Arab Republic and the United Nations Development Programme (UNDP), FDI was distributed as follows: communication sector (29.28 per cent), banking sector (19.42 per cent) and insurance sector (10.97 per cent). The survey indicated that most of the investment projects were concentrated in the governorates of Damascus (33.7 per cent), Aleppo (18.5 per cent) and the outskirts of Damascus (16.3 per cent). Additionally, the survey indicated that most of the inflows came from the region, mainly from Iraq, Jordan and Saudi Arabia.

The Government is putting considerable effort into diversifying the economy and reducing its dependence on oil by improving the investment environment and attracting investment in other sectors,

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[36] IMF, *Regional Economic Outlook, Middle East and Central Asia* (May 2010).

[37] Bank Audi, *Lebanon Economic Report* (first quarter 2011, p. 6).

[38] World Bank, *Doing Business in the Arab World 2010*.

[39] Ibid.

[40] IMF, *Regional Economic Outlook, Middle East and Central Asia* (May 2010).

[41] Central Bank of Syria, *Quarterly Statistical Bulletin* (first quarter 2010).

including agriculture, industry, communications, tourism, banking, electricity and transport. Moreover, structural reforms are underway, which, along with its improved trade relations, are expected to secure it a good position to benefit from the global recovery at the external sector level. While there are still improvements to be made in order to attract capital investment, the Government has announced that FDI is likely to become a major driver of economic growth in the future. Syrian authorities are continuing and intensifying plans aimed at attracting FDI in a number of sectors. Recently, the real estate and banking sectors were opened up for foreign investors and investment incentives were granted, including reductions in customs, exemptions to certain industrial projects from taxation on profits and removal of some trade barriers.[42]

In 2009, the Syrian Arab Republic enacted Investment Decree No. 8 that offers favourable incentives for FDI, including ownership of land and repatriation of profits; and paves the way for investors to enter several industrial zones.[43] In the same year, a new decree (No. 54), was issued to exempt those investment projects that were established in the governorates of Al Hassakeh, Deir ez-Zor and Al Raqqa from real profits income tax over ten years. Moreover, the Syrian Arab Republic continues to pursue more opportunities for free trade with other countries, including Turkey and countries in the European Union. In order to encourage further investment, the Government has created six duty free zones.

In 2010, a new law (No. 3) was issued on the work of licensed banks in the country. The law is set to help to further open the market to foreign investments and generally strengthen the investment environment. Additionally, recent efforts to encourage foreign investment include the introduction of a new commercial code, which has simplified business start-up processes by eliminating the involvement of courts and lawyers in the registration process; and reforms in the tax directorate that have further simplified tax registrations for new businesses. According to *Doing Business in the Arab World 2010*, the Syrian Arab Republic has also eased business start-ups by reducing the paid-in minimum capital requirement and by putting standard incorporation forms online.

The national development plans include huge investments in infrastructure, with the potential for foreign investment in the future, particularly the railway link between Hijaz in Damascus and Damascus International airport, the railway link from Damascus to the Syrian-Jordanian border, a new Damascus International Airport and the rehabilitation of the old port of Latakia.

C. LEAST DEVELOPED COUNTRIES

1. *The Sudan*

Sudan’s economy slowed significantly in 2009, with an estimated growth rate of 4.5 per cent, and is expected to grow at 5.5 per cent in 2010.[44] While the oil sector has been its main growth driver in recent years, agriculture accounts for more than one third of its GDP and the service sector continues to expand. FDI to the Sudan increased by 16.6 per cent, from US$2.6 billion in 2008 to US$2.9 billion in 2009. Its share in GDP increased from 4.5 per cent in 2008 to 5.5 per cent in 2009.

The sectoral distribution of FDI inflows during the period 1998-2008 indicates that the mining sector received more than 50 per cent, the service sector about 35 per cent and the manufacturing sector some 13 per cent.[45] On the other hand, the agriculture sector, where the country has a comparative advantage,

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[42] Inter-Arab Investment Guarantee Corporation, 2010, *Investment Climate in the Arab Countries*.

[43] These industrial zones include Adra in Damascus, Shiekh Najjar in Aleppo and Hissiya in Homs.

[44] IMF, *Regional Economic Outlook, Middle East and Central Asia* (May 2010).

[45] Ahmed O.H., *Factors that Impact the FDI Inflow in Sudan (1998-2008),* presented to the tenth International Conference of the Arab Planning Institute on Recent Trends in Financing Development (Beirut, 11-13 April 2011).

received only about 3 per cent. As for the countries of origin, Asian countries came first with 65 per cent, followed by Arab countries with 28 per cent and European countries with a very modest 2 per cent.[46]

According to the Ministry of International Cooperation, the main challenges to be tackled in order to attract more investment in the Sudan, apart from the political situation, remain land allocation, cumbersome administrative procedures and the failure to implement investment decisions.[47] According to the Sudanese Constitution, while the land is owned by the States that constitute the Sudan, the decision to allocate it is taken by the federal authorities, which creates a set of complications that operate to delay investments. The administrative procedures remain complex and investors still need to deal with numerous Government actors.

The Government has been taking action to deal with these challenges by establishing the Federal Ministry of Investment, which strives to promote domestic and foreign investment; and by simplifying administrative procedures through the one-stop shop at the same Ministry. According to *Doing Business 2011*, the Sudan has managed to shorten the time period required to register businesses (from 39 to 36 days), as well as the costs incurred during that process. Recently, it established the Higher Investment Council, which is intended to resolve coordination between the federal institutions and State officials on issues of land and concessions granted to investors.

The short-term outlook will depend to a large extent on the impact of the cessation of the South of the country after the referendum held in January 2011. Many analysts expect a drop in FDI, given that more than 50 per cent of current inflows are in the oil sector and that most oil reserves are located in the South. However, the country enjoys a rich agricultural sector, which could attract a higher share of FDI than the current 3 per cent. Additionally, infrastructure and telecommunications can play a major factor in attracting higher shares of FDI inflows. Consequently, the long-term outlook for the country remains positive, as it has the potential to attract higher FDI inflows. However, the country needs to do more to improve the business environment and create investment-friendly policies, and also needs to make additional efforts to achieve macroeconomic stability and combat corruption.

2. *Yemen*

The overall economic performance of the economy of Yemen worsened in 2009, thereby reflecting deteriorating security conditions and the fall in oil revenues, remittances and tourism.[48] Economic prospects for 2010 remain weak, even though overall growth is forecast at 7.8 per cent, stemming largely from the expected revenues from a major new liquefied natural gas plant.[49]

Foreign direct investment in Yemen witnessed a massive plunge in 2009, falling from US$1.55 billion in 2008 to US$129 million in 2009. This decrease of 91 per cent is one of the largest in the ESCWA region in 2009 and therefore contributes to Yemen's ranking as one of the countries in the region receiving the least FDI in 2009. While many factors caused the poor FDI performance in 2009, the deteriorating security situation in the country, and the global and regional financial crisis were key contributors. The prevailing political conditions in the country make it difficult for any rebound in FDI inflows. This will complicate further national efforts to boost economic growth to reduce the current high unemployment and poverty levels, particularly given that Yemen depends to a high degree on external sources for development finance.

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[46] Ibid.

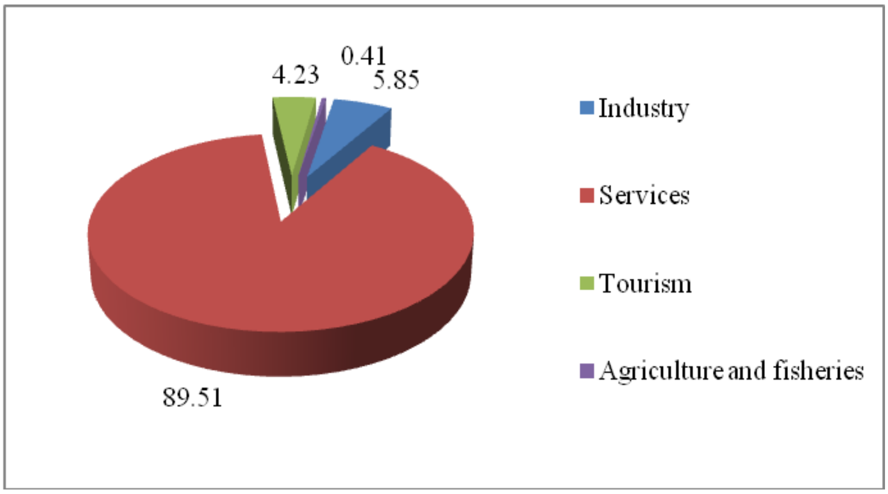
[47] This includes concessional approval and licensing, exemptions from taxes and custom duties, and other duties.

[48] Oil revenues, which account for more than 70 per cent of national revenues, almost halved in 2009. See also World Bank, *Yemen Economic Update* (Spring 2010).

[49] IMF, Regional Economic Outlook (April 2010).

Besides the general slowdown in the level of FDI inflows, there has also been a shift in the sectors receiving those investments. According to the Arab Investment and Export Credit Guarantee Corporation, the majority of foreign investments in 2009 went to the service sector, whereas the rest (around 10 per cent) targeted industry, tourism, agriculture and fisheries. The industry sector received 63 per cent of total FDI in 2008, compared with a paltry 6 per cent in 2009.

Figure XII. FDI inflows to Yemen by sector, 2009
(*Percentage*)



Source: ESCWA calculations, based on information supplied by the Arab Investment and Export Credit Guarantee Corporation.

According to the Arab Investment and Export Credit Guarantee Corporation, the only investors in Yemen in 2009 were from the Arab region. That is not surprising, given that in previous years, Arab investors accounted for about 95 per cent of FDI inflows to the country. The major Arab investors in Yemen in 2009 were Qatar, Iraq, the Libyan Arab Jamahiriya and Saudi Arabia. Compared with the previous year, it is noticeable that the investments originating from Saudi Arabia, Oman and Lebanon suffered a major decline, whereas the investments from Qatar alone accounted for 81 per cent of all FDI in 2009.

Yemen continued to ease business start-ups after officially being the world's fastest reformer in starting up a business in 2007-2008. It enhanced access to credit information by removing the minimum threshold for loans included in the database and guaranteeing the right of borrowers to view their credit reports. Additionally, it expedited trade through a new electronic document submission system and implemented a risk-based inspection system.[50] In late 2009, Yemen introduced a series of urgent reform measures under the so-called "Top 10 priority plan". This plan encompasses measures that directly affect the investment environment, including a fast-track initiative for oil exploration, strengthening of Government authority and the rule of law, and urgent solutions to water and land problems.

In an effort to encourage more investment and promote private sector growth, a draft investment law was reviewed by Parliament in July 2010. It includes more incentives and privileges for investors, as well as customs exemptions. It will be introduced in conjunction with an income tax law designed to lower the corporate income tax rate from 35 per cent to 25 per cent (and to 15 per cent for investments that create significant new job opportunities). Furthermore, the law includes reforms for the investment regulatory body and the establishment of a new independent authority for investment, Yemen Invest. This new authority will initially target foreign investors and will be supervised by the Prime Minister. The main challenges Yemen will need to tackle in the future are related to paying taxes, financing, trading across borders and the legal protection of investors' rights.[51]

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[50] World Bank, *Doing Business in the Arab World 2010*.

[51] Ibid.

III. THE IMPACT OF FDI INFLOWS ON WELFARE IN ARAB COUNTRIES

A. INTRODUCTION

Based on a widespread belief among policymakers that FDI inflows positively impact economic growth, many developing and emerging countries have engaged in FDI-oriented development strategies by reducing restrictions to inward investment, and offering tax incentives and subsidies to attract those flows. However, while developing countries receive an increasing share of global FDI flows, with their share having effectively doubled over the past decade, the majority of such investments are directed towards natural-resource extraction.[52] Consequently, they have not succeeded in promoting broad-based and sustained economic growth.

The empirical and theoretical literature about the impact of FDI on economic growth is not unanimous, even though it is predominantly established, empirically, that FDI inflows do encourage more rapid growth.[53] Foreign direct investments are more than capital flows. They are considered as a package of long-term capital, productive capacity, technology and management skills, with significant room for contribution to growth and development.[54] On the macroeconomic front, FDI is thought to alleviate the problem of local capital scarcity.[55] Foreign investments are further recognized as an important source of the capital investments necessary for poverty reduction and alleviation.[56] FDIs are indeed considered an engine for economic growth and development, helping to protect the poor from the impact of volatility in international financial markets, reducing vulnerability to sudden stops in flows, as FDI flows are found to be less volatile and more persistent than other types of flows.[57]

The impact of FDI on economic growth and development is, however, argued to be heterogeneous and conditional on the type of FDI; the mode of entry of FDI;[58] the sectoral composition of FDI;[59] and the absorptive capacity of the host country.[60] Furthermore, the heterogeneity of host country factors is considered to be the principal source of the mixed results in empirical research. Blomström, Lipsey and Zejan showed that in order for a country to benefit from FDI spillover effects, a threshold of development had to be attained.[61] Alfaro et al. found a significant role for financial development;[62] while Li and Liu found

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[52] United Nations Conference on Trade and Development (UNCTAD), 2011, *Foreign Direct Investment in Least Developed Countries: Lessons Learned from the Decade 2001-2010 and the Way Forward*.

[53] In a seminal paper, Carkovic and Levine found that FDI does not have a positive impact on output growth that is independent of other growth determinants. Carkovic and Levine, 2002, *Does Foreign Investment Accelerate Economic Growth?* University of Minnesota working paper.

[54] Aaron C., 1999, *The Contribution of FDI to Poverty Alleviation* (Foreign Investment Advisory Service).

[55] DeMello L.R., 1999, Foreign Direct Investment-Led Growth: Evidence from Time Series and Panel Data, *Oxford Economic Papers*. 51(1): 133-151.

[56] Gohou, D. and Soumaré I., Does Foreign Direct Investment Reduce Poverty in Africa and Are There Regional Differences? *World Development*, Working Paper (8 July 2010).

[57] Sarno L. and Taylor M.P., 1999, Hot Money, Accounting Labels and the Permanence of Capital Flows to Developing Countries: An Empirical Investigation, *Journal of Development Economics*. 59(2): 337-364; and Wei S., 2001, Domestic Crony Capitalism and International Fickle Capital: Is There a Connection? *International Finance*. 4(1): 15-45.

[58] Greenfield, as opposed to mergers and acquisitions.

[59] UNCTAD, 2001, *World Investment Report: Promoting Linkages*; and UNCTAD, 2005, *Economic Development in Africa: Rethinking the Role of Foreign Direct Investment*.

[60] Colen L., Maertens M. and Swinnen J., 2009, Foreign Direct Investment as an Engine for Economic Growth and Human Development: A Review of the Arguments and Empirical Evidence, *Human Rights and International Legal Discourse*. 3(2): 177-227.

[61] Blomström M., Lipsey R.E. and Zejan M., 1994, *What Explains Developing Country Growth?*, NBER Working Paper No. 4132.

[62] Alfaro L., et al., 2004, FDI and Economic Growth: The Role of Local Financial Markets, *Journal of International Economics*. 64(1): 89-112.

a positive role for human capital formation and a negative role for the technological gap.[63] In addition to financial market development, financial stability is also argued to increase the ability of the host county to attract FDI and absorb its associated benefits. Moreover, Dutta and Roy confirmed the importance of advanced financial markets in order to enjoy the benefits of FDI and found further support for the importance of political stability.[64] Alguacil, Cuadros and Orts argued for the importance of improving the political and macroeconomic framework in order for a host economy to exploit FDI efficiently.[65]

However, while the literature is rich in empirical research on the effects of FDI on economic growth, few studies examine the relationship between FDI and human development.[66] In effect, beyond the direct impact of FDI on economic growth and employment creation, wage increases and positive tax revenues, FDI can have beneficial effects on the whole spectrum of human development issues, including human capital upgrading, gender equality and improved health, and can encourage a "race to the top" in human rights, labour and environmental standards.[67] FDI positively contributes to human capital formation through both skills supply and demand.[68] Moreover, on the sectoral front, FDI investments in the non-traded sector, especially in the provision of infrastructure services (such as water supply and sewage services, telecommunications and transport sectors) can significantly contribute to poverty reduction and alleviation.[69] In this respect, public policies to promote and direct FDI significantly determine the poverty-reducing impact of FDI. Alfaro and Charlton militated in favour of sectoral targeting in order to attract "quality" FDI.[70] More recently, Reiter and Steensma found a more beneficial impact of FDI inflows on human development when public policy discriminates against foreign investors relative to domestic investors, and restricts foreign investors from entering country-specific economic sectors.[71]

Turning to the Arab region, several studies have been conducted to explore the impact of FDI on economic growth. Looking at the period 1975-1990 in selected countries across the region, Bashir found a positive, albeit statistically insignificant, impact of FDI on growth using fixed and dynamic panel methods.[72] This impact was found to be dependent on openness to trade. Furthermore, a positive statistical impact of government spending on growth points to the complementarity of domestic investment and FDI as sources of growth. Sadik and Bolbol investigated the impact of FDI on growth and total factor productivity

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[63] Li, X. and Liu, X., 2005, Foreign Direct Investment and Economic Growth: An Increasingly Endogenous Relationship, *World Development*. 33: 393-407.

[64] Dutta, N. and Roy, S., 2011, Foreign Direct Investment, Financial Development and Political Risks, *The Journal of Developing Areas*. 44(2): 303-327.

[65] Alguacil, M., Cuadros, A. and Orts, V., 2011, Inward FDI and Growth: The Role of Macroeconomic and Institutional Environment, *Journal of Policy Modeling*. 33: 481-496.

[66] The few exceptions include the work of Sharma and Gani (2004) who explored the impact of FDI on human development for low and middle-income countries for the period 1975-1999, and found positive impact for both groups of countries. See Sharma and Gani, 2004. The Effects of Foreign Direct Investment on Human Development, in *Global Economy Journal* 4(2): 9. More recently, Gohou and Soumaré investigated the relationship between FDI and welfare in Africa. Their results showed a more pronounced impact of FDI on poverty reduction for poorer countries. See Gohou and Soumaré, Does Foreign Direct Investment Reduce Poverty in Africa and Are There Regional Differences?, *World Development*, Working Paper (8 July 2010).

[67] Colen, Maertens and Swinnen, op. cit.

[68] Slaughter, M., 2002, *Skill Upgrading in Developing Countries: Has Inward Foreign Direct Investment Played a Role?*, OECD Working Paper No. 192; and Te Velde, D.W. and Morrissey, O., 2001, *Foreign Ownership and Wages: Evidence from Five African Countries*, CREDIT Discussion Paper.

[69] Aaron, C., 1999, *The Contribution of FDI to Poverty Alleviation* (Foreign Investment Advisory Service).

[70] Alfaro, L. and Charlton, A., 2007, *Growth and the Quality of Foreign Direct Investment: Is All FDI Equal?*, (Harvard Business School and NBER Working Paper).

[71] Reiter, S.L. and Steensma, H.K., 2010, Human Development and Foreign Direct Investment in Developing Countries: The Influence of FDI Policy and Corruption, *World Development*. 38(12): 1678-1691.

[72] Bashir, A.M., 1999, *Foreign Direct Investment and Economic Growth in Some MENA Countries: Theory and Evidence* (Department of Economics, Grambling State University).

on a sample of six Arab countries, namely Egypt, Jordan, Morocco, Oman, Saudi Arabia and Tunisia.[73] Their study, covering the period 1978-1998, found that FDI positively impacted growth through the capital accumulation channel, even though the relationship was significant only for Egypt, Jordan and Tunisia. More surprisingly, however, with the exception of Oman, the impact of FDI on total factor productivity appeared to be negative. The authors recommended the improvement of the investment environment in order to increase the social productivity of capital expenditures.

On a more comparative basis, Darrat, Kherfi and Soliman analysed the impact of FDI on growth in Central and Eastern Europe (CEE) and in the countries of the Middle East and North Africa (MENA).[74] Their results did not show any such significant impact in the case of the MENA and non-EU accession countries.[75] However, candidacy for European Union membership was found to be a determinant of the positive impact of FDI on growth through stricter performance requirements, and the broader, more effective reforms facing accession countries.

More recently, Jallab et al. explored the impact of macroeconomic instability on the growth-FDI nexus on a sample of MENA countries for the period 1970-2005.[76] The growth-effect of FDI was not found to be dependent on openness to trade or the level of development (as proxied by lagged income per capita). However, a threshold level of consumer inflation (a proxy for macroeconomic stability) was identified, conditioning the positive impact of FDI on economic growth. Moreover, Hasen and Giorgioni studied the impact of FDI on growth in four countries in the Arab Maghreb Union, namely Algeria, the Libyan Arab Jamahirriya, Morocco and Tunisia during the period 1990-2006.[77] Their results showed that the effect of FDI on growth depended on the technological and education level of the recipient country, the degree of openness of the trade regime and a stable macroeconomic environment. Furthermore, Masoud examined the impact of a reduction of FDI flows on the growth prospects of the economy of Egypt.[78] Covering the period 1991-2007, the author differentiated between greenfield FDI and M and As; using a set of controls, the results confirmed the positive and significant impact of greenfield FDI on growth, while M and As had an insignificant effect on growth. The size of the technological gap appears to have a negative impact on growth, while the level of human development has a positive impact.

This chapter examines the impact of FDI inflows on the economic welfare of the Arab region at the global and subregional levels. This represents arguably the first attempt to explore the FDI-economic development nexus at a subregional level in the Arab region. In this first attempt, real GDP per capita will be used as a proxy for income poverty in Arab countries, leaving future researchers to explore the FDI-human development nexus through alternative modelling specifications. Indeed, a conventional assumption in most previous studies on the FDI-growth development nexus is that economic growth automatically translates into human development.[79] The above literature review has briefly highlighted how questionable this assumption is. While the findings presented in this report confirm the positive impact of FDI inflows on income poverty

[73] Sadik, A.T. and Bolbol, A.A., 2001, Capital Flows, FDI and Technology Spillovers: Evidence from Arab Countries, *World Development*. 29(12): 2111-2125.

[74] Darrat, A. Kherfi, S. and Soliman, M., 2005, *FDI and Economic Growth in CEE and MENA Countries: A Tale of Two Regions*.

[75] Covering the period 1979-2002, their study encompassed six countries in the MENA region, namely Algeria, Egypt, Israel, Morocco, Tunisia and Turkey; and 17 countries in the CEE region.

[76] Jallab et al. covered Algeria, Egypt, Iran, Israel, Jordan, Kuwait, Lebanon, Morocco, Oman, Syrian Arab Republic and Tunisia. They used the generalized method of moments, which was developed by Arellano, M., and Bond, S., 1991, and Blundell, R. and Bond, S. 1998, as well as the two stage least squares estimation procedure. See Jallab, S.M. Gbakou, M. and Sandretto, R., 2008, *Foreign Direct Investment, Macroeconomic Instability and Economic Growth in MENA Countries*.

[77] Hasen, B. and Giorgioni, G., Impacts of Foreign Direct Investment on Economic Growth: A Panel Data Study for the AMU Countries (unpublished).

[78] Massoud, N., 2010, Impact of a Crisis-Induced FDI Drop on Growth in Egypt.

[79] Anand, S. and Sen, A., 2000, Human Development and Economic Sustainability, *World Development*. 28(12): 2029-2049.

in the Arab region, the elasticity of welfare to FDI inflows is found to differ across alternative subregional groupings. The following section introduces the econometric methodology and presents empirical results.

B. THE MODEL AND THE RESULTS

This section describes the econometric models used to assess the impact of FDI flows on welfare in the Arab region. The modelling methodology set forth below closely follows a recent work by Gohou and Soumaré, which examined the impact of FDI on welfare and poverty reduction in Africa.[80] Specifically, the following three research questions are addressed:

(a) Does FDI have a positive impact on growth in Arab countries?

(b) Is there a different impact of FDI on growth for oil and non-oil producers?

(c) Is there a different impact of FDI on growth for GCC countries, MDEs and the Maghreb countries?[81]

In order to explore the impact of FDI on welfare, the following general framework is considered:

$$Welfare_{ct} = \alpha_c + \beta * FDIVariable_{ct} + \gamma * Conditiong\_Set + \varepsilon_{ct} \quad (1)$$

Where c denotes individual countries and t represents the time subscript.

Within this general theoretical specification, several fits are considered. The welfare variable considered in this analysis is real GDP per capita (measured in logarithms). FDI is measured by FDI inflows as defined by UNCTAD;[82] and three FDI variables are used, namely: (a): the ratio of FDI inflows over total population (per capita FDI, *FDICAPITA*); (b) the ratio of FDI inflows over GDP (*FDIGDP*); and (c) the ratio of FDI inflows over gross fixed capital formation (*FDIGFCF*).[83]

The relationship between FDI and economic growth is conditional on a set of control and policy variables as indicated by the literature review above. The model classifies control variables into three groups, as follows:[84]

(a) The first set of variables, namely the economic and policy variables, include the government spending ratio (*GOVSPEND*), measured as government total consumption as a share of GDP, which captures government size and inflation (*INFLATION)* used as a proxy for macroeconomic stability and measured as the percentage change in the consumer price index. The infrastructure of the recipient country is further

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[80] Gohou, D. and Soumaré I., 2010, Does Foreign Direct Investment Reduce Poverty in Africa and Are There Regional Differences?, *World Development* Working Paper.

[81] These three groupings (the GCC countries, the MDEs and the Maghreb) were chosen in order to compare the Maghreb countries with ESCWA member countries in the conventional classification used at ESCWA. However, the Maghreb economies can be considered as more diversified.

[82] The components of FDI as defined by UNCTAD are equity capital, reinvested earnings and other capital (mainly intra-company loans).

[83] These are the most commonly used variables in the literature exploring the FDI-growth-development nexus. Alternative specifications are further meant to ensure the robustness of the main empirical findings. Given the developmental approach here, the choice of FDI per capita as a main regressor will subsequently be preferred in most models.

[84] The FDI variables are extracted from the UNCTAD statistical database; the institutional quality variables (*CORRUPTION* and *RULE OF LAW*) are extracted from the aggregate governance indicators developed by Kaufmann, Kraay and Mastruzzi (2010); the political risk variables are extracted from Freedom House; the *HDI* data are extracted from the Human Development Reports of the United Nations Development Programme (UNDP); the other variables are extracted from the *World Development Indicators* of the World Bank.

considered by including three alternative indicators, namely the number of fixed and mobile phones per 100 habitants (measured in log terms *LGPHONE*), the kilometres of roads paved per 100 habitants (*ROAD*), and the number of Internet users per 100 habitants (*INTERNET USERS*)).[85] In addition, the degree of openness (*OPENNESS*), measured as total imports plus exports over GDP, is used as a proxy for the trade regime, and education (*EDUCATION*), a measure of human capital is measured as the secondary gross enrolment ratio (*GER*);

(b) The second set of variables relates to the business environment and institutional quality of the host economy. These include financial market development, measured by credit by financial intermediaries to the private sector over GDP (*CREDIT*), and stock market capitalization over GDP (*MKTCAP*). Also included are the control of corruption index (*CORRUPTION*) and the rule of law index (*RULE OF LAW*), which measure the degree of investor protection;[86]

(c) The third set of variables, namely the political risk variables, include the political rights rating (*POLITICAL RIGHTS*) and the civil liberties rating (*CIVIL LIBERTY*), which measure freedom for political activism, and latitude for the exercise of civil freedoms respectively.

Covering the period 1990-2009, the sample comprises 18 Arab countries that are categorized into the following three groups: (a) the GCC countries, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; (b) the MDEs, which for this purpose includes LDCs, namely Egypt, Iraq, Jordan, Lebanon, Palestine, the Syrian Arab Republic, the Sudan and Yemen; and (c) the Maghreb countries, namely Algeria, the Libyan Arab Jamahirriya, Morocco and Tunisia.[87]

Table 4 shows the evolution of the main indicators for the Arab region during the period 1990-2009, using 5-year averages. Descriptives highlight the increase in FDI inflows, both in absolute and relative terms, especially during the 2005-2009 period, when FDI respectively reached an average of approximately 5.5 per cent of GDP and 25.6 per cent of GFCF. In addition, the data show an increase in welfare, both as measured by real GDP per capita and by the Human Development Index,[88] along with successful macroeconomic stabilization (as evidenced by the decrease in CPI inflation). Further, an increase in financial market development was observed, as evidenced by the important increase in market capitalization to GDP, reaching approximately 94 per cent of GDP on average in 2005-2009. In addition, a more moderate increase in financial intermediation was observed. Moreover, the region witnessed more widespread infrastructure availability and a better institutional environment.

[85] The importance of the infrastructure of recipient countries is highlighted by the recent recommendation by UNCTAD for the establishment of an LDC Infrastructure Development Fund for infrastructure upgrading in the LDCs through public-private partnerships targeting electricity supply, roads, railways, and computer and Internet connections. The proposal for the creation of an "aid-for-productive-capacities fund" further highlights the importance of human capital upgrading. See UNCTAD, 2011, *World Investment Report*.

[86] These were compiled by Kaufmann, Kraay and Mastruzzi, 2010, *in Worldwide Governance Indicators: Methodology and Analytical Issues*.

[87] According to UNCTAD *World Investment Report*, 2011, FDI inflows in the four selected Maghreb countries decreased from US$9.1 billion in 2009 to US$8.9 billion in 2010. For 2011, the "Arab Spring" dampened investor confidence. For instance, the Report mentions that there was no record of cross-border mergers and acquisitions in North Africa for the first five months of 2011.

[88] The Human Development Index has been included in the descriptive part of this work as a broader proxy of welfare. Considering this Index as the alternative measure of welfare in the econometric modelling exercise is a work in progress. In effect, it captures more thoroughly the multidimensional aspect of human development.

TABLE 4. EVOLUTION OF THE MAIN INDICATORS, 1990-2009

Year	FDI	FDICapita	FDIGDP	FDIGFCF	Real GDP per capita
1990-1994	175.32	49.75	1.34	6.89	5664.49
1995-1999	267.63	118.46	1.74	9.87	6490.59
2000-2004	706.23	173.16	2.41	12.65	6846.90
2005-2009	4143.15	717.69	5.42	25.58	8099.83
Total	1339.25	267.79	2.77	13.49	6807.19

Year	Real per capita GDP growth	Inflation	Govspend	Openess	MKTCAP
1990-1994	1.74	17.85	21.16119	83.08	25.55
1995-1999	3.23	9.21	19.0338	79.37	38.17
2000-2004	1.41	3.65	18.08913	82.47	49.91
2005-2009	2.98	6.99	16.71479	94.72	93.56
Total	2.37	8.76	18.7801	84.76	54.85

Year	Credit	Road	Internet users	Phone	Education
1990-1994	30.89	2482.82	0.00	11.04	59.95
1995-1999	35.53	2438.80	1.05	15.09	65.31
2000-2004	36.89	2453.23	6.81	33.42	72.33
2005-2009	41.17	2259.15	19.43	86.66	78.91
Total	36.21	2416.95	8.90	39.24	69.57

Year	HDI	Political rights	Civil liberty	Corruption	Rule of law
1990-1994	0.53	6.03	5.48	.	.
1995-1999	0.59	6.11	5.88	-0.33	-0.31
2000-2004	0.63	6.01	5.69	-0.14	-0.21
2005-2009	0.65	5.87	5.26	-0.25	-0.24
Total	0.61	6.00	5.58	-0.24	-0.25

Source: ESCWA calculations.

Table 5 presents the pair-wise correlations between the main indicators. There is a significant correlation between the FDI variables, with a strong positive correlation between FDI as a share of GDP and FDI as a share of gross fixed capital formation. FDI per capita appears to have a moderate significant positive correlation with real GDP per capita and with HDI. Inflation appears to have a negative significant relationship with welfare. Moreover, infrastructure variables, particularly the *PHONE* variable appears to have a positive relationship with FDI, real GDP per capita, financial development variables and institutional quality variables. Furthermore, there are significant positive correlations between the secondary enrolment ratio and real GDP per capita, the FDI variables and the financial development indicators. Finally, the political risks variables (*POLITICAL RIGHTS* and *CIVIL LIBERTY*) are highly positively correlated, while being significantly negatively correlated with most other indicators, as had been expected.[89]

Turning to the first research question, namely whether FDI inflows impact welfare in the Arab region, panel regressions were run following equation (1) and using the logarithm real GDP per capita (in constant 2000 United States dollars) as the dependent variable (see table 6).[90] Models (1) to (3) use FDI per capita, FDI to GDP and FDI to GFCF as explanatory variables without controls. The FDI coefficients are significant at the 1 per cent level for the three models, thereby indicating a positive impact of FDI on welfare. Model (4) uses lagged FDI as a regressor and the associated coefficient remains positive and significant at the

[89] This is consistent with the scale associating higher values with higher political instability.

[90] Unobserved country-specific effects have been controlled by using a fixed-effects panel methodology. The Hausman test was applied to discriminate between fixed and dynamic effects panel models.

1 per cent level. Model (5) tests for a non-linear relationship between FDI per capita and welfare, and confirms a non-linear relationship, as evidenced by the significant coefficient of the squared FDI per capita regressor at the 5 per cent level.[91]

Models (6) to (8) introduce selected control variables as described above. The impact of FDI per capita remains highly statistically significant and nearly all the variables show the expected signs. Infrastructure, as proxied by the number of phone lines and mobile phones per 100 habitants, has a positive and significant impact, as does openness to trade. Macroeconomic stability has a positive impact, along with a better institutional environment, higher financial intermediation, higher human capital and lower political risks.[92] Government spending appears with a negative sign, however, signalling the associated negative recessionary impact of the tax increases rendered necessary for fiscal sustainability. It is important to note that the increase in the explanatory power of the model is supportive of the relevance of the inclusion of the control variables.

Model (7) examines the robustness of these findings by running panel regressions on 5-year averages over the period 1990-2009 in order to purge the data from business-cycle effects.[93] The results are again supportive of the main conclusions of model (6). Model (8) further uses a two-stage, least-squares approach to account for the possible endogeneity of the FDI variable, using two lags of the FDI per capita variable as an instrument. The statistical significance of some of the explanatory variables is increased, especially regarding the positive impact of the business and institutional environment (the *RULE OF LAW* variable is significant at the 1 per cent level), human capital (the *EDUCATION* variable appears to be significant at the 1 per cent level), and the development of financial intermediation.

Overall, the findings support the positive significant impact of FDI per capita on welfare in the Arab region. More specifically, if everything else is held constant, an increase of US$1.00 in per capita FDI leads to a real per capita GDP growth of approximately 0.5 basis points.

In terms of potential subregional differences, the two following issues are examined: whether there is a different impact of FDI on welfare in the GCC countries, the MDEs and the Maghreb countries; and whether there is a different impact of FDI on growth in oil and non-oil producers.

Table 7 shows considerable subregional differences. Specifically, GCC countries record the highest FDI inflows in absolute terms. The gap becomes even larger when FDI inflows are considered in per capita terms, whereby GCC countries received an average of US$635, compared to less than US$87 for the MDEs and the Maghreb countries. When considering FDI inflows as a share of GDP or GFCF, however, the GCC countries are found to lag behind MDEs, given the size of their economies and the successive development plans entailing high levels of public investment. The GCC countries have the highest openness to trade, more developed financial markets, highest infrastructure indicators, the best institutional environment and the lowest level of political risks.

[91] The negative significant sign of the FDI squared coefficient suggests that the first dollars of FDI inflows have a more beneficial impact on welfare.

[92] The alternative inclusion of the *ROAD* variable as a proxy for infrastructure development, and the *CIVIL LIBERTY* variable as a proxy for political risks essentially leads to the same findings.

[93] Data has been averaged over non-overlapping five year periods. There are four observations per country for the periods 1990-1994, 1995-1999, 2000-2004 and 2005-2009.

TABLE 5. CORRELATION MATRIX FOR ARAB COUNTRIES, 1990-2009

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1	FDI	1.00																				
2	FDI per capita	0.45	1.00																			
		0.00																				
3	FDI to GDP	0.36	0.53	1.00																		
		0.00	0.00																			
4	FDI to GFCF	0.29	0.46	0.94	1.00																	
		0.00	0.00	0.00																		
5	Real GDP per capita	0.15	0.55			1.00																
		0.01	0.00																			
6	Real GDP per capita growth						1.00															
7	Real GDP growth		0.24			0.22	0.81	1.00														
			0.00			0.00	0.00															
8	Consumer inflation			-0.11		-0.22			1.00													
				0.07		0.00																
9	Government consumption to GDP					0.29			-0.31	1.00												
						0.00			0.00													
10	Roads paved		0.24			0.32			-0.30	0.20	1.00											
			0.00			0.00			0.00	0.01												
11	Internet users	0.43	0.51	0.28	0.23	0.49		0.17				1.00										
		0.00	0.00	0.00	0.00	0.00		0.01														
12	Phone users	0.53	0.65	0.30	0.23	0.54		0.20	-0.14		0.32	0.91	1.00									
		0.00	0.00	0.00	0.00	0.00		0.00	0.02		0.00	0.00										
13	Trade to GDP	0.11	0.35	0.27	0.24	0.45		0.16	-0.34	0.27	0.14	0.46	0.45	1.00								
		0.05	0.00	0.00	0.00	0.00		0.01	0.00	0.00	0.07	0.00	0.00									
14	Gross enrolment ratio (Secondary level)	0.20	0.34	0.24	0.24	0.55		0.12	-0.13	0.14	0.43	0.36	0.46	0.35	1.00							
		0.00	0.00	0.00	0.00	0.00		0.06	0.08	0.05	0.00	0.00	0.00	0.00								
15	HDI	0.23	0.48			0.73		0.19	-0.44	0.32	0.73	0.55	0.69	0.67	0.47	1.00						
		0.00	0.00			0.00		0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00							
16	Market capitalisation to GDP	0.23	0.36	0.38	0.36	0.34	0.19	0.29				0.36	0.49	0.50	0.34	0.43	1.00					
		0.00	0.00	0.00	0.00	0.00	0.01	0.00				0.00	0.00	0.00	0.00	0.00						
17	Domestic credit to GDP	0.16	0.24	0.34	0.25	0.27			-0.34	0.14		0.47	0.39	0.46	0.26	0.50	0.24	1.00				
		0.00	0.00	0.00	0.00	0.00			0.00	0.01		0.00	0.00	0.00	0.00	0.00	0.00					
18	Control of corruption	0.16	0.47			0.73		0.18	-0.26	0.28	0.32	0.50	0.56	0.57	0.26	0.76	0.30	0.59	1.00			
		0.03	0.00			0.00		0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00				
19	Rule of law	0.16	0.39	0.15		0.65		0.13	-0.37	0.30	0.40	0.48	0.52	0.61	0.19	0.81	0.33	0.67	0.90	1.00		
		0.02	0.00	0.03		0.00		0.07	0.00	0.00	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.00	0.00			
20	Political rights	0.09							0.13		0.25	-0.20		-0.27	0.18		-0.19	-0.42	-0.42	-0.39	1.00	
		0.09							0.02		0.00	0.00		0.00	0.01		0.01	0.00	0.00	0.00		
21	Civil liberty		-0.11	-0.22	-0.12	-0.10			0.19		0.23	-0.32	-0.15	-0.36		-0.17		-0.59	-0.43	-0.44	0.77	1.00
			0.05	0.00	0.04	0.06			0.00		0.00	0.00	0.01	0.00		0.03		0.00	0.00	0.00	0.00	

Source: *ESCWA calculations.*

Notes: *Pairwise Pearson correlation coefficients (calculated using country-year data) with a minimum significance of 10 per cent are reported. P-values in italics.*

TABLE 6. REGRESSION RESULTS OF THE IMPACT OF NET FDI INFLOWS ON ECONOMIC GROWTH IN THE MENA REGION WITH CONTROLS, 1990-2009

	1	2	3	4	5	6	7 (5-year averages)	8 (2SLS)
INTERCEPT	8.058768***	8.048425***	8.077069***	8.078427***	8.048754***	7.831848***	7.584609**	7.535864***
	(0.0080292)	(0.0111005)	(0.0134764)	(0.0080419)	(.0085408)	(0.0912282)	(0.2146062)	(0.1736816)
FDICAPITA	0.0000935***				.0001729***	.000023***	0.0000346**	0.0000637***
	(0.000012)				(.0000317)	(7.21e-06)	(0.0000126)	(0.0000204)
Lag(FDICAPITA)				0.0001048***				
				(0.0000117)				
FDICAPITA Square					-2.05e-08**			
					(8.47e-09)			
FDIGDP		1.475808***						
		(0.3612678)						
FDIGFCF			1747489***					
			(0.0914831)					
GOVSPEND						-.0045731**	-0.0019202	
						(0.0023127)	(0.0047005)	
INFLATION						-.000137	-0.0002678	-0.001172*
						(0.0003008)	(0.0012721)	(0.0006801)
LGPHONE						0.10349***	0.0789598***	
						(0.006981)	(0.0161657)	
RULE OF LAW						0.0508416	-0.006866	0.1565355***
						(0.0323877)	(0.0620096)	(0.0557353)
POLITICAL RIGHTS						-0.0046518	-0.016923	-0.0141245
						(0.0109865)	(0.0322805)	(0.0239759)
EDUCATION						0.0004381	0.0010922	0.0054428***
						(0.0012115)	(0.0022866)	(0.0020223)
OPENESS						.0011887*	0.0042432***	0.0029076**
						(0.000613)	(0.0013507)	(0.001178)
CREDIT						0.0011527	0.0001228	0.0036567**
						(0.001114)	(0.0014896)	(0.001565)
Number of Obs.	336	335	300	336	336	111	41	110
F-Stat/Wald Chisquare	60.39**	16.69***	3.65*	79.95***	30.84***	84.76***	43.56***	1.15e06***
Adjusted R-square	0.1915	0.0064	0.0018	0.1943	0.2305	0.6608	0.6028	0.742

TABLE 6 (*continued*)

	9	10	11	12	13	14	15
INTERCEPT	0.8.049323***	7.558006***	8.038269***	8.036046***	8.05387***	7.80848***	7.699422
	(0.008071)	(0.1531778)	(0.0818925)	(0.009801)	(0.0102361)	(0.0282761)	(0.1445553)
INFLATION		-0.0010586*				-0.0000929	-0.0011823
		(0.0006018)				(0.0003933)	(0.0005413)
LGPHONE						0.0856547***	
						(0.0073855)	
RULE OF LAW		0.1466245***				0.0539842*	0.1163011
		(0.0501041)				(0.0313926)	(0.0455758)
POLITICAL RIGHTS		-0.01897				-0.0036678	-0.0318056
		(0.0204143)				(0.0129617)	(0.0187626)
EDUCATION		0.0045095**					0.0045913
		(0.0020689)					(0.0015518)
OPENESS		0.0031358***					0.001861
		(0.0010772)					(0.0008719)
CREDIT		0.0050827***				0.001563*	0.0055624
		(0.001307)				(0.0008056)	(0.0013662)
FDIperCAPITA*GCC			0.0000766***			0.0000243***	0.0000261
			(0.0000108)			(0.00000689)	(8.55e-06)
FDICAPITA*MDE			0.0004606***			0.0003014***	0.0003312
			(0.0000589)			(0.0000647)	(0.0000745)
FDICAPITA*MAGHREB			0.000686***			0.0001607***	0.0007545
			(0.0001541)			(0.0000599)	(0.0001888)
FDICAPITA*OILPRODUCER	0.0000841***	0.0000274***					
	(0.0000112)	(0.00000894)					
FDICAPITA*NONOILPRODUCER	0..0004193***	0.0002718***					
	(0.0000548)	(0.0000801)					
FDI/GDP*GCC				0.7591408			
				(0.5036025)			
FDI/GDP*MDE				1.734268***			
				(0.3741778)			
FDI/GDP*MAGHREB				4.845529***			
				(0.9064756)			
FDI/GFCF*GCC					0.0151436		
					(0.0491845)		
FDI/GFCF*MDE					0.3411196***		
					(0.0936758)		
FDI/GFCF*MAGHREB					1.103647***		
					(0.2177553)		
Number of Obs.	336	111	336	335	300	169	111
F-Stat/ Wald Chisquare	57.48***	31.75**	43.77***	17.44***	13.01***	59.54***	34.34***
Adjusted R-square	0.1191	0.6588	0.0759	0.0148	0.0685	0.4964	0.5715

Source: *ESCWA calculations*.

Notes: Estimates are made by controlling for fixed effects. The Newey-West robust method is used to control for heteroscedasticity and autocorrelations.

Newey-West Robust Standard Errors are in parentheses.

GCC, MDE and Maghreb represent the subregional dummy variables where the value 1 is assigned if the country belongs to the region and the value 0 is assigned if the country does not belong to the region.

*** Significant at the 1 per cent level.

** Significant at the 5 per cent level.

* Significant at the 10 per cent level.

TABLE 7. SUBREGIONAL AVERAGES, 1990-2009

	FDI	FDICapita	FDIGDP	FDIGFCF	Real GDP per capita
GCC	2170.80	634.58	2.74	13.99	16906.98
MDE	921.21	86.37	3.31	16.87	1583.97
Maghreb	931.07	71.61	2.03	8.18	2850.36
Total	1349.36	270.03	2.82	13.72	7099.26

	Real per capita GDP growth	Inflation	Govspend	Openess	MKTCAP
GCC	2.04	2.92	22.74	107.34	67.89
MDE	2.71	14.79	15.83	71.50	54.11
Maghreb	2.05	5.31	16.90	71.37	23.83
Total	2.33	8.52	18.53	84.06	54.12

Region	Credit	Road	Internet users	Phone	Education
GCC	41.61	3274.11	17.04	64.97	85.50
MDE	32.69	1298.75	5.52	23.27	61.96
Maghreb	34.57	2824.07	6.17	29.36	61.56
Total	36.41	2432.39	9.69	40.31	70.77

Region	HDI	Political rights	Civil liberty	Corruption	Rule of law
GCC	0.76	6.02	5.51	0.55	0.54
MDE	0.51	6.01	5.71	-0.75	-0.75
Maghreb	0.62	5.96	5.39	-0.34	-0.40
Total	0.63	6.00	5.56	-0.22	-0.24

Source: *ESCWA calculations*.

In order to examine whether FDI impacts growth differently in hydrocarbon-based and non-hydrocarbon based economies, the following regression was run:

$$Welfare_{ct} = \alpha_c + \beta_1 * FDI_{ct} * OILproducerDummy + \beta_2 * FDIVariable_{ct} * OILnonproducerDummy$$
$$+ \gamma * Conditiong\_Set + \varepsilon_{ct}$$

Where *c* denotes individual countries and *t* represents the time subscript. The *OilproducerDummy* (*OILnonproducerDummy*) takes a value of 1 when the country is an oil producer and 0 otherwise.[94]

While models (9) and (10) confirm that FDI per capita positively impacts welfare in both oil and non-oil producers, the FDI effect appears to be much more pronounced for non-oil producers than for oil producers, with an increase of US$1.00 in FDI per capita leading to an increase of approximately 3 basis points in real GDP per capita in the former group of countries. The significance of the augmented model with controls is confirmed by the increase in explanatory power.

Models (11) to (15) test for subregional differences considering GCC countries, MDEs and the Maghreb countries by considering the following specification:

$$Welfare_{ct} = \alpha_c + \beta_1 * FDIVariable_{ct} * GCCDummy + \beta_2 * FDIVariable_{ct} * MDEsDummy$$
$$+ \beta_3 * FDIVariable_{ct} * MAGHREBDummy + \gamma * Conditiong\_Set + \varepsilon_{ct}$$

[94] The group of non-oil producers comprises Jordan, Lebanon, Morocco and Palestine.

Where *c* denotes individual countries and *t* represents the time subscript. The *GCCDummy* (*respectively the MDEsDummy/MaghrebDummy*) takes a value of 1 when a GCC (respectively MDE/ Maghreb) country is considered and 0 otherwise.

Models (11) to (13) present the regression results without the inclusion of the conditioning set. For the FDI variable, the focus is on the FDI per capita, FDI to GDP and the FDI to GFCF respectively. In all three models, there is a high, statistically significant (at the 1 per cent level) positive impact of the FDI variables on welfare in the Maghreb and the MDEs, with the highest impact observed in the Maghreb countries. Adding up controls, the impact of FDI remains highly significant for all three subregions.

C. MAIN CONCLUSIONS RELATED TO THE FDI-GROWTH NEXUS

This work has examined the impact of FDI inflows on welfare in 18 Arab economies, with specific emphasis on subregional comparisons. The results support the main conclusions in the literature related to the FDI-growth nexus. Overall, FDI is found to have a significant positive impact on income poverty in the region, after controlling for macroeconomic stability, political stability, openness to trade and the absorptive capacity of the recipient country. Moreover, the FDI impact on growth is more pronounced for non-hydrocarbon producers than for hydrocarbon producers in the region. In addition, the growth elasticity to FDI inflows is found to be highest in the Maghreb countries, followed by the MDEs in the ESCWA region and, finally, the GCC countries. These findings are robust to alternative model specifications and econometric methodologies. Future research could explore the relationship between FDI, welfare and human development in the context of Arab countries through more broad-based indicators of welfare that would mirror more closely the multidimensional nature of development. A further direction of research could tackle the potential existence of a reverse causality between FDI and human development in the Arab region.

IV. CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS

Thanks to the sound macroeconomic environment and continuous implementation of measures aimed at enhancing the business environment, ESCWA member countries have witnessed a major increase in the level of FDI inflows over the past decade. The ESCWA region has experienced almost a seven-fold increase in FDI inflows from 2003 to 2009. In the same period, its share in total FDI received by developing countries has steadily increased from 6 per cent to almost 15 per cent. During the crisis year of 2009, the region experienced, on average, a milder decline than developing countries in other regions.

Even though several ESCWA member countries have recently undertaken financial reforms and pursued sound macroeconomic policies, the current financial crisis is posing additional macroeconomic hurdles, which member countries will need to address in the near future. Despite the fact that certain countries performed well in attracting FDI in 2009 and further steps have been taken to improve the business environment, many challenges remain to be tackled in order to bring about long-term positive changes. Despite expectations for a quick recovery in 2010 and 2011, preliminary data for 2010 imply a further slowdown in FDI in several member countries. Saudi Arabia witnessed a sharp decline in FDI in the first quarter of 2010, compared to the fourth quarter of 2009;[95] while data for Jordan indicate that the FDI inflows witnessed a steady decrease throughout 2009 and the first half of 2010.[96] In Egypt, however, FDI was estimated to have picked up in 2010, compared with its level in 2009.[97]

Apart from pursuing policies aimed at increasing the amount of FDI in the region, it is even more important to increase the effectiveness of such investments. In order to provide greater leverage on the inflow of foreign investment, ESCWA member countries need to tackle several issues. First, there is a high concentration of FDI in three countries (Saudi Arabia, the United Arab Emirates and Egypt) and three sectors (oil, real estate and construction). Secondly, most FDI is only profit-seeking and not necessarily employment-generating. As a result, the region still faces high rates of unemployment, which do not necessarily reflect the increased inflow of investment to respective countries. There is also little technology transfer, given that most FDI inflows go to the mining or real estate sectors, with low levels invested in the manufacturing sector. For all these reasons, ESCWA member countries need a new approach for directing FDI to those sectors that produce higher value added and those that require higher rates of technology and knowledge transfer.

Moreover, the recent political instability experienced in several ESCWA member countries poses further constraints on economic recovery in the short term. However, the ability of member countries to perform well in attracting investment and promoting development in the long run will depend on their ability to undergo a constructive transitional process that needs to be synchronized with sound economic and social policies, and institutional and political reform. In the short term, political instability is expected to lead to lower FDI inflows. Consequently, FDI performance in both 2010 and 2011 is expected to be moderate.

FDI should lead to increases in productivity and wages, and in the transfer of knowledge and technology, thereby ensuring higher levels of economic and social development in the region. Therefore, the above-mentioned challenges need to be addressed in order to enjoy more widespread economic and social benefits from foreign investment.

[95] SAMA, *Quarterly Statistical Bulletin* (third quarter, 2010).

[96] Central Bank of Jordan, *Monthly Statistical Bulletin* (2010).

[97] Central Bank of Egypt, *Monthly Statistical Bulletin* (February 2011).

B. RECOMMENDATIONS

The recommendations of this report can be summarized as follows:

(a) To further improve the institutional environment, both in terms of efficiency and transparency. Despite ongoing efforts, many ESCWA member countries still rank very low (according to the World Bank *Doing Business* reports) in terms of enforcing contracts, closing a business, protecting investors and dealing with construction permits. All of these are major impediments to attracting more FDI;

(b) To introduce policies aimed at promoting FDI with more impact on long-term growth prospects. According to the analysis presented in this report, most FDI in the ESCWA region targets the mining, oil and service sectors, with a very modest portion directed at manufacturing and agriculture. In order to enjoy more widespread benefits of FDI, particularly more employment, and technology and knowledge transfer, ESCWA member countries need to adopt policies that are likely to attract FDI to sectors that provide more solid grounds for long-term development;

(c) To promote intraregional FDI. While intraregional FDI is quite significant in certain countries, on average it represents a smaller share of the total. Adopting policies to promote intraregional FDI increases investment in the region and, moreover, encourages more regional integration. In this context, having some regional projects financed by FDI could be an option to push for greater regional integration;

(d) To invest in both transportation and communication infrastructure, thereby improving the overall competitiveness of ESCWA member countries as investment destinations;

(e) To invest in education as a means of upgrading the skills of the workforce and to make it better tailored to the needs of potential investors. Improved quality of the workforce is one of the key factors that can promote innovation and attract capital in the long term;

(f) To commit to more regional integration by liberalizing services and investment flows;

(g) To adopt appropriate policies and measures aimed at attracting some of the investments flowing out of the Arab region;

(h) To focus on the type (as well as the volume) of FDI that can lead to employment generation and technology transfer, and that invests in the real economy, particularly the agricultural and manufacturing sectors, which currently receive the lowest share of these inflows.